
Political Parties, Municipalities Regulations, and Startups: Abenomics in Japan

Hideyuki NAKAGAWA*
Hiroyuki SHIBUSAWA**
Fiona SUSSAN***

Abstract: *Research on entrepreneurial ecosystems (EE) needs to be more contextual; the change of political party dominance is one such contextual situation. Political party dominance impacts national policies that directly influence the actions of regional and local government. Using Abe's win in Japan's December 2012 election as the main political event, this paper investigates the relationship between local regulations and entrepreneurial activities and proposes that Abenomics is more favorable to EE. Specifically, startup rates for more than 1900 municipalities for two time periods, 2009 to 2012, and 2012 to 2014, were collected alongside with data from each municipality passing a promotional regulation for small and medium-sized enterprises (SMEs). Multiple regression results support the hypothesis that the Abenomics period (2012–2014) experienced better EE. The findings of this study shed light on the relationship between political party dominance and EE.*

Key Words: *Entrepreneurial ecosystem, election, municipal government, regulations, Japan.*

Introduction

THE ADVENT OF THE DIGITAL ECONOMY and the rise of “unicorns” has put Japan in a peculiar position as Japan has not produced many unicorns per se. Unicorns are often viewed by practitioners and industry experts as trendy indicators to measure the pulse of entrepreneurship. In 2016, there were 174 unicorns, with the US claiming 96, China 37, India 8, the UK 7, and Germany 4 while Switzerland, Indonesia, Japan, Nigeria, and the UAE each gave

* Hideyuki NAKAGAWA, Akita International University, Yuwa, Akita-city 010-1292, Japan, hnakagawa@aiu.ac.jp

** Hiroyuki SHIBUSAWA, Toyohashi University of Technology, 1-1 Hibarigaoka, Tempaku-cho, Toyohashi, Aichi, 441-8580, Japan, hiro-shibu@tut.jp

*** Fiona SUSSAN, Corresponding author: School of Advanced Studies, University of Phoenix, USA, fsussan@gmail.com

birth to their first unicorn (CB Insights, 2016). One argument for why Japan did not have as many unicorns is that companies in Japan tend to go to initial private offer (IPO) before they reach \$1 billion in value, the *de facto* value of a unicorn. In other words, Japanese startups or scaleups tend to go public before their value reaches one billion dollars.

Although it is debatable why Japanese startups do not choose to be unicorns from a global perspective, it is obvious that Japan has its own unique institutional practice; thus, the study of entrepreneurial ecosystems (EE) in Japan needs a contextual approach. This paper examines the impact of a new government on EE. Specifically, in Japan, the dominant political party, the Liberal Democratic Party of Japan (LDP), ruled for more than 50 years, from 1955 to 2009 (except 1993–1994). In 2009, the Democratic Party of Japan (DPJ) ruled for three years and, by the end of December 2012, LDP's Abe returned to power.

This paper begins with a brief background of EE, followed by an overview of Japan's EE. Next, the political event of 2012 and subsequent political party change is described, together with the historical timeline of legislation related to small and medium-sized enterprises (SMEs) at the local government level. A conceptual model follows, depicting the workings from political party change leading to policy change trickling down to the local level. Data from Japanese sources on startup rates and legislation in more than 1,900 municipalities are collected for two periods: 2009 to 2012 and 2012 to 2014. Multiple regression models are used to show the relationship among startup rates, municipalities, regulations, and the two time periods. Results are reported, with discussions followed by a conclusion with managerial implications.

Background Literature

Research on the role of geography and institutions is an important agenda for economic development (Acemoglu et al. 2001; Acemoglu et al. 2002). Institutions and geography affect the speed of economic development through multiple channels, including labor productivity (Hall and Jones 1999) and endowments (Easterly and Levine 2003; Engerman and Sokoloff 1997; 2004). As Isenberg (2010) highlighted, in the case of Rwanda, the entrepreneurs' development of innovative ideas accelerated the speed of growth in the country. Researchers have extensively examined the relationship between innovation, geography, and institutions (Boschma and Martin 2010; Cooke et al. 2011). One approach has been through the lens of an entrepreneurial ecosystem, which is defined as "a set of interdependent actors

and factors coordinated in such a way that they enable productive entrepreneurship within a particular territory” (Stam and Spigel 2018). An entrepreneurial ecosystem is geographic in the sense that each ecosystem reflects the specificity of local conditions. In addition, an entrepreneurial ecosystem is institutional and “focuses on the cultures and networks that build up within a region over time” (Stam and Spigel 2018). Isenberg (2010) suggested six domains of ecosystems: policy, finance, culture, support, human capital, and markets. Research on the entrepreneurial ecosystem has increased over the past few years, but most of this research has involved stationary analysis rather than an evolutionary approach, with the exception of some case studies (Rice et al. 2014; Schaeffer and Matt 2016; Sussan et al. 2017). Indeed, with few exceptions (Mack and Mayer 2016), not many studies have examined how the dynamic changes in formal institutions have taken place.

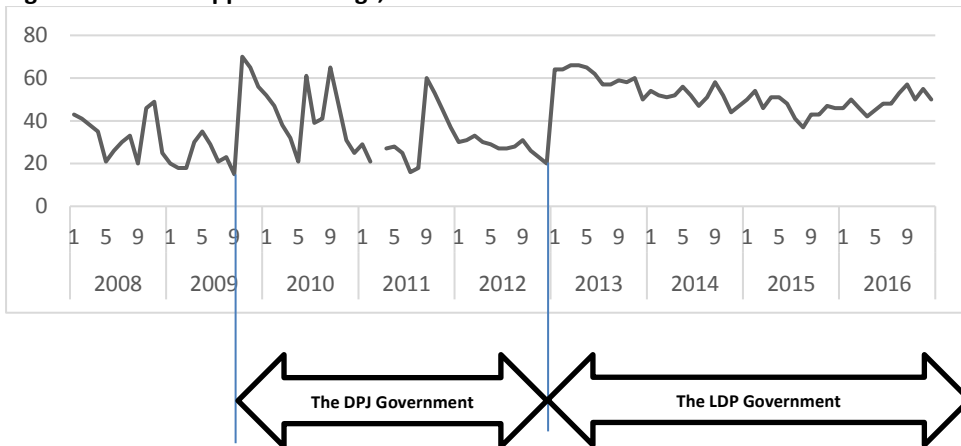
Japan played a significant role in creating innovative ideas in industries throughout the 1980s. However, after the stock market bubble burst in 1989, the country suffered an economic downturn, and the private sector lost its momentum, yielding its relative importance in innovation to other Asian countries, while the United States kept up the momentum of its vibrant entrepreneurial environment. After two decades of stagnant economic growth in Japan, the government has tried to promote a favorable entrepreneurial environment through structural reforms and expansionary macroeconomic policies. Some of its efforts have positively influenced ecosystems whereas others have failed. We analyze how the entrepreneurial ecosystem has evolved through the change in government by examining how the entrepreneurial environment has changed, measured by the geographic and time differences in the startup rate, which indicate the change in the output of entrepreneurial ecosystems.

Political Party Dominance: 2009 and 2012

After the LDP’s founding in 1955, the party kept control of the Diet (Japan’s bicameral legislature) until 2009, except for ten months between 1993 and 1994. In 2009, the LDP lost significant political support and eventually lost the election for the House of Representatives to the DPJ. Citizens initially welcomed the DPJ’s rule, with a support rate of 70 percent, as measured by the NHK Broadcasting Culture Research Institute, an organization affiliated with the national public broadcasting organization (NHK Broadcasting Culture Research Institute 2018). The DPJ had an ambitious reform agenda to break the long legacy of the LDP’s rule in the political sphere, but the DPJ could not carry out most of these reforms, partly because it had three prime ministers in three years due to multiple scandals related to corruption and dissatisfaction over poor management after the earthquake and the Fukushima nuclear

disaster (Kushida and Lipsky 2013). Legislative activity in the DPJ became stagnant in 2012, and the LDP regained control over the House of Representatives in the December 2012 elections, which led to Shinzo Abe's second administration. Abe's administration enjoyed relatively stable support for at least the first four years, which enabled his government to pursue his "three arrows for economic growth" policy agenda, focusing on monetary easing, fiscal stimulus, and structural reforms. Figure 1 shows the trends in political support for the Cabinet.

Figure 1: Cabinet approval ratings, 2008–2016



Source: NHK Hoso Bunka Kenkyujo (2018). *Seiji Ishiki Getsurei Chosa* [Monthly Survey on Political Consciousness], (<https://www.nhk.or.jp/bunken/research/yoron/political/2018.html>)

Structural Reforms under the DPJ and the LDP

When the DPJ won the majority in the Diet, it attempted to formulate its identifiable growth strategies, but the prime ministers were forced out before the party's growth strategy was fully implemented (Haidar and Hoshi 2015). In this subsection, we discuss some of the DPJ's legislation results related to entrepreneurship. In 2009, the Diet first legislated the Moratorium Act for SMEs to alleviate the impact of the Lehman Brothers' bankruptcy shock. In June 2010, the Cabinet approved the Small and Medium Enterprise Charter, recognizing that SMEs were the driving force behind the Japanese economy and expressing a commitment to support them (Muramoto 2013). This Charter was inspired by the European Charter for Small Enterprises in June 2000 and follows its main ideas (Watanabe 2015). In June 2012, Congress passed the Small and Medium-sized Enterprises Business Enhancement Act, under which the national government certified third-party organizations with the expertise to support SMEs. This was done to establish an enforced support system. Although the DPJ intended to further promote entrepreneurship and SMEs, its

limited overall legislative ability, reflected by the passage rate of its proposed legislation and the public's rising discontent with its policies, resulted in the turnover of the DPJ's rule before it could implement many of the initiatives it had promised in its 2009 Manifesto pledges ([Kushida and Lipsky 2013](#)).

After the LDP took over the Diet, Abe's second administration tried to express the stark difference in policy making related to SMEs between its policies and those the DPJ had introduced in trying to break the legacy the LDP had left ([Obayashi 2015](#)). The Abe administration formulated economic growth strategies based on monetary easing, fiscal stimulus, and structural reforms. Structural reform related to entrepreneurship was part of the third arrow of Abenomics, and subsequent legislation was accordingly introduced. In February 2013, the LDP instructed the Small and Medium Enterprise Agency to launch a team to promote the growth of small enterprises. The team focused on four basic principles: more effectively leveraging the resources of local small enterprises in the community; stimulating the metabolism of the small enterprise sector; strengthening the autonomy of small enterprises by softening the subcontract structure and dominance of upstream contractors, which has long been prevalent in Japan; and facilitating small enterprises' overseas expansion ([Small and Medium Enterprise Agency 2013](#)). In June 2013, the Diet legislated the amendment of eight laws and abolished one act related to small businesses. The amendments were introduced to define the important policy agenda supporting small businesses—namely, to enhance the flexibility of local government definitions of SMEs to better reflect local conditions; to enhance the credit mobilization of small businesses; to establish a certification system for those introducing various professionals and experts to small business owners; to define exemptions from the Small Business Credit Insurance Act in cases where small enterprises jointly seek credit; and to add a debt–equity swap function to public financing banks (i.e., Japan Finance Corporation and The Okinawa Development Finance Corporation).

Meanwhile, the Act on Equipment Installation Support for Small Enterprises, whose function was substantiated by the above measures, was abolished. The government tried to promote a favorable entrepreneurial environment through structural reforms and expansionary macroeconomic policies June 2014; the government enacted the Basic Act for Promoting Small Enterprises and the Act for Assisting Small Enterprises. The Basic Act for Promoting Small Enterprises made “the sustainable development of business” a basic principle to go along with “the growth and development of business” that had already been stipulated under the Small and Medium-sized Enterprise Basic Act ([National Association of Trade Promotion for Small and Medium Enterprises 2017](#)). The Act for Assisting Small Enterprises strengthened the assistance system provided by the Chambers of Commerce in local cities and

towns. In October 2014, the Cabinet formulated the Basic Plan for Promoting Small Enterprises, a measure for planning the five-year PDCA cycle of policy implementation based on the Small and Medium-sized Enterprise Basic Act. In summary, these measures under the Abe administration emphasized the sustainability of small enterprises in addition to the ethos of the amended Small and Medium-sized Enterprise Basic Act in 1999, which emphasized the creative destruction and revolution in the management of SMEs (Obayashi 2015).

Increasing Local Governments' Support for SMEs

The central government and local governments have to play important roles in creating and sustaining a successful entrepreneurial ecosystem that suits local economic conditions (Isenberg 2010). Local government entities, both prefectural and municipal, gradually realized the significance of their roles in nurturing the entrepreneurial environment. The first action they took was to explicitly define their roles in promoting the growth of SMEs in their regions, as successful policies to foster an ecosystem cannot be implemented ad hoc (Ueda 2007). Another aim of the local regulations is to share the vision of local economic development and growth of SMEs with the relevant players (Ueda 2007). The characteristics of such regulations by local governments resemble the Small and Medium Enterprise Charter in nature, but there is a variety in the contents of regulations across municipalities. For example, some municipalities explicitly stated the need for regular investigations of the economic conditions of local SMEs. They also established committees consisting of entrepreneurs, public administration officers, related NPO members, and academic researchers. The established committees usually drafted all local regulations and subsidy policies related to SMEs (Wada 2014). Once a municipality sets the regulations, its SME promotion policies should align with the ethos of the regulations.

The regulations do not contain specific programs; they are essentially the ideas the local governments represent. However, establishing the regulations is highly correlated with the degree of support provided by local governments. In July 2013, the Small and Medium Enterprise Agency created an online platform, Mirasapo, to provide useful information and tools for SMEs. A list of available subsidy programs identifies those registered by local governments for starting a business in their communities (Small and Medium Enterprise Agency 2013). As of June 30, 2018, 81 municipalities had registered their subsidy programs or preferential taxation systems for startups. Many of these subsidies are provided to prepare new businesses. For example, the city of Hikone in Shiga prefecture provides a subsidy of 50,000 yen to compensate for monthly office rents for six months. If a startup acquires land in Hikone, the

fixed property tax will be exempt for three years up to the amount equivalent to the acquisition cost of the asset. Komaki in Aichi prefecture provides a subsidy for registering a new business or for payment to a judicial scrivener, with a maximum of 200,000 yen. Takasaki sends contracted incubation managers to startup companies to provide detailed support, such as revising business plans and bridging between startup companies and credit sources. In addition, support programs help existing small enterprises scale up. The subsidy program in Hekinan in Aichi prefecture covers interest for investing capital to a maximum amount of one million yen. Fuchu provides a subsidy for startups within two years of foundation to cover advertising costs.

Conceptual Model

Based on the relationship between the policy agenda by the central government and the local governments toward EE discussed in the previous section, we propose a hierarchical model in Figure 2 that depicts from left to right the step-by-step influence of political party change to EE change. As the change of a new political party takes place, new national policy changes take place, which will then trickle down to lower level of government such as municipal governments to change regulations. It is the changes of regulation within these lower levels of formal institutions that impact entrepreneurial activities. In other words, in Figure 2, the municipal governments follow and interpret national policies and translate them to local regulations based on local economic and social conditions. These regulatory changes at the municipal levels influence entrepreneurial actions.

Figure 2: Conceptual model

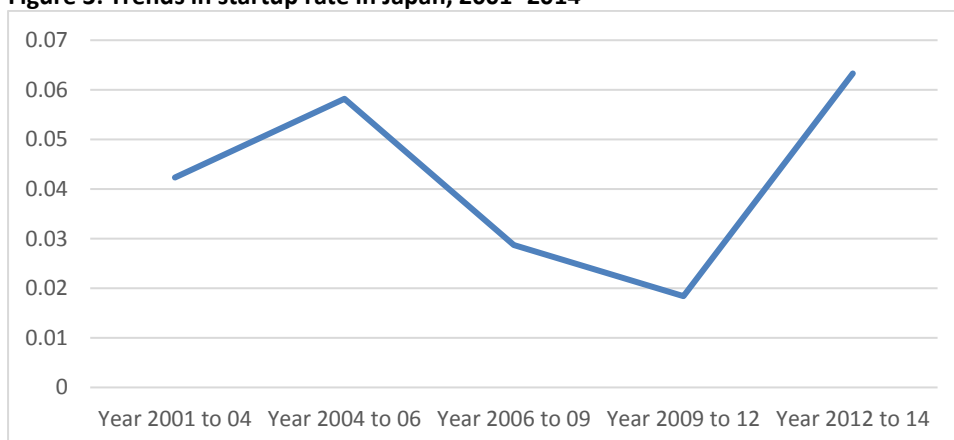


Measuring the Entrepreneurial Ecosystem

An entrepreneurial ecosystem can also be measured by entrepreneurial activities (Stam 2017). The ideal proxies for entrepreneurial activities would be the startup rate for high-growth firms, such as gazelle firms (Henrekson and Johansson 2010). However, such a measurement is not available in Japan, so this paper uses a general startup rate. Figure 3 shows the

trends in the startup rate based on the five waves of Economic Census for Business Activity since 2001, obtained through the Regional Economy Society Analyzing System (Cabinet Office, Government of Japan 2018). The Economic Census for Business Activity is conducted at two to three-year intervals, and startup rates are measured for the period between two waves of the census. We observed a drop in the rate starting in 2004–2006 for two rounds of the census, then an increase for the period between 2012 and 2014. The increase in the startup rate is partly explained by the favorable macroeconomic conditions Japan experienced during that period. In particular, the drop in the startup rate in the 2006–2009 and 2009–2012 periods can be partly explained by the 2009 financial crisis. However, the analysis at a more disaggregate level reveals that the rise in the startup rate is correlated with the degree of local governments' support for SMEs.

Figure 3: Trends in startup rate in Japan, 2001–2014

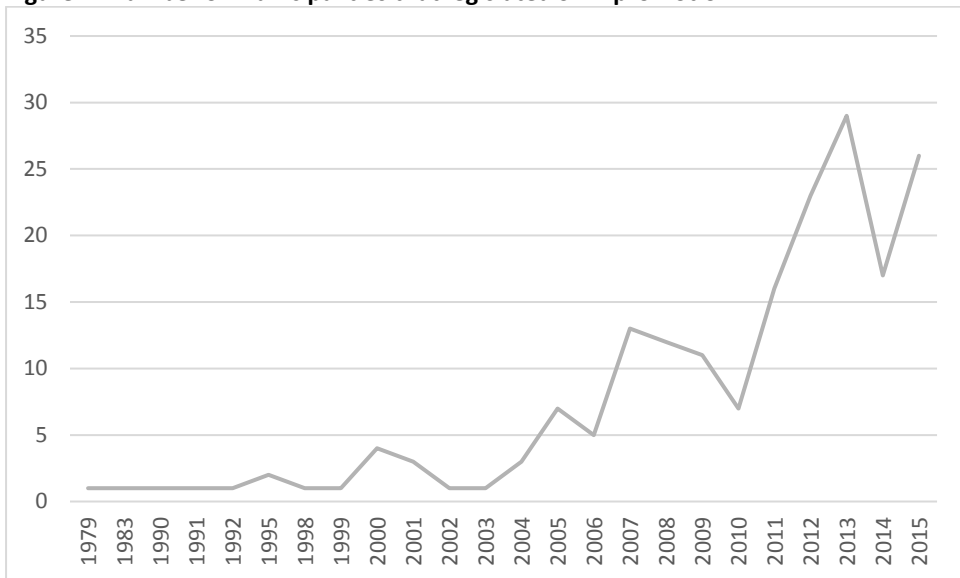


Source: Economic Census for Business Activity, multiple waves (Cabinet Office, Government of Japan 2018)

Among the 81 municipalities that have put their support programs on Mirasapo, 32 follow the SME promotion regulations as of June 2018. At the same time, 248 out of 1,718 municipalities established SME promotion regulations. Thus, although only about 14% of municipalities have SME promotion regulations, these municipalities represent 40% of those that put SME support programs on Mirasapo. It may be true that some municipalities have not registered their subsidy programs for startups on the Small and Medium Enterprise Agency's platform and that the list on Mirasapo is not an exhaustive list of available support programs. Even so, local governments are applying more efforts to disseminate relevant information for startups through the SME promotion regulations, thereby contributing to a more effective entrepreneurial ecosystem.

Figure 4 shows the trends in municipalities that have established SME promotion regulations (Zenkokushokojigyokyodokumiairengokai 2018). After Sumida-Ku (ward) in Tokyo first enacted the regulations in 1979, the number of following municipalities did not increase until 2000. There was a slight increase in the 2000s, but a significant increase was evident only after 2011. By the end of 2012, when the government change occurred, 74 municipalities had legislated the SME promotion. Since 2012, the number of municipalities enacting such regulations has increased by between 20% and 30%. Obayashi (2015) predicted that more municipalities will establish such regulations in the future. This trend is not necessarily the byproduct of the change in government; rather, it is a long process triggered by the amendment to the Small and Medium-sized Enterprise Basic Act in 1999. However, the role of local governments in promoting entrepreneurship can be a moderator that enhances the quality of the entrepreneurial ecosystem.

Figure 4: Number of municipalities that legislated SME promotion



Source: *The National Chamber of Commerce and Industry Federation (2018)*

Identification Strategy

The empirical model examines whether the establishment of the regulation of promoting SME activities functions as a moderator of the entrepreneurial ecosystem. In essence, the model examines the change of startup rate before and after a new government at the municipal level by

identifying the characteristics of municipalities that have affected the change in the startup rate. First, consider the following equation:

$$y_{it} = \alpha + \beta T_t + \gamma_i + \varepsilon_{it} \quad (1)$$

where y_{it} is the startup rate of municipality i during period t , based on the Economic Census for Business Activity. Startup rates for two periods—between 2009 and 2012 and between 2012 and 2014—were extracted from a sample of 1,904 municipalities. T_t represents a dummy variable for the second period. γ_i is a municipality dummy variable to eliminate the time-invariant fixed effects through the transformation within. ε_{it} is the time-varying unobservable characteristics of municipality i at time t . β is being interpreted as a change in the startup rate between the two periods. Equation (2) identifies the differential effect of government change across municipalities by adding the interaction variable of the period dummy and municipality characteristics. Demonstrating the conceptual model of the importance of local government, this empirical model shows that municipalities that registered SME promotion regulation are associated with a higher change in the startup rate.

$$y_{it} = \alpha + \beta_1 T_t + \beta_2 x_{it} + \beta_3 T_t \times x_{it} + \gamma_i + \varepsilon_{it} \quad (2)$$

where x_{it} is a dummy variable of whether municipality i has established the SME promotion regulation at time t , as obtained from Zenkokushokojigyokyodokumiarengokai (2018). In this context, β_3 represents the effect of the legislation in the second period relative to the first period (2009 for period 1 and 2012 for period 2). The estimation results from equation (1) and (2) are shown in Table 1.

Table 1: Change in Startup Rate after Government Change in 2012

	(1)	(2)	(3)
Constant	0.0143*** (0.000437)	0.0146*** (0.000380)	0.0148*** (0.000399)
Period 2 dummy	0.0359*** (0.000617)	0.0359*** (0.000543)	0.0356*** (0.000546)
SME promotion regulation dummy	0.0123*** (0.00178)	0.00595 (0.00431)	-0.00974* (0.00552)
Interaction of period 2 dummy and SME promotion regulation dummy			0.0161*** (0.00356)
Fixed effects	No	Municipality	Municipality
Observations	3,808	3,808	3,808
R-squared	0.478	0.802	0.804

Note: The dependent variable is the startup rate for municipality i at time t . Standard errors are in parentheses. *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

Column (1) shows the simplest specification without the fixed effects or interaction terms. The model in column (2) adds the municipality fixed effects. The specification in column (3) adds the moderation effect of support level provided by the local governments. Regarding the increase in the startup rate from the first period to the second period, all models have consistent results: on average, the startup rate rose about 3.6 percentage points between 2009–2012 and 2012–2014, which is significantly different from zero (at the 1 percent significance level). The coefficient for the dummy variable of municipalities with SME promotion regulation is sensitive to the model specification and challenging to interpret.

The results depicted in column (3) confirm that the municipalities with SME promotion regulation raised the startup rate more than those municipalities without the legislation: The coefficient for the interaction term for the dummy for period two and the dummy for legislating SME promotion is 1.6 percentage point, which is also significantly positive. Combined with the findings in the previous subsection, conditions for entrepreneurs to start a business were more favorable during the 2012–2014 period relative to the 2009–2012 period, and municipalities with a local government that supported entrepreneurship made the most of this opportunity.

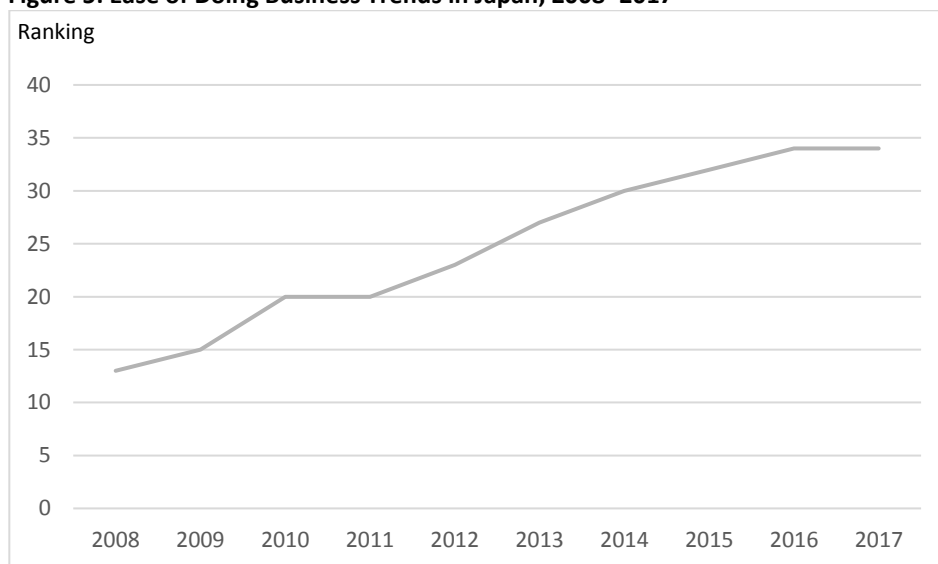
Discussion

The empirical model and its results confirmed the proposed conceptual model that political party change impacts local municipalities regulatory practices which in turn impact EE in startup rates. This local institutional level impact on EE contrasts with prior studies that investigate Japan as it compares to other nations. For example, a very common measurement of Japan's EE relies on national ranking as compared with other countries. One such common measurement is the World Bank's (2018) Doing Business ranking, which was first published in 2003 with five sets of indicators for 133 economies to measure the business climate of economies (Besley 2015). The latest report in 2018 covers 11 areas of business regulations for 190 economies (World Bank 2017): starting a business; dealing with construction permits; getting electricity; registering property; getting credit; protecting minority investors; paying taxes; trading across borders; enforcing contracts; resolving insolvency; and labor market regulation. These indexes have been used in numerous

academic studies to measure the business climate (Besely 2015). Policy makers also take the ranking seriously; the Abe administration used this measure as a benchmark of the quality of government support and, in 2013, aimed to ensure Japan ranked third by 2020 in its growth strategies for the country (Prime Minister of Japan and His Cabinet 2013).

Figure 5 shows the trends in Japan's ranking. The change in ranking represents the business climate relative to other economies, but it does not show the actual change in the business climate. Having said that, Japan's position has worsened throughout under both the DPJ and LDP rules. These ranking reports do not suggest Japan has improved as a place to do business since Abe took over in 2012.

Figure 5: Ease of Doing Business Trends in Japan, 2008–2017



Source: World Bank (2017)

Another indicator of EE is the ease of starting a business in a nation as compared with other nations. Table 2 shows the trends of Japan in its ranking of starting a business as compared to other countries. Again, these numbers presented in Table 2 do not flatter the Abe administration. Haidar and Hoshi (2015) scrutinized possible improvements in each indicator that the Japanese government can make to improve its rank, based on the criteria used in the 2014 report. The authors claimed that completing reforms that did not encounter big obstacles would improve the ranking from 27th in 2014 to 13th. However, such reforms have not yet been realized, and the outcome of criteria, such as the cost of starting a business or the required minimum capital, has not changed (see Table 2).

Table 2: Ease of Doing Business Ranking and Starting Business Ranking

Year	Ease of Doing Business	Starting Business
2008	12	44
2009	12	64
2010	15	91
2011	18	98
2012	20	107
2013	24	114
2014	27	120
2015	29	83
2016	34	81
2017	34	89
2018	34	106

Source: World Bank (2017)

As these World Bank-based rankings reflect nation-to-nation comparison, they are useful for understanding global EE in a broadstroke. The empirical results from the model presented in this paper provided a contextual approach to understand EE evolution within Japan, thus serve a different purpose than the global ranking presented in World Bank data. It is possible to interpret from the World Bank data that Japan has not improved its business environment for firms, both large and small, since Abenomics, when compared to other countries. However, the empirical results of this study show that Abenomics is doing something to increase entrepreneurial activities via municipal institutional support.

Conclusion

This paper investigated the impact of government change that occurred at the end of 2012 in Japan, the turnover of the DPJ administration, and the advent of the second Abe administration on the change of quality in the entrepreneurial ecosystem measured by the changes in the startup rate. A new conceptual model is proposed to depict the step-by-step workings from political party change leading to national policy changes which in turn direct local government regulatory actions that positively impact EE. The role of the local government in promoting entrepreneurship is empirically tested as a moderator that enhances the quality of an entrepreneurial ecosystem. The

empirical results confirmed that, within 1,900 municipalities, their relevant acts that aimed to promote an environment for SMEs contributed to the recovery of the startup rate during 2012 and 2014. Such recovery was found larger for municipalities that had registered an SME charter or relevant regulations to promote SMEs.

The findings of this paper have two implications for policy makers in Japan. First, as national policy changes need buy-in by local municipal governments, a continuous and intense dialogue is necessary to encourage healthy EE building. Second, municipalities' action matters. Local government should pass more regulations to support EE. The focus on municipalities in this research can be improved further by including involvement at the prefectural level, in particular the interactions between prefectural and municipal governments in building EE.

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