Third-Country Trade: Good Business for Sogo-Shosha

By Yoshiyuki Ikeda

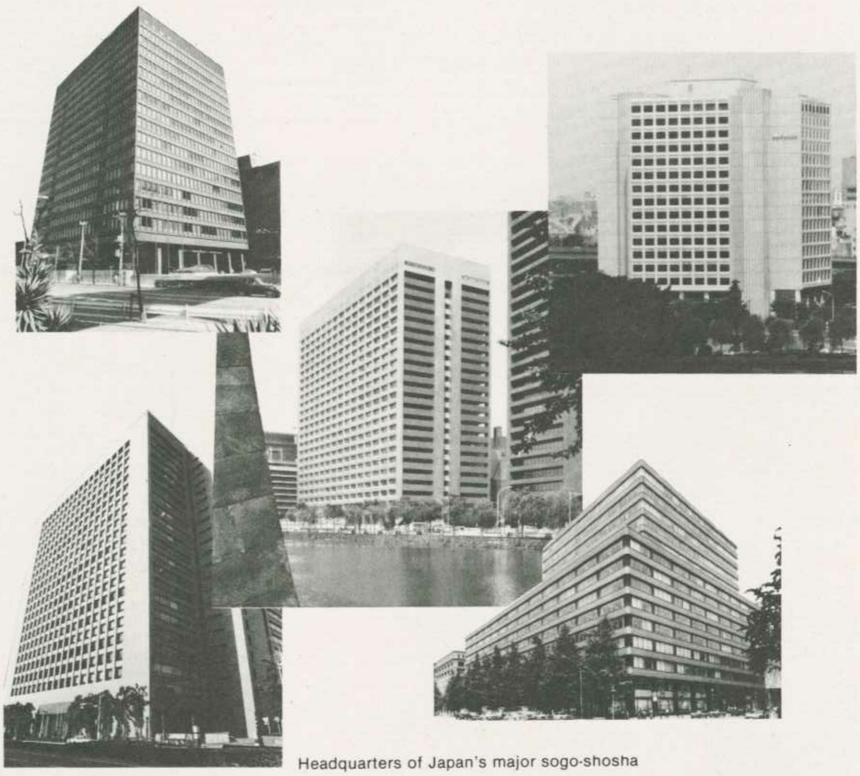
Growing third-country trade

The sogo-shosha are increasingly promoting third-country trade. This is trade in which a sogo-shosha acts as an intermediary for companies in two foreign countries who wish to trade.

Why is it foreign companies should look to a sogo-shosha for such assistance? Two reasons may be given.

The first is that a foreign product may not be internationally competitive, either because it is too expensive or because its quality is poor. Obviously, any product that does not comply with the norms of international competitiveness cannot sell on the international market where severe competition prevails. As a result, a company overseas may consult sogo-shosha on how to make the product internationally competitive. The sogo-shosha will already be familiar with the features of the product in question and well versed in the worldwide supply-demand situation. Consequently, it knows how the production process should be altered, or how much the price should be reduced, or how the quality should be improved in order to make the product marketable. In other words, the company can sell its product on the international market by making use of the guidance of the sogo-shosha.

The other reason is that the company may not be well informed of possible outlets for its products. Consequently, the product is still not fully competitive, although it has been sufficiently improved to be marketable. The sogo-shosha, which maintains a global information network, can help find a suitable customer who is interested in the product.



Headquarters of Japan's major sogo-shosha

Counter purchase (CP)

Third-country trade also takes the form of so-called "counter purchase." This is a special type of transaction in which a foreign government agrees to buy, say, 100 units of a product from Japan on the condition that Japan buy, say, 100 or 200 units of a certain product by the sogo-shosha. In this case, the products to be purchased by the sogo-shosha usually lack international competitiveness, since transactions are conducted under the authority of the foreign government. Such deals were initially concluded in trade with Communist countries, but in more recent years counter-purchase transactions have

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also been conducted increasingly with non-Communist developing countries with balance of payments difficulties.

When Japan, for instance, has concluded a CP agreement, it often cannot sell the products on its domestic market because they are not internationally competitive. Therefore, they must be marketed elsewhere, even if certain losses are incurred. Such transactions may well be described as "compulsory third-country trade."

Absence of statistics

No comprehensive statistics are available on third-country trade despite the fact that it has been growing rapidly in recent years. Of course, not only Japanese companies but firms of other countries as well are engaged in this form of trade. Nor are the sogo-shosha the only Japanese enterprises operating in this area. Presumably, some Japanese manufacturing concerns are conducting third-country trade on a considerably large scale.

The only source of information is the portfolio reports published by the sogo-shosha. These reports, submitted to the Ministry of Finance each accounting term, include reports on trade volume by category. The total volume of trade conducted by a sogo-shosha during a given accounting term is divided into four categories—exports, imports, domestic transactions and third-country transactions. A general idea of the progress in third-country trade can be obtained by gleaning relevant figures from these reports.

Table 1 shows how third-country trade through the sogo-shosha (nine companies) has developed over the past decade or so. The value of such transactions expanded 14.6 times between 1970 and 1982. By contrast, Japan's total export value increased 4.7 times in the same period. It is somewhat meaningless simply to compare the total value of Japan's exports and that of third-country transactions involving Japanese companies. Nevertheless, such a comparison is useful as an indicator of the relative scale of third-country trade. In 1982, for example, such transactions conducted by the sogo-shosha accounted for about one-third of the total export value.

The nine sogo-shosha are: Mitsubishi Corp., Mitsui and Co., C. Itoh and Co., Marubeni Corp., Sumitomo Corp., Nissho Iwai Corp., Kanematsu-Gosho, Toyo Menka Kaisha, and Nichimen Co.

Table 1 Volume of Cross Trade of Nine Major Trading Houses

Fiscal year	Volume of cross trade (in ¥ billion) (A)	Total of Japan's exports (in ¥ billion) (B)	Ratio of A to B (%)
1970	800	7,300	11.0
1975	4,100	17,000	24.1
1980	8,700	30,100	28.9
1981	10,700	34,400	31.1
1982	11,700	34,000	34.4
'82/70	14.6 times	4.7 times	

Japan's major trading companies—sogo-shosha—have set up branch offices virtually all over the world.

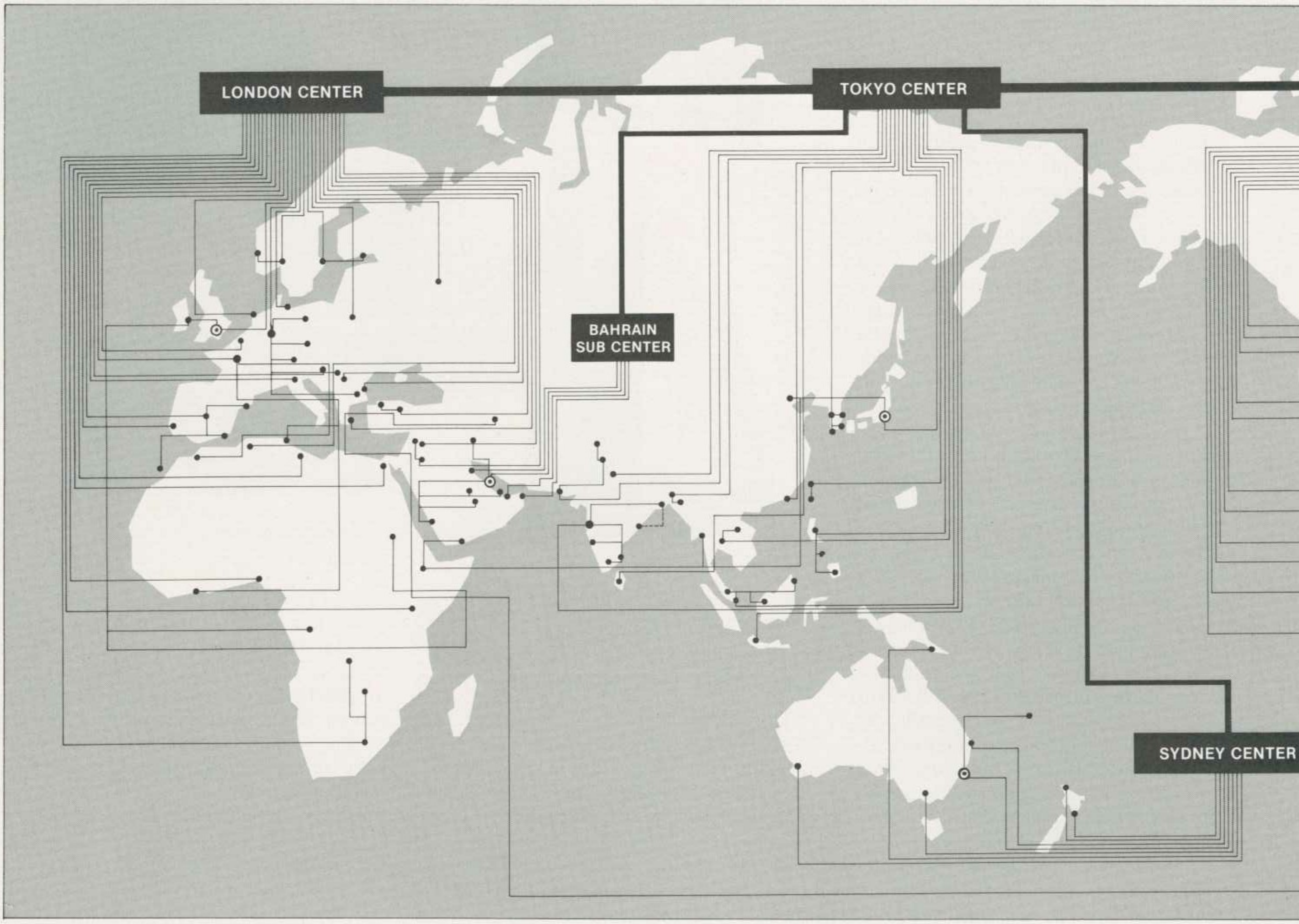


Table 2 Number of Overseas Offices and Employees of the Nine Major Trading Houses

Company name	Overseas office (Branch & representative)			Local corporation (Affiliate with 100% capital, joint venture)				Total			
	Places	Sent-out employees	Local employees	No. of co.'s	Places	Sent-out employees	Local employees	Places	Sent-out employees	Local employees	Total
Mitsubishi	93	422	2,473	25	63	542	1,935	156	964	4,408	5,372
Mitsui	85	394	961	26	64	587	1,491	149	981	2,452	3,433
C. Itoh	66	417	1,072	18	45	427	878	111	844	1,950	2,794
Marubeni	83	508	1,323	22	54	536	1,222	137	1,044	2,545	3,589
Sumitomo	82	347	911	19	43	400	860	125	747	1,771	2,518
Nissho-Iwai	83	330	869	19	45	338	752	128	668	1,621	2,289
Kanematsu-Gosho	43	129	435	13	28	199	541	71	328	976	1,304
Toyo Menka	56	228	642	10	29	194	437	85	422	1,079	1,501
Nichimen	52	131	389	17	30	183	417	82	314	806	1,120
Total	643	2,906	9,075	169	401	3,406	8,533	1,044	6,312	17,608	23,920

(Portfolio Report to MOF in FY 1982)

Sogo-shosha's global networks

The sogo-shosha maintain many operating bases abroad to carry out their global trading activities. Operating bases consist of overseas branches, representative offices and locally established corporations (hereafter referred to as "local corporations"). Overseas branches and representative offices belong directly to head offices in Japan and personnel assigned there receive instructions from the head offices. Local corporations, however, are independent, and use separate accounting units. Most are wholly owned subsidiaries with the majority of their executives dispatched by head offices. Consequently, local corporations operate predominantly in areas closely related to head-office operations.

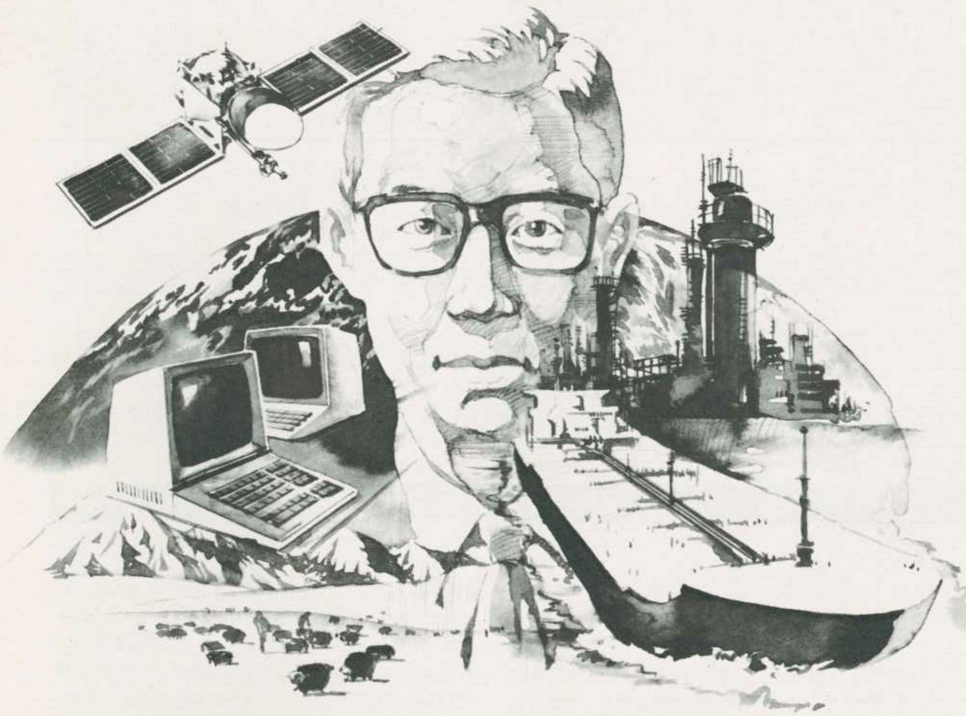
The sogo-shosha use their worldwide networks to collect information on the wide variety of commodities they handle while maintaining close liaison with local corporations. The information gathered is analyzed systematically at head offices, and the results fed back to overseas operating bases. At the same time, necessary instructions are given to these overseas organizations. The nine major trading firms currently maintain bases at 1,044 locations around the world (Table 2). A total of about 24,000 employees are assigned overseas. The globe-circling information networks of the sogo-shosha have been developed over a period of some 100 years, dating their birth back to the early Meiji period. These networks enable them to find outlets for a vast array of commodities around the world. In addition, they can help firms in developing countries upgrade commodities unfit for export.

The overseas activities of local corporations may be classified into three fields—exports from and imports into Japan, exports from and imports into third countries, and local transactions or domestic distribution transactions. Activities in the third field are extremely limited in volume since it is difficult for enterprises affiliated with Japanese companies to penetrate local distribution markets. Transactions in the second area are third-country transactions from the viewpoint of head offices in Japan. Activities in the first area have slowed down in recent years, reflecting the stagnation of the Japanese economy. As a result, local corporations are beginning to step up activities in the second category.

Local corporations require data pertaining to the export and import practices of foreign trading countries and the credit standing of their trading partners, for example, when they trade with countries other than Japan. Such data can be supplied from head offices through their global information networks. Head offices, being aware of the fact that local corporations are understaffed, work hard to collect such data. Thus, third-country transactions conducted by local corporations are facilitated by support from head offices.

Composition of third-country trade

Third-country trade divides into two fields—transactions conducted within head-office organizations, and transactions conducted by local corporations. Transactions by head offices are identifiable by portfolio reports, but those by local corporations are not. As already stated, no comprehensive statistics are currently available on third-country trade. This was the reason behind the creation of a study group on third-country trade within the Japan Foreign Trade Council. The group, chaired by this writer, has nine members representing the nine trading companies. The results of the studies conducted by the group on the current condition of third-country trade and its prob-



lems were published in a 132-page report ("A Discussion on Third-Country Trade in Japan") in May 1983.

This report includes a section entitled "Third-Country Trade Volumes of Nine Sogo-Shosha, by Commodity (Fiscal 1981)." The total volume reached ¥14 trillion ($58.3 billion) (Table 3). What is most notable is that fuels and foods both account for a very high proportion of transactions. The former represented 32.0% of the total value and the latter 30.5%, demonstrating not only that Japan is a major importer of fuels and foods, but also that the sogo-shosha frequently and extensively participate in third-country transactions involving these items.

According to United Nations statistics, machinery accounts for the largest proportion of world trade, followed by fuels and foods. This suggests that machinery will gradually take a greater share of the third-country transactions conducted by Japanese companies. Table 3 shows that machinery represents only 11.0% of the total trade volume. A major question for the sogo-shosha, therefore, is how to expand third-country trade in this field.

Difficulties in third-country trade

Third-country trade by the sogo-shosha has continued to grow steadily, and the pace of growth is expected to accelerate in the years ahead. It cannot be overlooked, however, that this form of trade is by nature fraught with high risks. It takes the form of simultaneous transactions between two third countries, and problems arise when the export conditions of one country and import conditions of the other differ. One such example is when one country abruptly imposes import quotas. In fact, the situation often changes suddenly in the course of implementing a trade contract.

Sometimes in third-country trade a certain company must be selected as the trading partner despite the fact that its credit standing is not fully known. For example, Company A, the supplier in Country A, may prove to have a shortfall of supply capacity because its statements were not fully investigated. Conversely, if Company B, the buyer in Country B, has only been in business a short while, complaints may develop which could prove difficult to resolve. Such cases have actually happened. Where longstanding trade relations exist, such problems, if they ever develop, can be handled through mutual efforts in such a way that damage is minimized. It will even be possible for both sides to share some losses. But in cases where such relations do not exist, it is difficult to take stopgap measures. Once a problem develops, both sides will blame the other; even a small problem could turn into a major legal issue. A problem related to third-country trade, involving either exports or imports, requires a great deal of time, effort and money to resolve, because it occurs abroad.

Benefits

Thus, third-country trade is a high-risk business. Yet developing countries, too, have much to gain from the promotion of such trade by Japanese companies. By exporting commodities that have heretofore been denied access to export markets, such countries can promote foreign sales. In addition, exports will increase national income and create jobs at home. An increase in foreign exchange receipts will ease the balance of payments difficulties facing developing-country governments.

Third-country trade compels Japanese companies to make certain sacrifices. This is because they sell third-country products to third-country markets where they might have been able to sell Japanese products were it not for the need for such transactions. What is needed is bold rethinking. This applies especially to local corporations, which should change their attitude by putting primary emphasis on contributing to the economic development of host countries. They should view transactions with Japan as only part of their wider transactions with many other countries. In other words, only through the expansion of transactions with third countries can local corporations integrate themselves with local economies. ●

Table 3
Volume Item-Wise of Cross Trade of the Nine Major Trading Companies
April 1981-March 1982 (in ¥ billion)

	Head office	Local corporation (A)	Total (B)	Ratio of A to B (%)
Metals	1,034.6	287.0	1,321.6	9.4
Machinery	1,153.3	385.9	1,539.2	11.0
Textiles	594.7	327.5	922.2	6.6
Foodstuffs	3,559.1	715.5	4,274.6	30.5
Chemicals	622.8	301.2	924.0	6.6
Fuel	3,367.9	1,118.2	4,486.1	32.0
Others	408.9	132.3	541.2	3.9
Total	10,741.3	3,267.6	14,008.9	100.0