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TOPICS

Business Conditions for Japan's Emerging Internet Companies (Fiscal Year 2002 to Fiscal Year 2007)

Introduction

In recent years, Japan's venture business companies have been in a slump against the background of the depressed stock market. According to one survey, the scale of the funds invested in venture capital and the like in fiscal year 2008 will only be one third of what it was in fiscal year 2006 (based on the survey on venture capital investment trends by Venture Enterprise Center). At the same time, if one takes a close look at the business operations status (business conditions) of Japan's major venture companies in the information and communications field (referred to below as "emerging Internet companies"), even though there are contrasting shades according to sector, quite a few of them have maintained brisk performance, sustained by the expansion of the electric commerce market and the Internet advertising market. In fact, one must pay attention to the effect of the business recession in fiscal year 2008, due to the instability of global financial markets, which has resulted in a growing sentiment of a slowdown, even in these "well performing" areas, so that one must also consider the case that, as a result of the business slump, "nesting" trends among consumers might be to invite good performance among electronic commerce companies (such as the virtual store "Rakuten" which will be discussed later).

MIC's Institute for Information and Communications Policy has, on an ongoing basis, been studying the information publicly released (corporate results, etc.) by Japan's major emerging Internet companies from fiscal year 2002 to fiscal year 2007, and has in addition gathered and analyzed information from other sources, such as newspaper articles. This document aims to clarify the outline of this study. Former issues of this newsletter have featured an ongoing (fiscal year 2001 to fiscal year 2007) study of business conditions in Japan and overseas for telecommunications business operators and an ongoing study (fiscal year 2001 to fiscal year 2007) of business conditions for broadcasters and media operators. And an ongoing study (fiscal year 2001 to fiscal year 2007) of business conditions of information and communications equipment manufacturers is featured in the *Information and Communication Journal* (only in Japanese). The current study should be considered in conjunction with the earlier ones.

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Business conditions as referred to in this text refer to sales and operating profits of emerging Internet companies. In addition, emerging Internet companies encompass, in addition to those included in “information and communications” as defined by the Japan Standard Industrial Classification, from among “electronic parts and devices manufacturing,” “advertising,” and “finance” companies that fulfill all of the four conditions listed below: (1) they have, as a rule, been established after 1995, (2) they have the top share in the various related markets, (3) they are, as a result, listed on Japan’s stock markets, and (4) they have, as a rule, no capital affiliation with major companies (there are, however, some exceptions to conditions 1, 3 and 4, as listed above). Among such emerging Internet companies, the businesses that are covered by this survey include portal site operator Yahoo Japan, electronic commerce site operators Rakuten and Kakaku.com, community site operators DeNA and mixi, communications operators Usen, Internet Initiative and ACCA Networks, software related companies such as ACCESS and Cybozu (the above are in business-related software), as well as Trend Micro and LAC (the above are in security related software), Index and Cybird as contents distributors, CyberAgent, Cyber Communications and DAC (Digital Advertising Consortium) as Internet advertising agencies, SBI Securities, Matsui Securities, Monex, Kabu.com Securities, Japan Net Bank and eBank in Internet-specific financial institutions, NEC Electronics, Elpida Memory and THine Electronics for semiconductor manufacturers. In addition to the above, business conditions for related American companies have, as needed, been analyzed for comparative purposes. This document, however, omits, as a matter of publication convenience, business conditions for Internet-specific financial institutions and semiconductor manufacturers.

Furthermore, the period meant by “fiscal year” can differ according to the business operator and so we have conformed to the individual fiscal years. With regard to the business operators covered in this document, many companies have March year ends, but ACCESS and Cybozu have January year ends, Usen and Index have August year ends, CyberAgent has a September year end, Digital Advertising Consortium (DAC) has a November year end, whereas Rakuten, ACCA Networks and Trend Micro have December year ends. With regard to the American companies that are mentioned for reference, Oracle has a May year end, Symantec has a March year end, with all the others having December year ends. Also, where fiscal years are mentioned, we have conformed to a year starting in October and ending in September of the following year. Therefore, for example, CyberAgent’s fiscal year 2006 runs from October 2006 to September 2007, and Digital Advertising Consortium’s fiscal year 2006 runs from December 2005 to November 2006.

Overview of business conditions for emerging network companies

In broad terms, these companies have seen a steady growth in business performance against a background of the penetration of the Internet and the progress of the shift to broadband. For example, in terms of operators of portal sites or electronic commerce sites as well as advertising agencies, the fundamentals are for a growth in sales underpinned by good performance in the Internet advertising business and the online shopping business. Community site operators have been supported by the growth in users and the associated increase in advertising revenue, and have shown trends for increases in both sale and profits. Also, software development business operators have been showing good business performance due to sales growth brought about by greater demand.

However, one must remember that, even though these are business categories that have comparatively little vulnerability to the effects of business conditions, against the background of the recent slowdown in business conditions, and less consumer spending, revisions in plans for ICT related investments at many companies, and the move towards cutting costs, starting with advertising expenses, and the drop in shipment volume for mobile phones have all increased the severity of market conditions.

Please find below individual business performance by business sector.

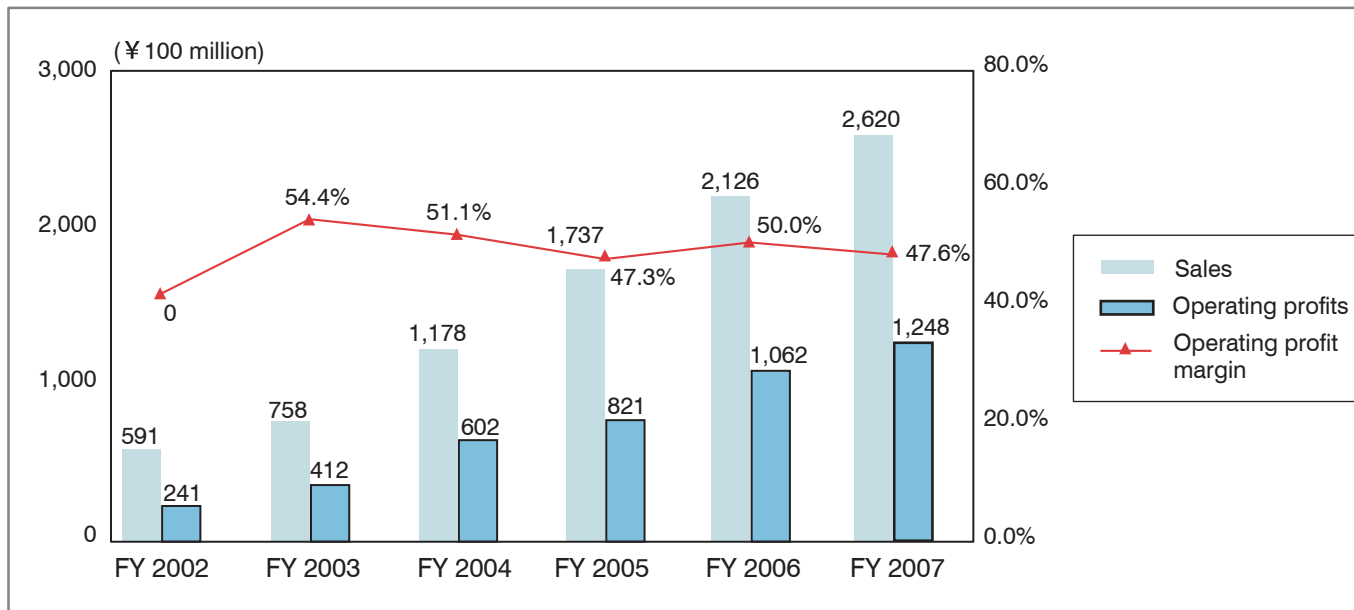
Business conditions for emerging Internet companies by business sector

(1) Business conditions for portal site operators

With regard to Yahoo Japan (established in January 1996), the trend for growth in both sales and profits, and good business performance is continuing against a background of good performance in the advertising business and the shopping business. In particular, in fiscal year 2007, the development of new advertising products in conjunction with the renewal of the website’s home page, and the spinning off into a subsidiary (August 2007) of Overture which provides sponsored search results, led to an increase in sales. Also, in terms of the shopping business, good performance continued due to an increase in the number of stores and an increase in mobile phone shopping. Furthermore, Overture (mentioned above) started the distribution of behavior-targeted advertising (by analyzing from many angles the contents of the pages viewed by users, and displaying advertising that matches their interests) in September 2008 for PC users, and in January 2009 for mobile phone users.

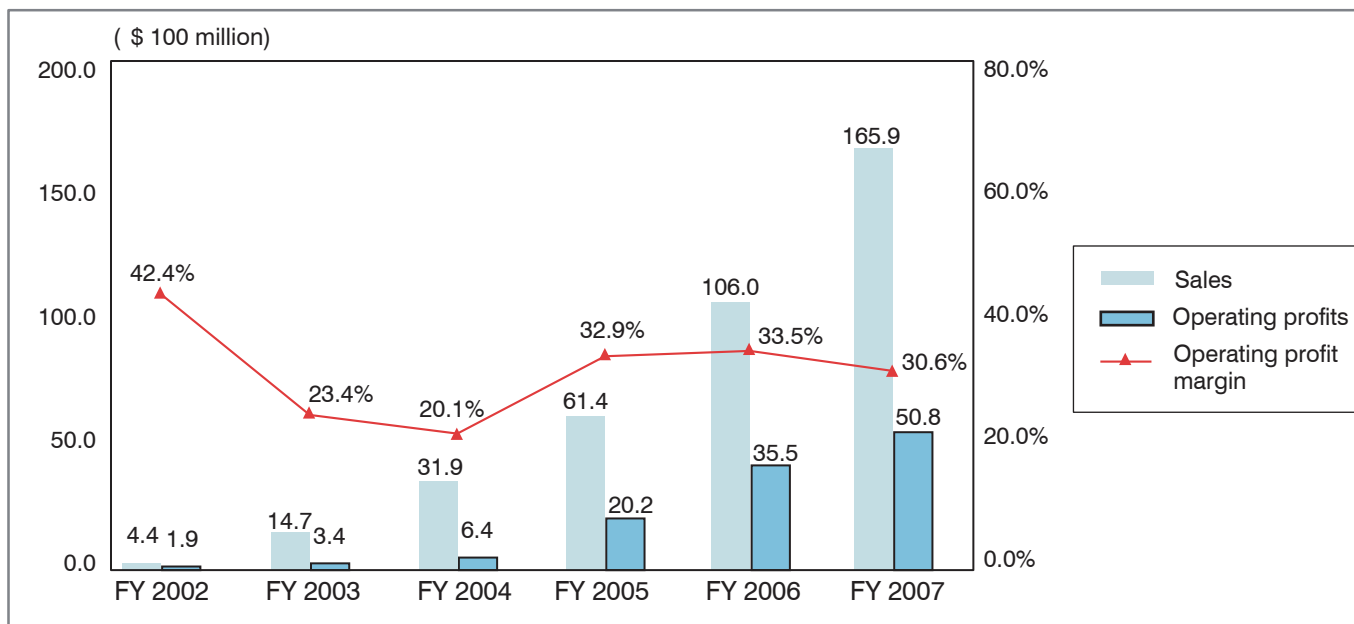
The Internet advertising market continues to show sharp growth, with search-linked advertising and mobile advertising for mobile phones providing the main impetus, with behavior-targeted advertising coming to the forefront recently and likely to attract attention in performance in the future. (Figure 1)

Figure 1: Business Conditions at Yahoo Japan



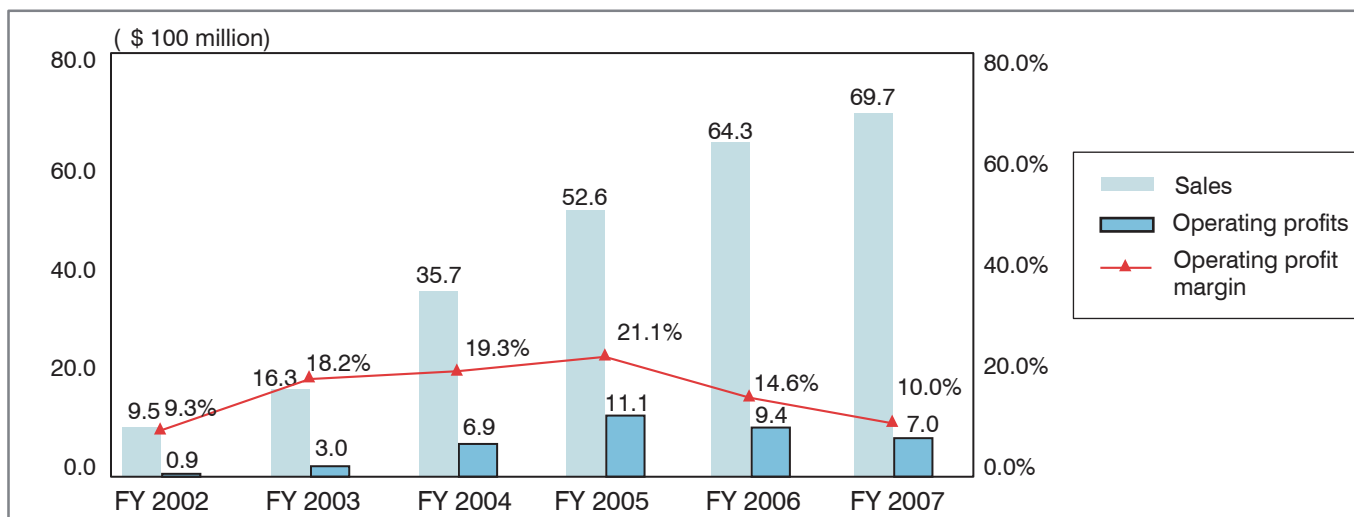
Furthermore, let's take a look at the comparative performance of Google and Yahoo! which are the two representative American portal site business operators. With regard to Google (established in September 1998), against a background of good performance in the advertising business, and as a result of increasing its user base through free services such as its mapping service and email service, the company has been increasing sales and profits. In particular, having improved its search-related advertising, it has increased both access to advertising from the Internet and the number of times advertisements are displayed. Also, a particularity is the trend towards increasing the proportion of sales coming from outside the United States. However, against the background of the recent global slowdown, it is necessary to consider the possibility that this company too will see a slacking off in the strong growth it has maintained. (Figure 2)

Figure 2: Business Conditions at Google



Yahoo! of the United States (established in March 1995) has been seeing a trend towards increased sales, but in recent years, operating profits have been on a downward trend. Even though the marketing service business (online advertising and the like) in Yahoo! related sites has been performing well, the increase in sales marketing expenses and development costs are promoting a trend towards a profit decline. (Figure 3)

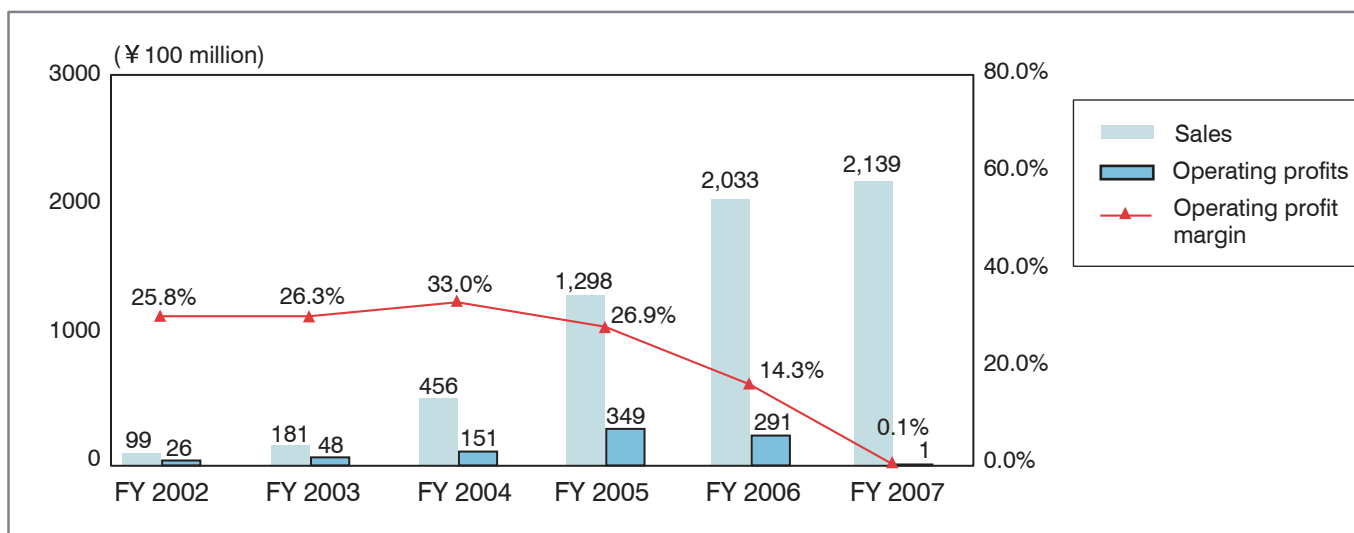
Figure 3: Business Conditions at Yahoo!



(2) Business conditions for electronic commerce site operators

With regard to Rakuten (established in February 1997), sales have been continuing to rise but against the background of growing red ink in the consumer credit business and a slump in the securities business, the company has seen a major reduction in its operating profits in fiscal year 2007. In the same fiscal year, the core business of electronic commerce continued strong and registered increases in sales and profits, but as a consequence of a lump sum provision for interest repayment losses in the consumer credit business, and a fall in income from charges for share commissions in the securities division, both businesses saw falls in profits. But recent conditions point to good performance in the electronic commerce business (Internet sales through the “Rakuten Market” and the hotel bookings business), and one must bear in mind that losses in the consumer credit business are also being redressed. (Figure 4)

Figure 4: Business Conditions at Rakuten



With regard to Kakaku.com (established in December 1997), against a background of good performance for the price comparison site it operates, the general trend has been for increases in both sales and profits. In particular, with regard to fiscal year 2007, the increase in user numbers following a major revamp of the price comparison site in October 2007, and the associated increase in advertising revenue and commission income from related companies resulted in a major increase in both sales and profits. (Figure 5)

Furthermore, for comparative analysis purposes, business conditions were compared with those of representative American electronic commerce site business operators, Amazon.com and eBay. With regard to Amazon.com (established in July 1994), sales have been on an upward trend and profits have also been generally on an upward trend, with the exception of a drop in operating profits in fiscal year 2006. The background to this is strong performance in the various areas of contents (books, magazines, music, DVDs, etc.) as well as consumer electronics, household goods, etc. (Figure 6)

Figure 5: Business Conditions at Kakaku.com

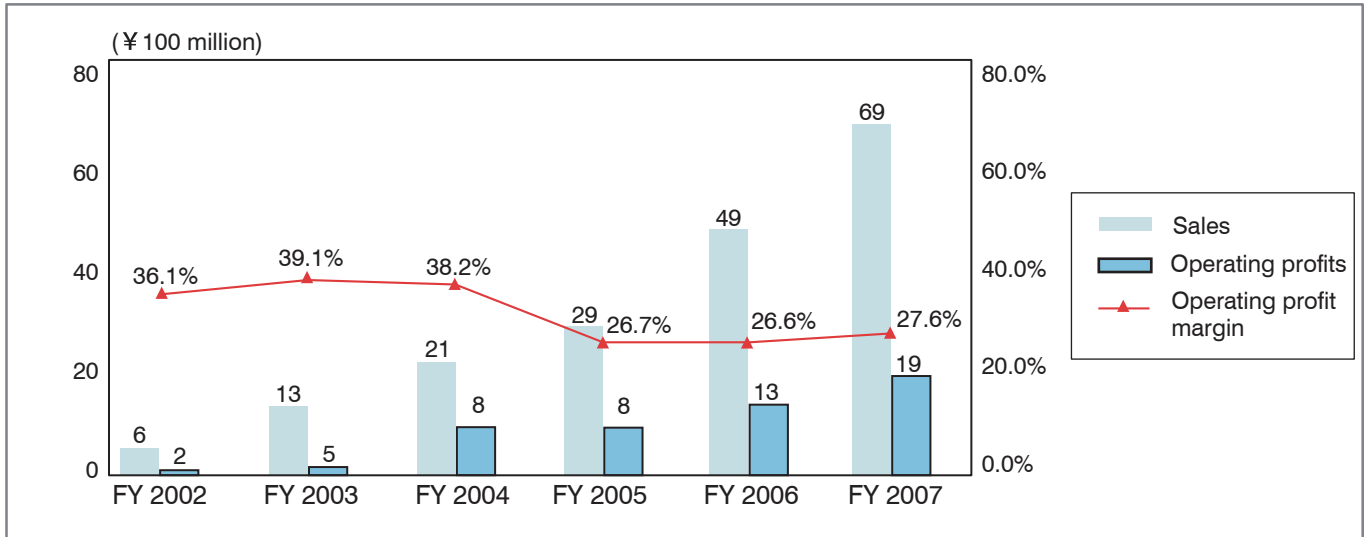
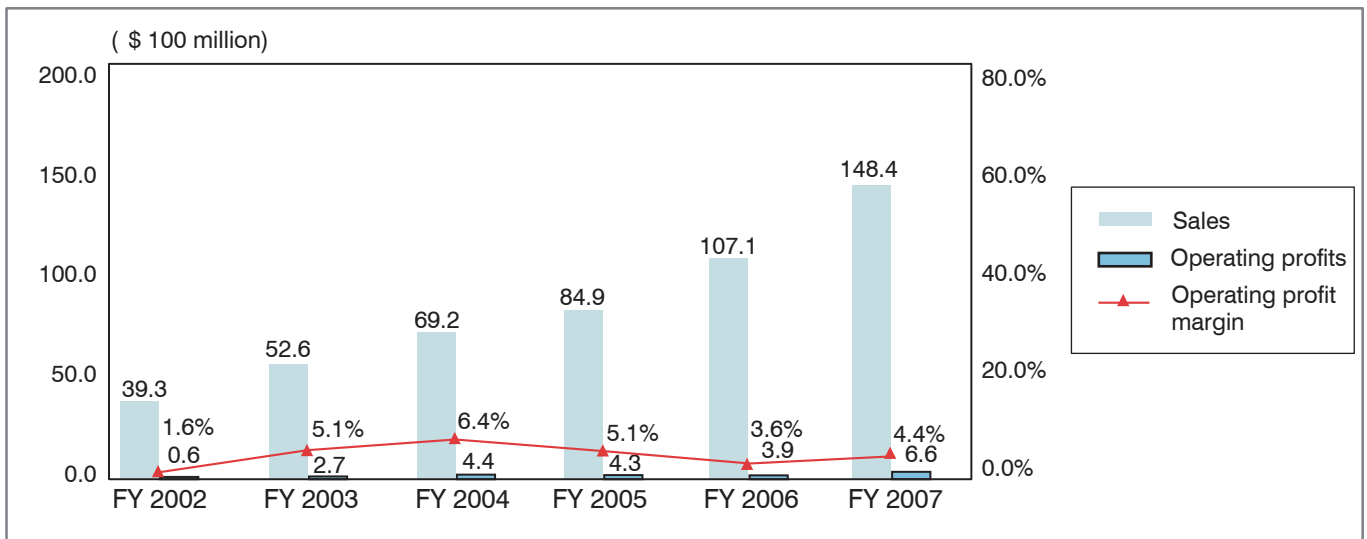
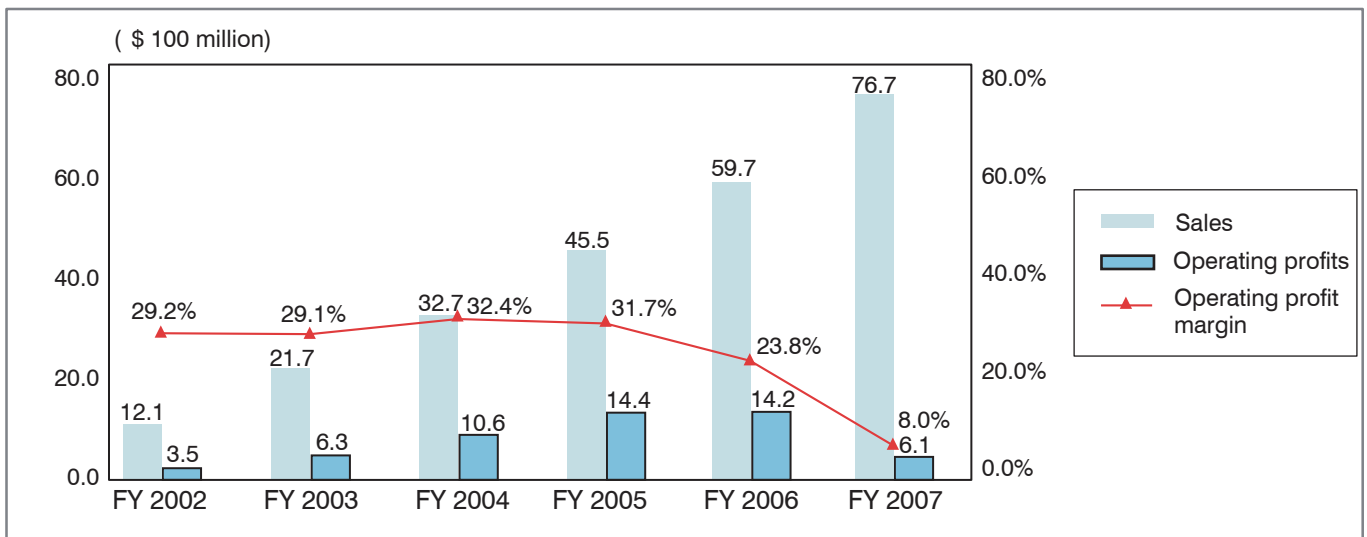


Figure 6: Business Conditions at Amazon.com



With regard to eBay (established in September 1995), sales have been on an upward trend but operating profits have been dropping in recent years. In fact, the major reason for the drop in profits was the disposal of impaired assets following the purchase of Skype in October 2005, and in fact the Internet auction business, settlement business and IP phone business are all doing well. (Figure 7)

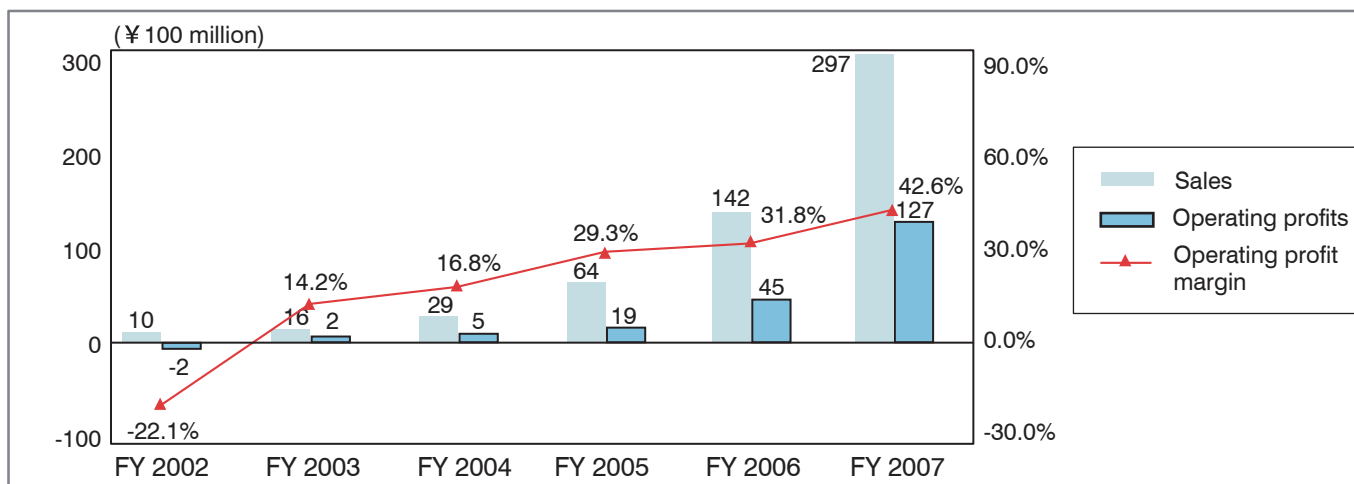
Figure 7: Business Conditions at eBay



(3) Business conditions for community sites

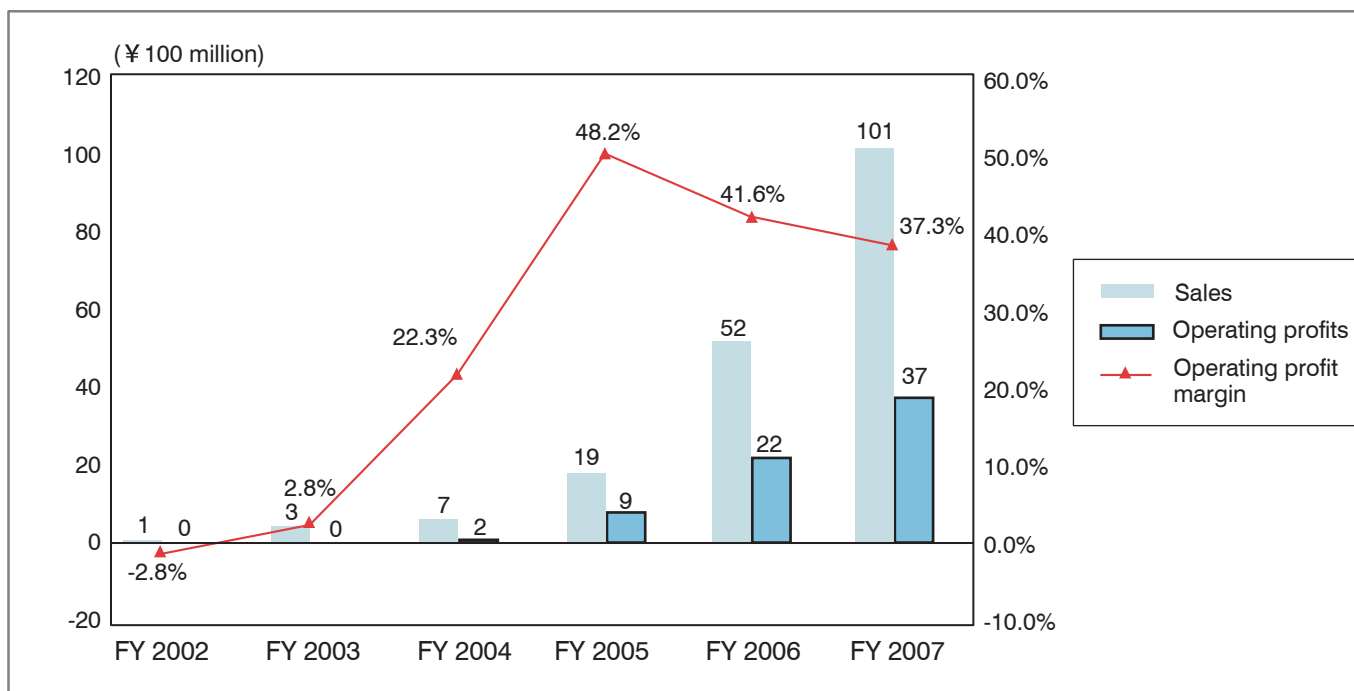
With regard to DeNA (established in March 1999), the rapid growth in the mobile business has resulted in large-scale increases in sales and profits. In fiscal year 2007, with the increase in subscribers to portal/SNS (Social Networking Service)/gaming platform *Mobage-town* for mobile phone users which it operates, advertising revenue increased, and the scale of the mobile business grew approximately 2.6 fold over the previous year. Also, aside from the scale of the mobile business, the shopping business also performed well. Furthermore, figures are based on parent company only figures until fiscal year 2004, and consolidated figures from fiscal year 2005. Also, since the company did not disclose operating profits or operating profit margins for fiscal year 2002, the numbers shown in figure 8 are for recurring profit and recurring profit margin instead. (Figure 8)

Figure 8: Business Conditions at DeNA



With regard to mixi (established in October 2000), there has been a sharp rise in sales figure in conjunction with the increase in the number of users of the SNS (Social Networking Service) it operates, leading to continuing growth trends for both sales and profits. In fiscal year 2007 in particular, the revamp of the SNS site design in October 2007 and the start of services in June of the same year, enabling the posting of videos led to an increase in the number of subscribers and visitors to the site, resulting in a shift to strong advertising which acted as an impetus to sales growth. Recently, the company has been increasing its behavior-based targeted advertising, and the growth in advertising revenue resulting from this has been noticeable. Furthermore, in terms of the company's performance, figures were not released for operating profits or operating profit margins in fiscal years 2002 and 2003. And the numbers shown in figure 9 are for recurring profit and recurring profit margin instead. (Figure 9)

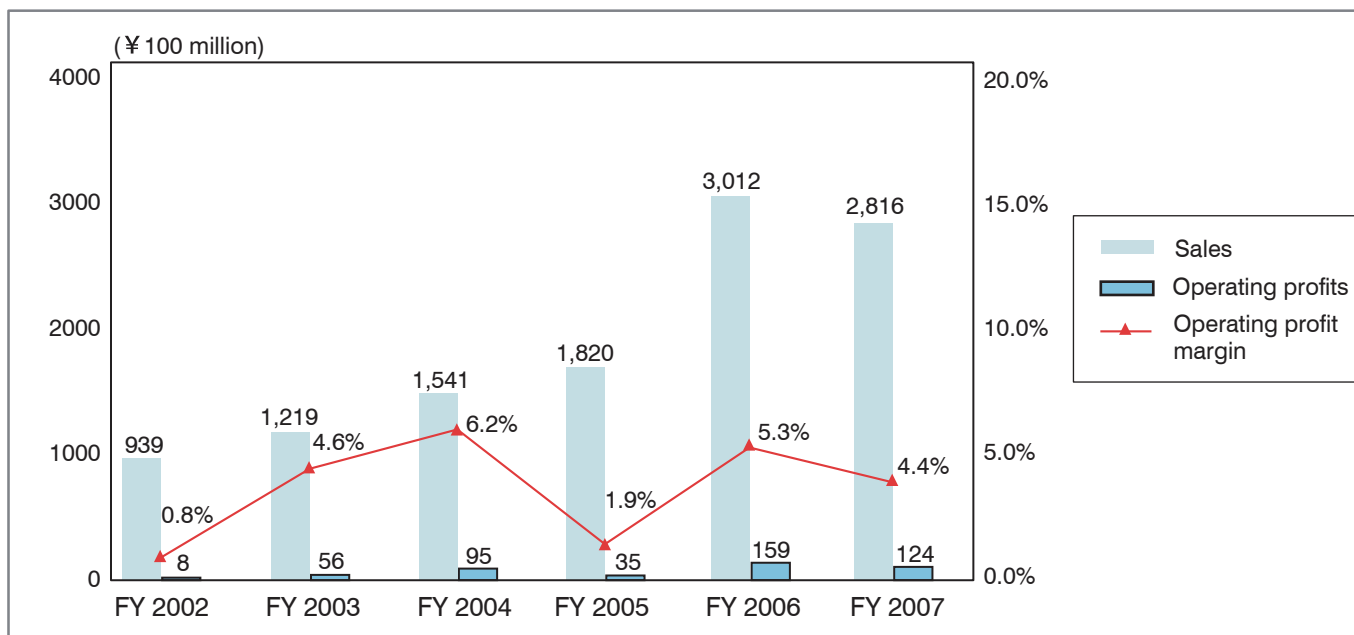
Figure 9: Business Conditions at mixi



(4) Business conditions at communications business operators

With regard to Usen (established in September 1964), sales had continued to show an upward trend but there was a decrease in sales in fiscal year 2007, with operating profit also decreasing that same year. This was mainly due to a reduction in recruitment by companies as a result of a feeling of unease about future business prospects, resulting in poor performance by subsidiary Intelligence which provides human resources services (want ads, etc.). Also, with regard to GyaO, its Internet based video distribution service, costs for procuring contents have been high and increasing advertising revenue has proved difficult, slowing down the shift to profitability and also adding to the causes of lower sales and profits. Furthermore, with regard to the contents business, the company announced its withdrawal from the movie business in April 2008, and has stopped new purchases and production of movies, and how this strategy will affect business performance should be watched closely. (Figure 10)

Figure 10: Business Conditions at Usen



With regard to Internet Initiative (established in December 1992), the ISP (Internet Service Provider) and SI (System Integration) businesses have been doing well, leading to four consecutive years of growth in sales and profits. With regard to the good performance of the ISP business, reasons include the spinning off of hi-ho which operates the ISP into a subsidiary in June 2007 and the good growth in subscriptions to corporate services. In addition, the background to the good performance in the SI business includes brisk business in network construction initiatives and increases in system operation and maintenance contracts. Furthermore, with regard to the slump in operating profits in fiscal years 2002 and 2003, reasons included the escalation of expenses as a result of the start in investments in the SI business, the disposal of losses associated with bankrupt affiliated company Crosswave Communications, and the reduction in fees for ISP services. (Figure 11)

With regard to ACCA Networks (established in March 2000), sales have been on a downward trend in recent years against a background of poor ISP business for individual users, and operating profits have shown little growth. The company's corporate-use communications services have remained more or less flat, and the reduction in DSL contracts as the market has matured has further exacerbated the slowdown in the ISP business for individuals. However, in fiscal year 2007, as a result of reductions in various costs, such as improved management due to the consolidation of DSL facilities, the reduction of fixed costs such as usage fees for relay lines, there was a slight increase in operating profits. Furthermore, the company's business performance is shown as consolidated results incorporating ACCA Solutions and ACCA Wireless as from fiscal year 2006, whereas results up to fiscal year 2005 are for the parent company only. Also, the fact must be considered that, in June 2009, the company will be acquired by and absorbed into eAccess with which it has had a capital and business relationship since July 2008. (Figure 12)

Figure 11: Business Conditions at Internet Initiative

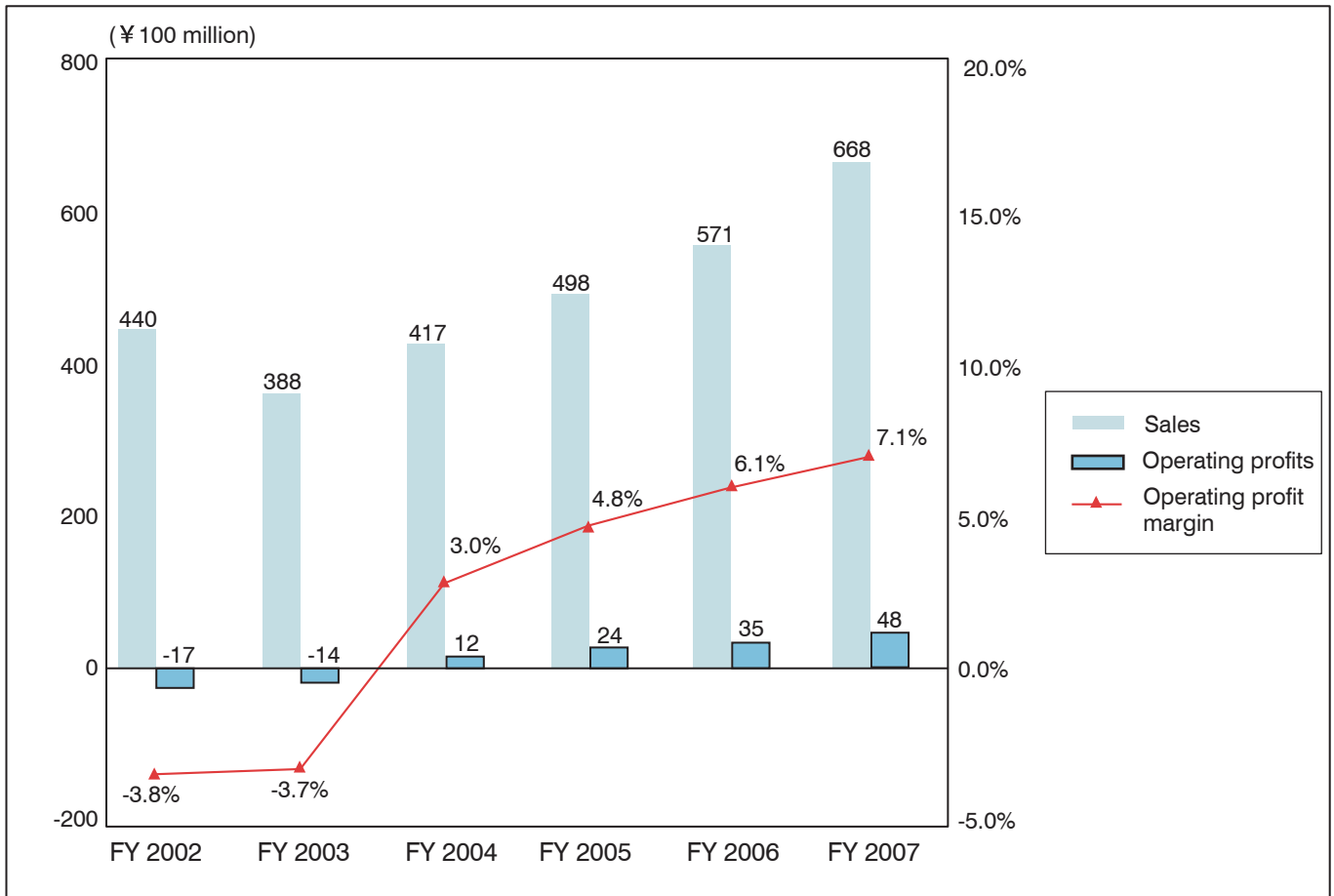
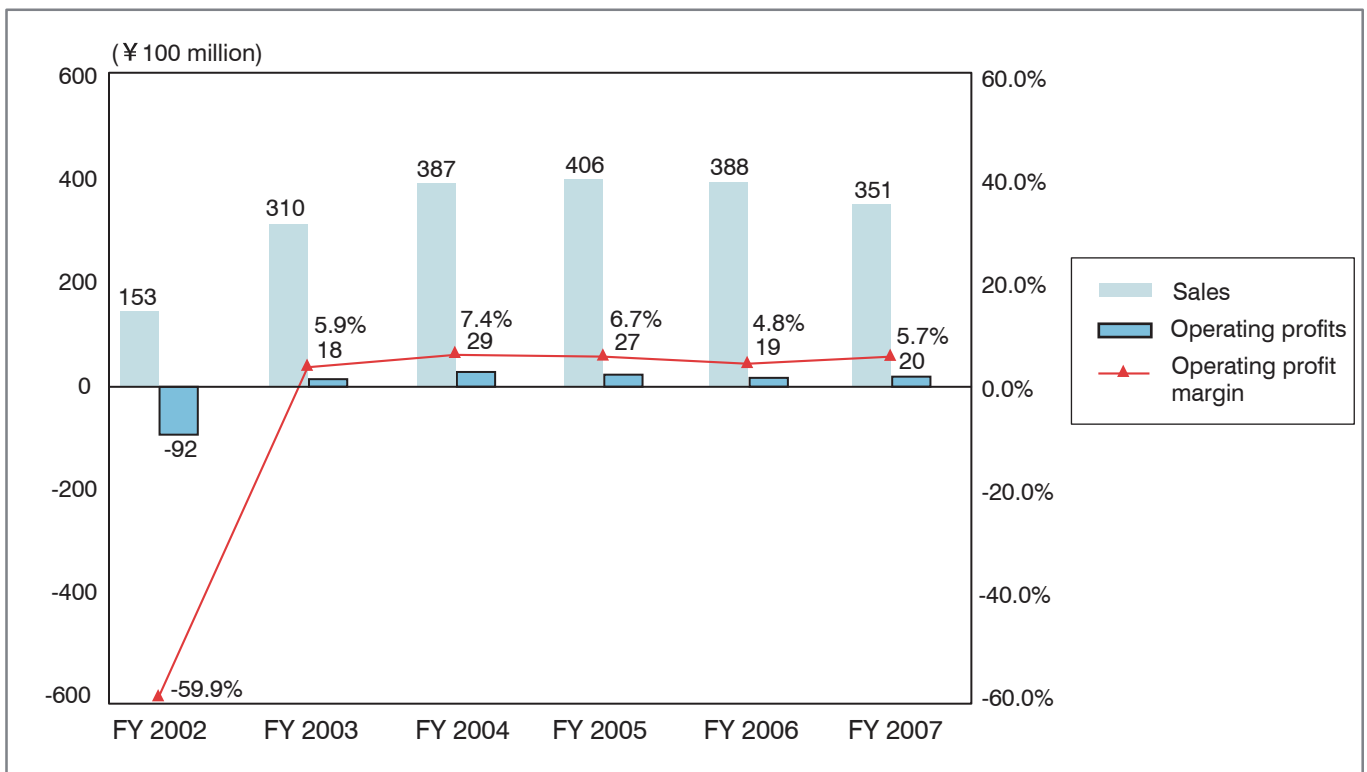


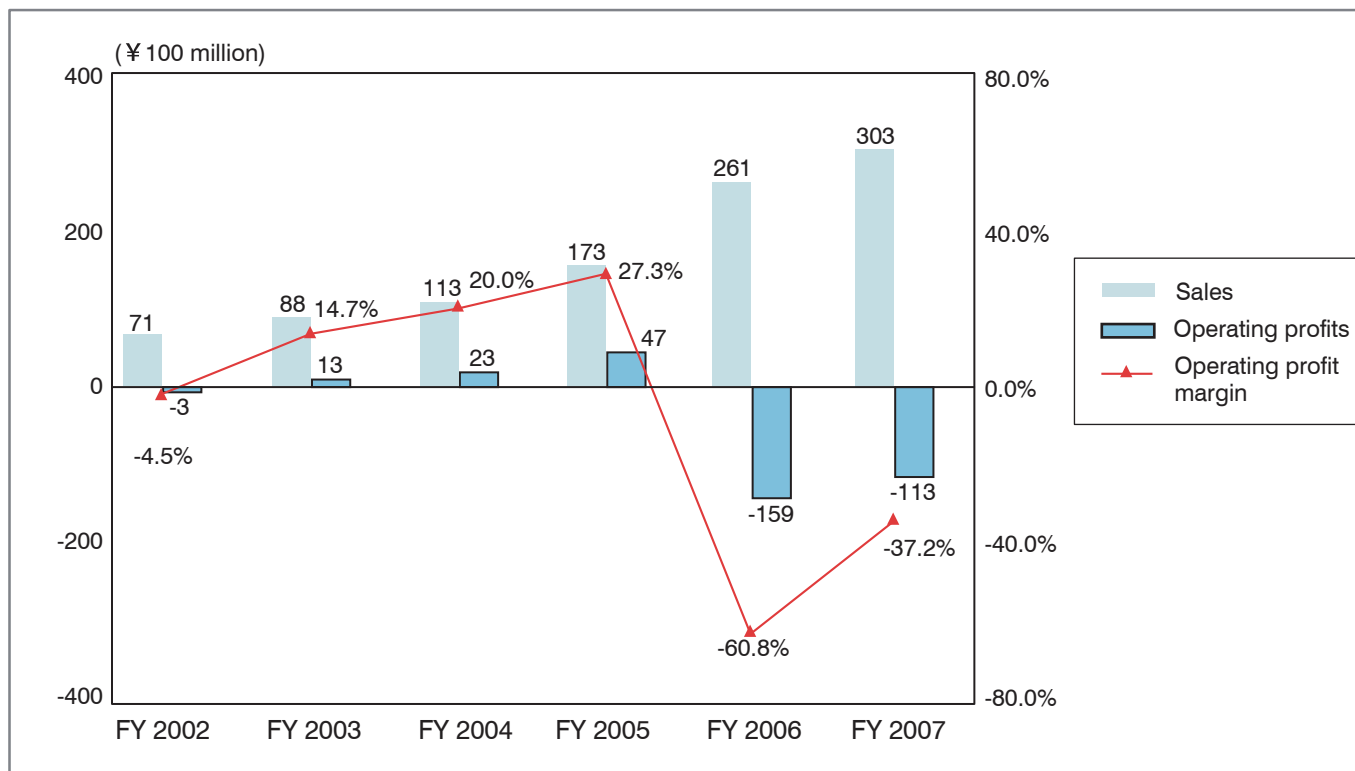
Figure 12: Business Conditions at ACCA Networks



(5) Business conditions for software developers

First of all, we will analyze business conditions for companies that develop software for corporate use. ACCESS (established in February 1984) has seen continued increases in sales but showed an operating loss starting in fiscal year 2006. The main reasons for the increase in sales is that sales in the software business for mobile terminals have been growing steadily in conjunction with the increase in use by manufacturers and growing sales of terminals. The main reason for the operating loss is the depreciation of goodwill and other costs involved with the purchase of US software vendor PalmSource (now known as ACCESS Systems) in November 2005. (Figure 13)

Figure 13: Business Conditions at ACCESS



With regard to Cybozu (established in August 1997), sales have been on an upward trend and operating profits, which had fallen slightly in fiscal year 2006, recovered in fiscal year 2007. The main causes for the sales increases include improvements in the performance of the software business and the solutions business following the addition of companies to consolidated sales (for example, the company made Blog Engine, now known as Feedpath, which develops blog software into a subsidiary in March 2006, and Integratto Business Systems which develops systems and markets software packages, into a subsidiary in June 2006). Also, in fiscal year 2007, the reduction in costs such as business consignment fees and communications fees led to the improvement in operating profits. (Figure 14)

Furthermore, for comparative purposes, we took a look at business conditions for Oracle (established in June 1977) which is the United States' representative software developer. The company has been on an upward trend in both sales and operating profits on the back of strong performance in the software business and consulting business. With regard to the software business, business performance has been good both for new product development and updating and support of existing products. Also, looking at sales by geographical area, performance has been good in all areas but the proportion of overseas business (business outside of the United States) has been increasing. (Figure 15)

Let's go on to analyze business conditions for security-related software business operators. With regard to Trend Micro (established in October 1989, and changed names in January 1998), the company has been showing steady growth in both sales and profits against a background of strong performance in businesses related to security software. The company's security software has been doing well both for the individual user market and the corporate user market, against a background of growing diversification of computer virus attacks, providing impetus for the growth in sales. Also, even though personnel related costs have been rising due to hiring more staff, the growth in sales has been greater than the growth in expenses, leading to continuing growth in operating profits. (Figure 16)

Figure 14: Business Conditions at Cybozu

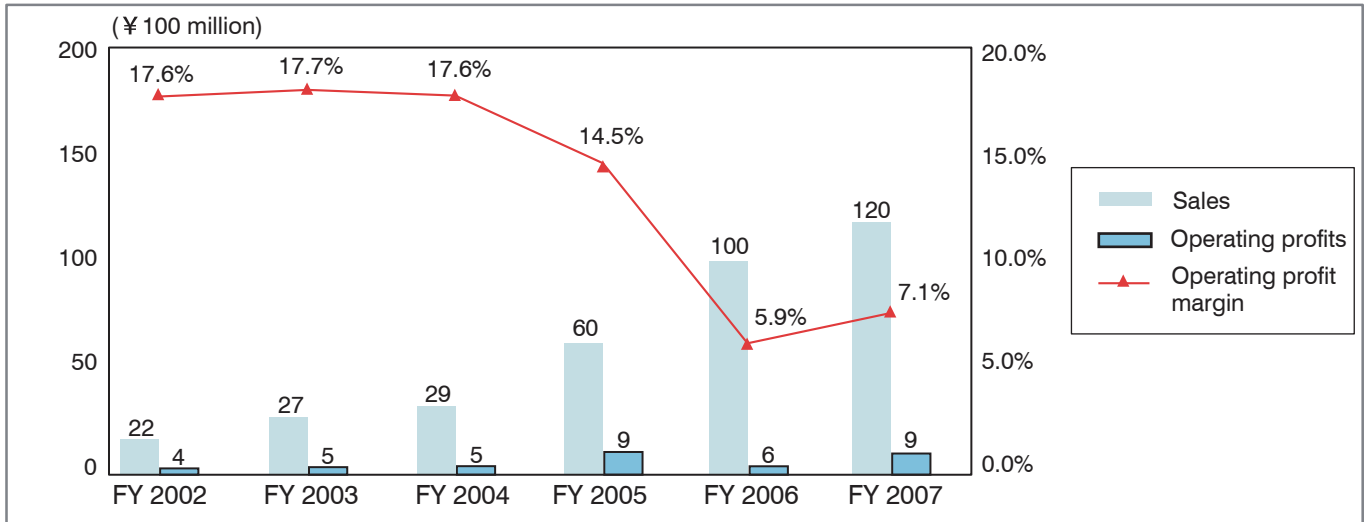


Figure 15: Business Conditions at Oracle

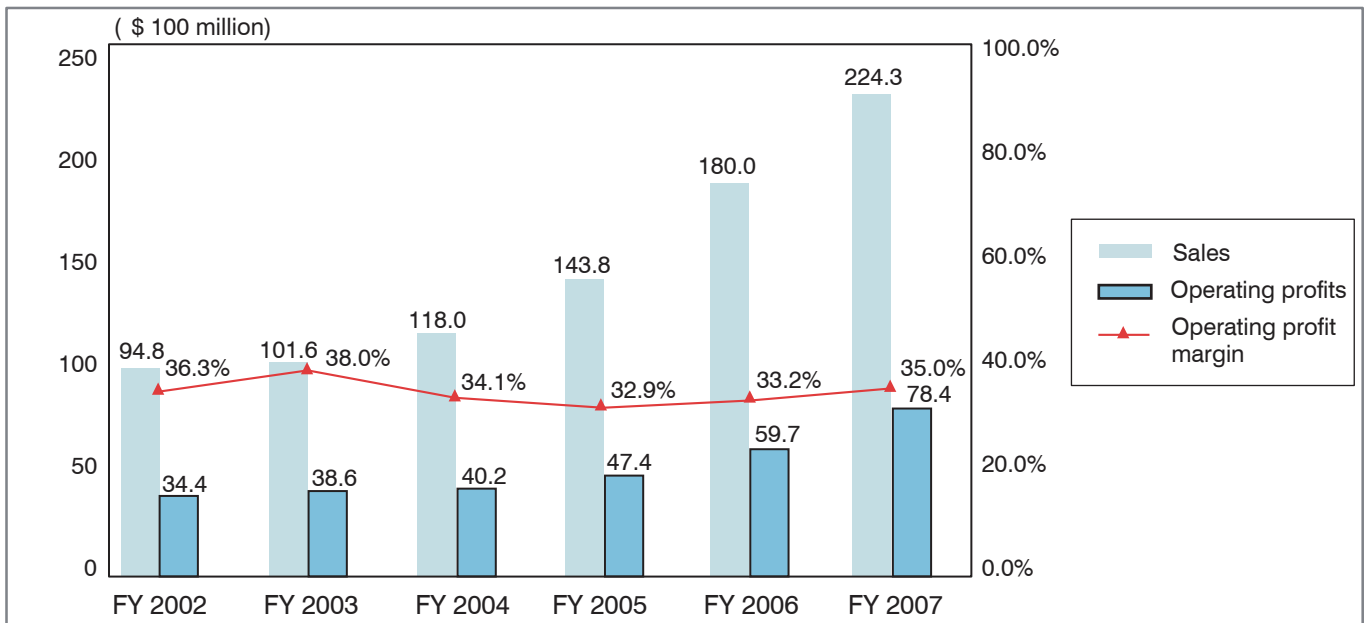
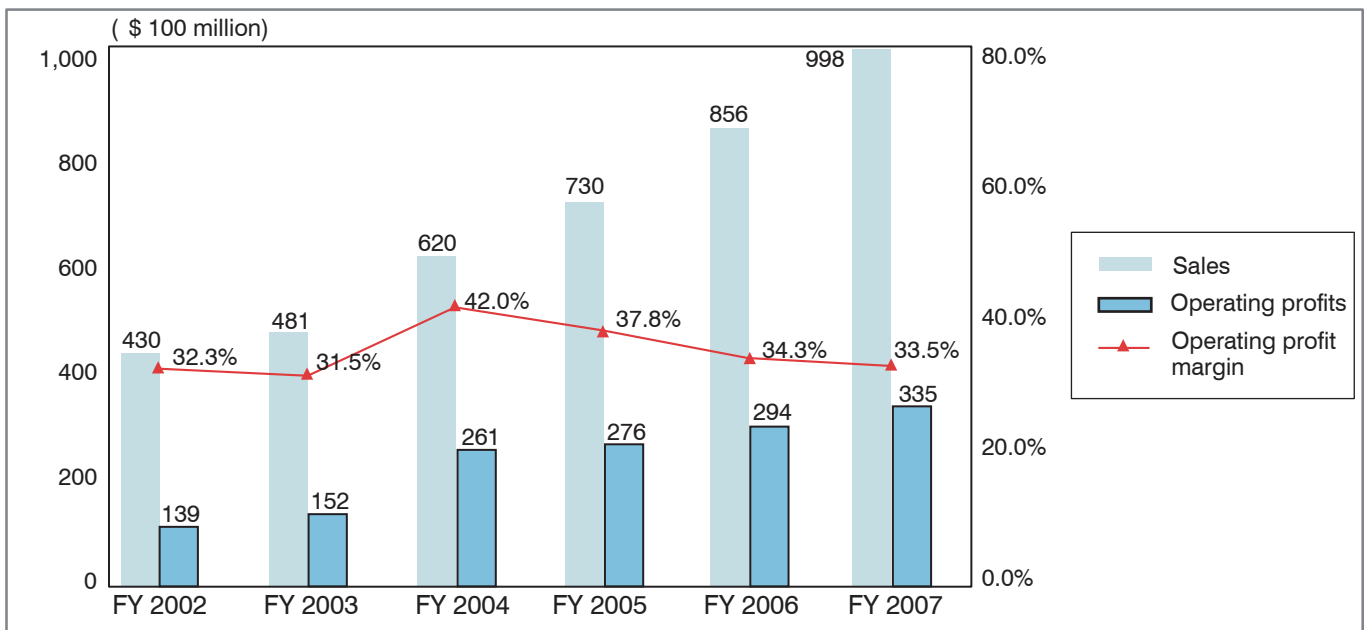
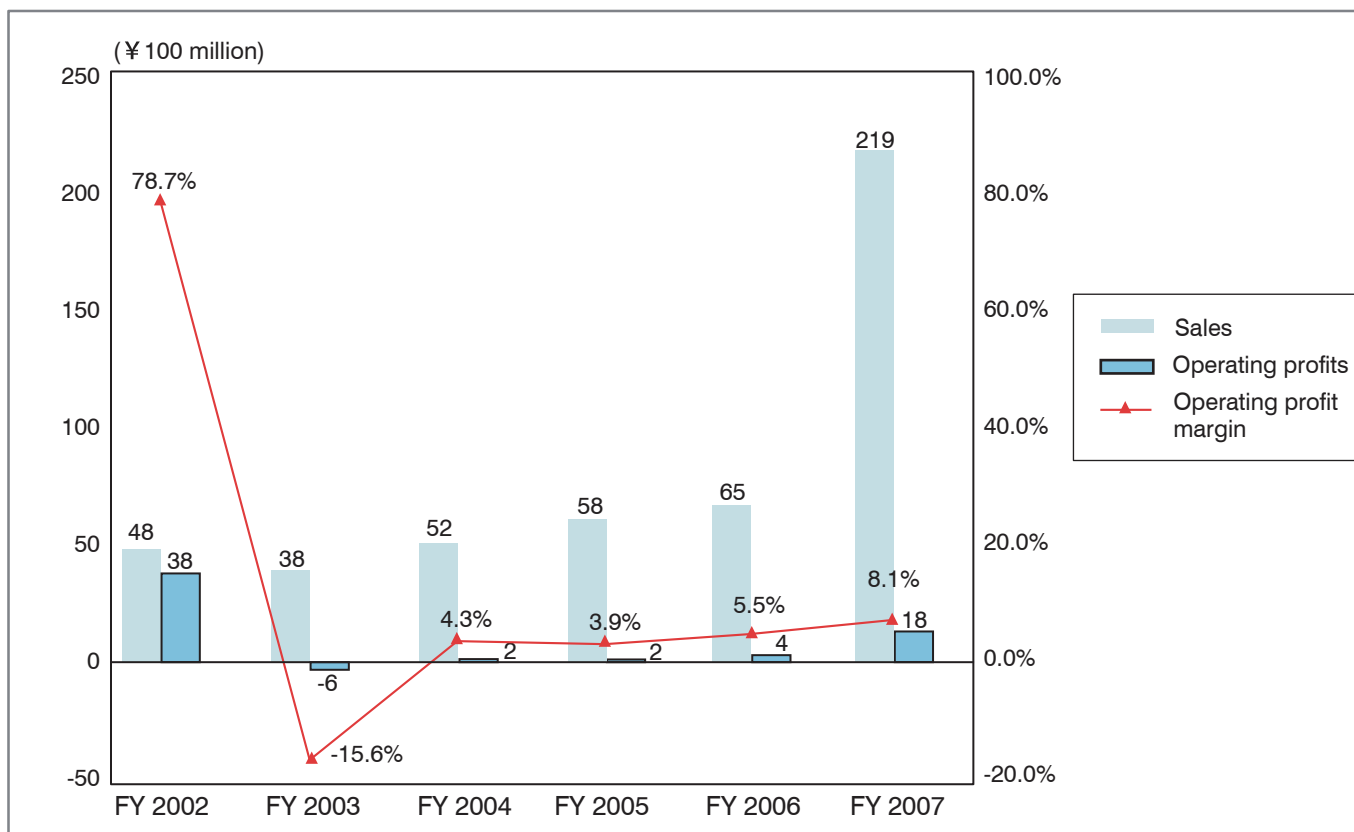


Figure 16: Business Conditions at Trend Micro



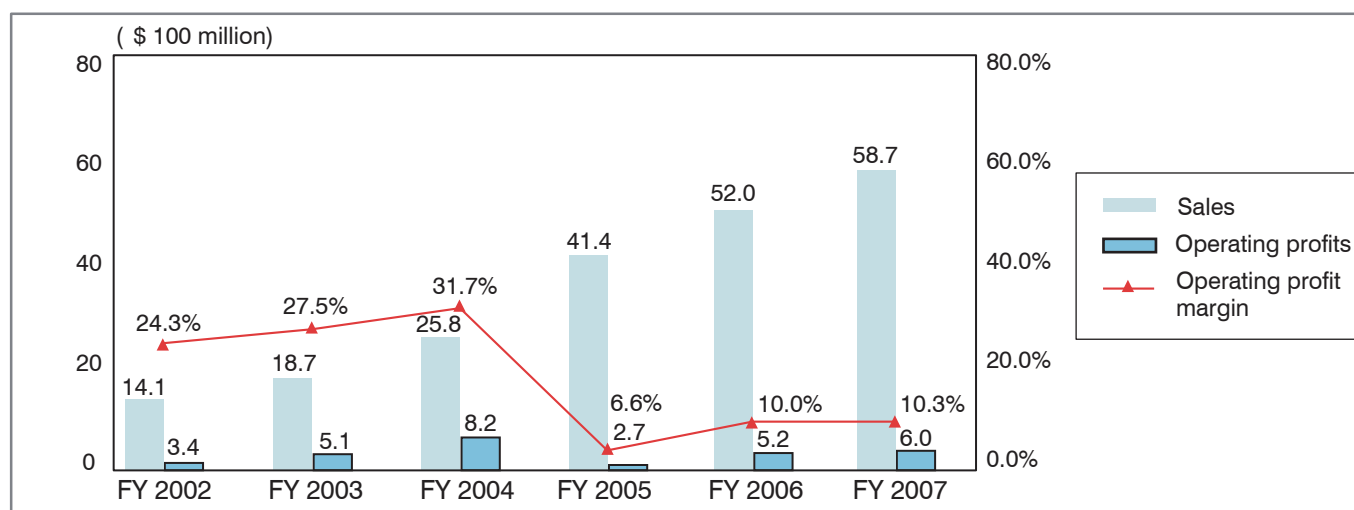
With regard to LAC (established in September 1986), the most noticeable thing is that sales in fiscal year 2007 were up more than 3-fold over the previous fiscal year, with operating profits up more than 4-fold. The main reason for this can be considered to be the merger in October 2007 of business with A&I System which operated a systems development and solutions-related business. The company's security service business has been progressing steadily, and its SI business has been doing well. Furthermore, in terms of the company's business performance, the figures shown are for consolidated performance for fiscal year 2007 and parent company until fiscal year 2006. (Figure 17)

Figure 17: Business Conditions at LAC



Furthermore, for comparative purposes, we also looked at business conditions for Symantec (established in March 1982), the United States' representative company in security software. Against a background of good performance in the corporate security software business, the company has largely been on an upward trend for both sales and profits. In particular, the storage (external storage equipment) and server administration business have been performing well, so that sales have been on an upward trend, not just within the United States, but also overseas. (Figure 18)

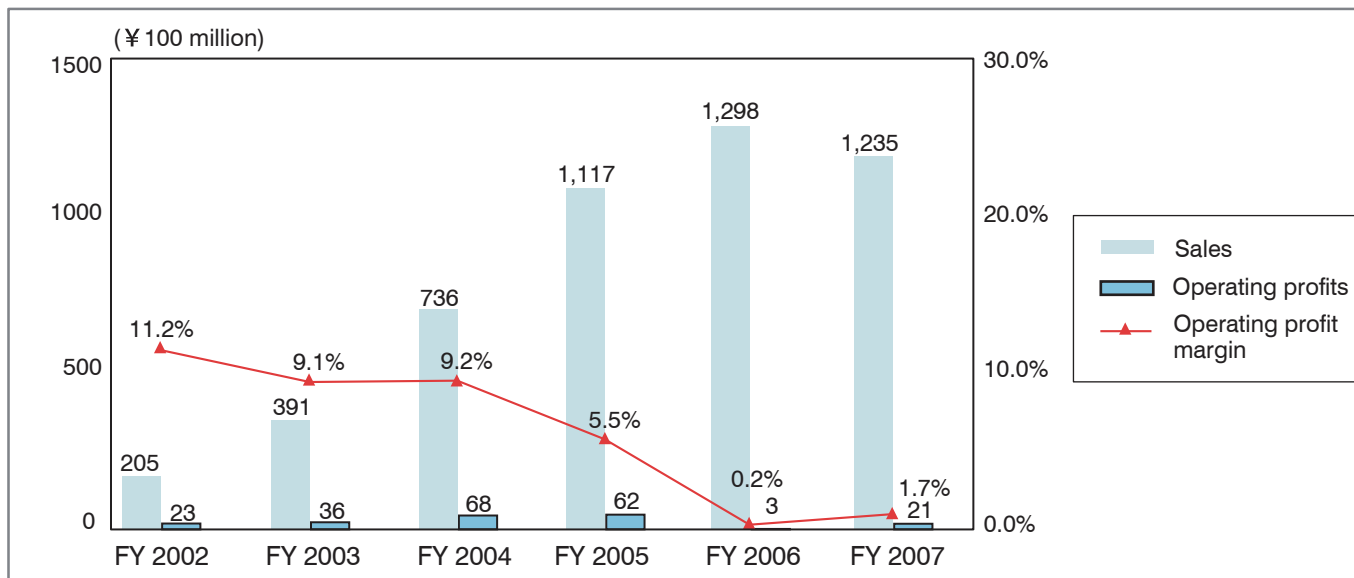
Figure 18: Business Conditions for Symantec



(6) Business conditions for contents distribution business operators

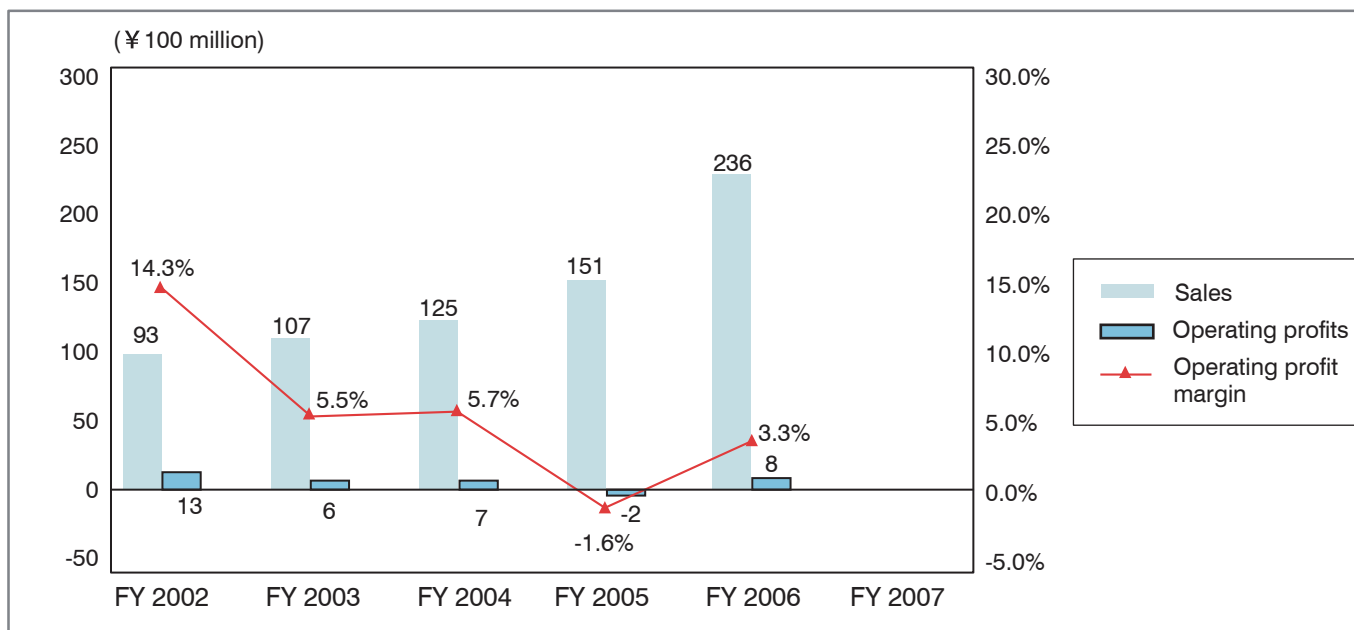
With regard to Index (established in September 1995), sales were on an upward trend until fiscal year 2006, but there was a drop in fiscal year 2007. Operating profits fell sharply in fiscal year 2006, but were on the road to recovery in fiscal year 2007. The company experienced major drops in profits in fiscal year 2006 in all of its businesses, in particular in the mobile contents business and the game and video contents business. However, in fiscal year 2007, as a result of selling its entire holdings in subsidiary NEO Index which develops VOD (Video on Demand) services for television, to investment company Ibiza, sales revenue was down but with good performance in the game business and strong advertising in China, profits were up. (Figure 19)

Figure 19: Business Conditions at Index



With regard to Cybird (established in September 1998), sales were largely on an upward trend between fiscal years 2002 and 2006, but operating profits fell in fiscal year 2005. In fiscal year 2005, the company recorded an operating loss due to the depreciation of goodwill payments for CYB Investment, an overseas business consolidated subsidiary. But with depreciation figures being reduced in fiscal year 2006, operating profits increased, and the purchase in October 2006 of JIMOS which operates a mail order business led to an increase in sales. Following a management buyout, the company delisted from JASDAQ in March 2008, and has not made public its fiscal year 2007 performance. (Figure 20)

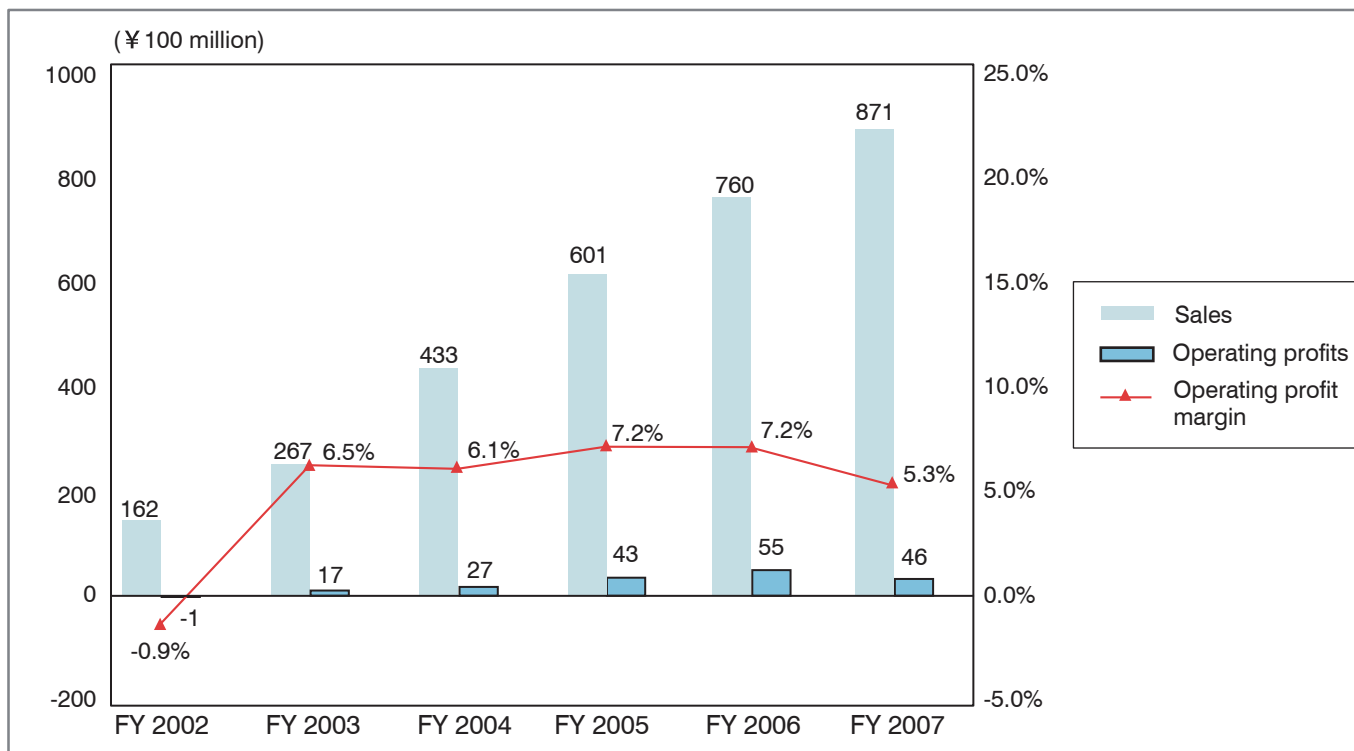
Figure 20: Business Conditions at Cybird



(7) Business conditions for internet advertising business operators

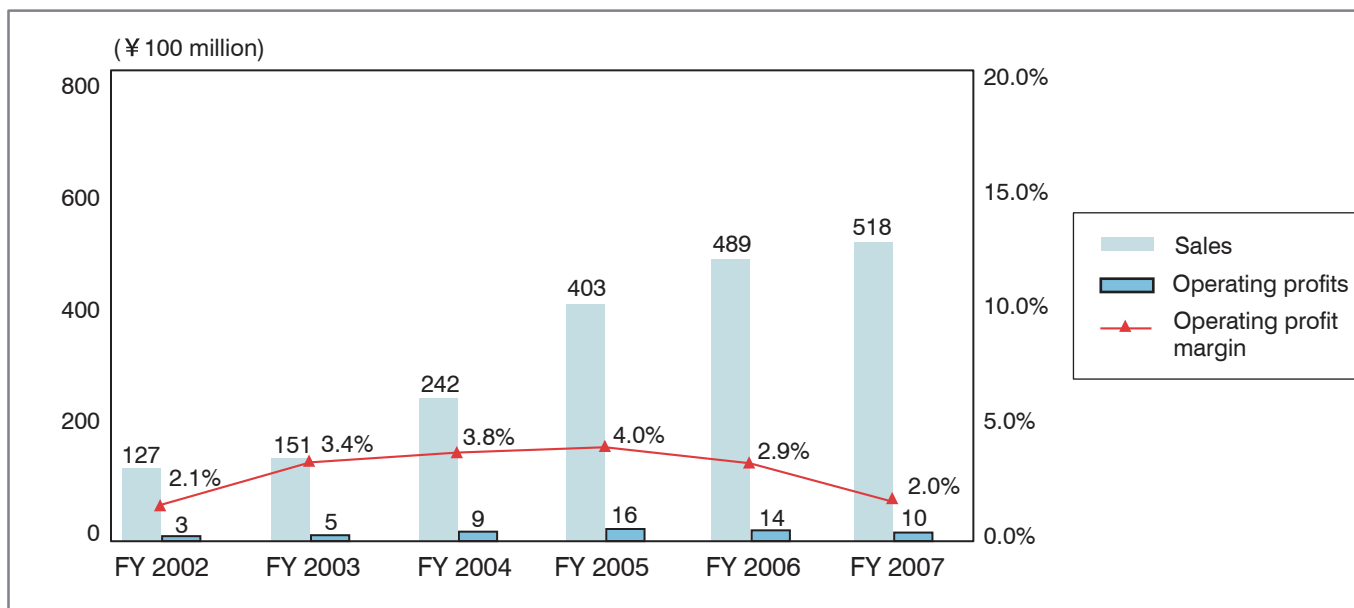
With regard to CyberAgent (established in March 1998), sales have been on an upward trend on the back of the growing market for Internet advertising, but operating profit fell slightly in fiscal year 2007. Even though the company's site listing advertising related business is now doing well, profits declined in fiscal year 2007 since profits from sales of stocks held in its venture investment business were lower than the previous year's. (Figure 21)

Figure 21: Business Conditions at CyberAgent



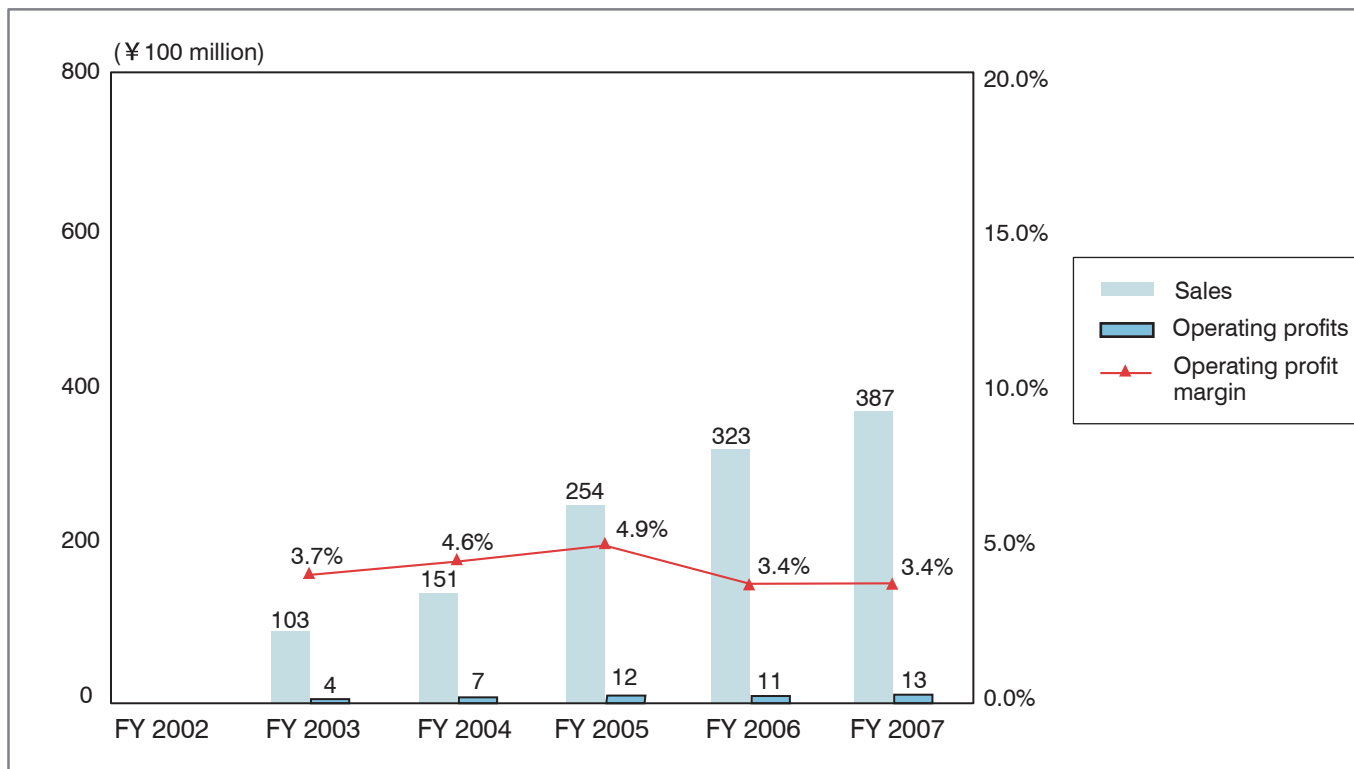
Cyber Communications (established in June 1996) has, in the same way, seen an upward trend in sales against a background of the expanding market for Internet advertising, but operating profits have been declining since fiscal year 2006. The company's web advertising (video advertising, etc.) and mobile advertising related business has been doing well but, in fiscal year 2007, increases in sales management costs such as personnel costs and rentals resulted in a drop in profits. Furthermore, the company's business performance is shown in consolidated figures from fiscal year 2003 and for the parent company alone for fiscal year 2002. (Figure 22)

Figure 22: Business Conditions at Cyber Communications



With regard to Digital Advertising Consortium (DAC) (established in December 1996), it also has seen its sales on an upward trend as a result of the expansion in the Internet advertising market, but operating profits have been largely flat since fiscal year 2005. The principal reason for this can be seen as the fact that its major product, which is web advertising (planning and marketing advertising space centering on banner advertising) has been doing well. Furthermore, the company's performance prior to fiscal year 2002 is not publicly disclosed. (Figure 23)

Figure 23: Business Conditions at Digital Advertising Consortium (DAC)



Summary

The trend of recent years for business conditions shows that there are a comparatively large number of positive topics for emerging Internet companies, such as the expansion in the scale of the SNS market, and the growth in the Internet advertising market, and that business development in response to these has had a positive effect on corporate performance. At the same time, as has been mentioned above, market environments have recently grown progressively more difficult, and since it can be said that competition has been growing stiffer with both domestic and overseas competitors, it can be said that the key to future business management for emerging Internet companies lies in how appealing the services they provide will be and whether they can build their business based on this.

Whatever happens, emerging Internet companies should take into consideration the factors that are affecting business performance of other companies and put in place appropriate business strategies while at the same time continuing to work on improving their business conditions.