

# Chapter 1

## Time for Regional Areas to Incorporate Management Perspectives in Pursuit of a Sustainable Society



### 1.1 Shifting from Regional “Administration” to “Management”

Japan is at the forefront of the global trend, particularly among advanced countries, of an aging population with declining birthrate and urbanization. The way Japan responds to and resolves these issues may serve as a remedy for other countries going forward. Among Japan’s policies targeting “regional revitalization” and “regional development,” which seek to establish a sustainable society, this book focuses on Hometown Tax Donations.

Administration policies by rural areas to strengthen or maintain regional platforms using the national budget are no longer valid. Although this model was effective while Japan as a whole was achieving rapid growth, rural areas now need to fortify their independent revenue sources as national growth flattens and falters. Regions can be likened to a nation—they must “export” regional goods and services to earn foreign currency, while also increasing inbound visitors (tourists) and boosting their consumption. Most importantly, regions must suppress population outflow as much as possible. If the local workforce shrinks, productivity and local consumption will drop, leading to an economic slowdown. Accordingly, the remedy for revitalizing or developing regions is to create a scheme where people, goods and capital circulate within rural areas and regions.

Fortunately, we are shifting into a small-business friendly era. Since the Internet now enables small-scale retailing, businesses can start small, and may even develop local hit products if successfully able to create a buzz on social media. Also, from a financing aspect, businesses have less interest payment burden since borrowing rates are nearly zero percent. Furthermore, “social finance,” a category for new financing methods alternative to equity financing and loans, has emerged in recent years. Social finance funds need not be repaid, and are helpful in that, at times, they simultaneously enable capturing customers of goods and services.

In this way, a more accessible business platform for small businesses is developing; however, businesses face difficulty in single-handedly outplaying competitors across Japan and winning business opportunities. Such challenges will require support from municipalities, local trading companies, or other organizations. Also, in the event that small businesses successfully capture business opportunities, they will then aim for business expansion, which will require securing new personnel. Unless regions become attractive places to live in, such new personnel may not be secured, making the scheme incomplete. Thus, it is necessary to develop marketing strategies that promote regional attractiveness. This essentially implies “managing” regions.

## 1.2 Why is Regional Revitalization Difficult?

One characteristic of regional revitalization is that success achieved in one region is not necessarily applicable in another, because each region faces vastly different issues and circumstances. Thus, while accumulating best practices is important, successful cases of revitalization are often led by and dependent on specific central figures. It is therefore important to develop a holistic system that inclusively bolsters all regions, and such a system is the focus of the research presented in this book.

Regional revitalization has been gaining much attention recently, and the “White Paper on Land, Infrastructure, Transport and Tourism in Japan, 2017” reported that approximately one out of four respondents in their twenties seeks “promotion of migration to rural areas including support for living in the countryside.” Such opinions will most likely increase beyond 2020 because of the novel coronavirus pandemic. Yet, migration to rural areas has been slow to progress. This is in part due to the lack of a sustainable system to promote migrations.

In the past, the formula for successful municipal administration was to attract plants of large companies, thereby creating jobs and increasing the local population. However, traditional manufacturers have moved their production overseas, and the manufacturing industrial model itself has changed, shifting toward light manufacturing that requires less human resource. The model of attracting plants to the region are now a thing of the past. What is needed now is to raise the productivity of existing local businesses, or to develop new local businesses and startups. To do so, financing becomes essential. During the phase of Japan’s rapid growth, municipalities could secure abundant revenues with the help of local allocation tax grants, and using such revenues, solidify the base for locals’ living standards and local businesses. However, Japan no longer has leeway in its revenues and thus, rural areas can no longer depend on the central government. While deterioration of rural areas may be avoided with active local business deployment and local consumption, in reality, manufacturers are shifting their production overseas and residents are migrating to urban areas, leaving behind only senior citizens. It is therefore necessary to create remedies and systems of some kind to make regions sustainable.

There has been active discussion lately on Sustainable Development Goals (SDGs) in the realm of company management. “Development” and growth are preconditions

when discussing SDGs in light of company management; however, in the case of rural or regional areas, emphasis is placed on halting deterioration and maintaining or sustaining current levels. In this context, it is necessary to develop a scheme where not only funds are simply procured to deploy businesses but also non-locals become involved as associating or interacting populations, and people, goods and capital, as well as knowledge are constantly exchanged between rural and urban areas. Hometown Tax Donation, the main topic of this book, holds the potential of extending beyond simple financing to accomplish dynamic regional management through creating such associating and interacting populations.

### 1.3 High-Risk Funds Previously Limited in Regions

While companies mostly procure funds through equity financing or bank loans, both methods do not function sufficiently in rural areas in Japan (see 2018 White Paper on Small and Medium Enterprises in Japan, among others). It is difficult for rural projects to capture investments since many venture capitals (VCs) invest heavily in Tokyo-based projects, while equity financing does not suit rural companies since many are not large enough to scale nation-wide and go public. As for loans, while startup support loans and loan security systems have been enhanced, regional financial institutions often hesitate to lend working capital in the following expansion stage.

In this way, opportunities to receive funds, especially high-risk funds, were restricted for small- and medium-sized enterprises (SMEs) and venture businesses in rural areas, as well as social businesses aiming to resolve regional or social issues. However, recent years have seen the emergence of various social finance methods which serve as new financing sources for resolving social issues, and companies have been procuring funds through crowdfunding (CF), social impact investments, and Hometown Tax Donations among other methods (hereafter referred to collectively as “social finance”) to create new businesses or expand existing ones, thereby playing a role in resolving social and regional issues.

Meanwhile, much remains unknown about each social finance method, including their effective usage, constraints in funds if any, and macro flow of funds, demanding further research. The following questions are important from both practical and academic aspects: what kind of businesses are compatible with each financing method; and how effective is social finance relative to conventional financing methods in driving regional entrepreneurship and resolving regional issues (Fig. 1.1).

To revitalize Japan’s economy, it is necessary to revitalize SMEs which support regional economies and account for 99% of all companies in Japan. Regional revitalization requires both community-based business activities and financing which supports such activities. Traditionally, research on such elements were conducted separately; for example, regional revitalization was mostly discussed in the context of theories of SMEs or banking, while startups were discussed in the context of entrepreneurship, focusing on IT unicorns whose market capitalization would reach



**Fig. 1.1** Changes in financing environment of local businesses. *Note* Created by the author

hundreds of billions of yen. However, there have recently been overseas studies that take a multidisciplinary approach by consolidating the two elements, and the following chapters of this book also attempt to adopt this approach whenever possible. For example, CF and Hometown Tax Donation not only enable procuring funds but also serve as tools for expanding sales network across the nation. Local businesses that only serve the community may not be motivated to develop new products as it could erode profitability of existing products. However, CF and Hometown Tax Donation may encourage entrepreneurship among local businesses by providing a new market outside the region. Deploying businesses using these new financing methods can be considered effective particularly in rural areas facing a population decline.

## 1.4 The Emergence of New Alternative Financing Methods (Social Finance)

Such new alternative financing methods which have recently emerged are unique in that they not only enable companies to procure funds but also may be most effective when companies aim to resolve regional or social issues. This is in part owing to the fact that small-lot financing is possible via the Internet. Companies gain support and empathy from individuals, procure funds, and at times, have such individuals engage in their business (e.g., through supporting marketing or PR activities).

Much research has been carried out globally on CF, the leading social finance method. This book therefore omits discussions on CF and instead focuses on Hometown Tax Donation, a social finance method unique to Japan. The next chapter will describe the system's outline, and for now, I will simply state that this system is a policy for revitalizing regional municipalities and businesses by using donations by individuals.

This book first examines the effectiveness of Hometown Tax Donation as an alternative financing method by unveiling its effect on local businesses and economies. Specifically, we explore how effective Hometown Tax Donation is for local businesses in terms of prompting better cash flows and enhancing business capabilities.

In particular, I will clarify whether there is collaboration with regional financial institutions and if so, whether this enhances their contribution to regional economies. I will also unveil how Hometown Tax Donation contributes to community-based activities aimed at resolving regional issues and how it affects demographics, and validate its effectiveness as a regional development policy. While population has increased in some municipalities owing to improved living standards from funds procured through Hometown Tax Donation, it will be necessary to analyze the system's effect on migration and settlement since such demographic trends may translate to erosion of population in neighboring municipalities. Although such analysis is complex since various factors influence demographics, I would like to examine whether the system simply triggers a zero-sum competition among rural areas, or whether it effectively mitigates urbanization and urges the population to shift back to rural areas.

I will also discuss civic crowdfunding (CCF) which are public projects led by citizens, civic organizations including NPOs and NGOs, and at times, rural municipalities. CCF has a strong social aspect, and is driving the shift toward citizen engagement from the financing phase in resolving social and regional issues—an area which was typically handled solely by municipalities. This trend is in response to the tightening of municipalities' budgets and rising demand for budget disclosure, the inclination toward “silver democracy” in which budgets for elderly citizens are prioritized, and the spread of empathy-driven investments by citizens (Stiver et al. 2015). In Japan, we face the same issues, and CCF is mainly carried out using the Hometown Tax Donation scheme.

While Hometown Tax Donation is a system unique to Japan, overseas researchers who I have held discussions with have expressed strong interest in its function for fostering local businesses. According to Global Entrepreneurship Monitor which monitors entrepreneurship activities around the world, the level of Japan's ecosystem for entrepreneurs is among the worst. However, alternative financing methods can contribute largely to venture and local businesses which have limited financing means, and may be the key for developing venture businesses and raising corporate value of local businesses in Japan.

Another alternative financing method is social impact bonds (SIB). SIB is a financing method mainly targeting businesses that aim to reduce future fiscal or expense burden of municipalities, and is innovative in that it is outcome-oriented. SIB was originally launched to use private funds in assessing pilot programs for prophylactic intervention in such fields as healthcare, nursing care and welfare, employment, and education. However, more recently, some SIB projects are also targeting incubation for young people or the long-term unemployed, showing promise that SIB may also be applied in regional revitalization. Yet, since there have only been some 200 cases using SIB worldwide, its optimal usage is still unclear. SIB is valuable as it aims to reduce future costs and introduces the outcome-oriented concept in municipal spending; however, simply put, outcomes are not worth the time and effort required since projects currently demand the engagement of many stakeholders. If an easier scheme is introduced, SIB may gain a foothold and prosper in the field of regional revitalization in Japan, especially incubation and migration support.

## Reference

Stiver A, Barroca L, Minocha S, Richards M, Roberts D (2015) Civic crowdfunding research: challenges, opportunities, and future agenda. *New Media Soc* 17(2):249–271

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