

BOOKSHELF

Keiretsu

by Kenichi Miyashita and David Russell; McGraw-Hill, 1996, 225 pages, \$19.95.

When the internal operations of a company (or set of companies) start causing political tension between countries, it is probably time to sit up and take notice.

That is what happened when the U.S. inaugurated the Structural Impediments Initiative talks in 1990 and there was speculation about a possible trade war between the U.S. and Japan. The main issues in the talks were: did Japan have government-sanctioned syndicates of banks, manufacturers, suppliers, and distributors? Were such syndicates (*keiretsu*) protectionist cartels disadvantageous to both the Japanese consumer and Western companies eager to compete in Japan? Or, were keiretsu merely efficient organizational systems streamlining the Japanese economic machine?

Further, should the U.S. allow keiretsu to operate unchallenged? Should they be allowed to expand their influence in the U.S.? Or should U.S. firms perhaps try to emulate keiretsu in order to improve their elusive competitiveness?

In examining what keiretsu actually are and, more important, how they are viewed in Japan, Miyashita and Russell provide a fascinating range of information on the subject. They begin by defining keiretsu as a grouping of companies with at least a main bank, a general trading company (*sogo shosha*), a stable network of cross-shareholdings, intra-group financing, intra-group trade, and interconnecting directorates.

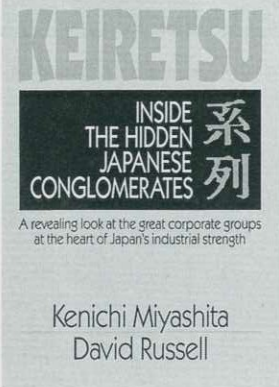
They examine briefly the history of keiretsu from their origin in mid-19th century *zaibatsu*, explain the distinction between *yoko* and *tate* (horizontal and vertical) keiretsu, discuss the horizontal Big Six as well as the seven principal vertical keiretsu, and produce valuable evidence of what life is like in the lower rungs of the ladder of keiretsu companies.

The authors conclude that both the horizontal and the vertical keiretsu came together through a confluence of government encouragement, government protection and private design in order to shield key industries from foreign

takeover while powering Japan out of its post-war economic doldrums back to economic independence. The keiretsu achieved exactly what they were designed to do, and did that probably better than anyone had anticipated. Those foreign companies which have been successful in Japan have paid keiretsu the ultimate compliment of either joining them or copying their approach to business in Japan.

What of the future? While membership of keiretsu imposes some uncomfortable demands on member companies, the benefits of belonging still outweigh the inconveniences. Companies outside keiretsu are still generally keen to become members if at all possible. Interestingly, keiretsu members are not more profitable than non-members. In fact, member firms are slower to grow and slower to increase profits than non-members. However, keiretsu members have a less volatile rate of growth as well as of profits. In other words, keiretsu membership provides a kind of large-scale insurance scheme in which member firms are insurers and insured at the same time. Members help one another in times of serious business hardship. For example, when a financial difficulty arises, the bank will usually render assistance—financial and sometimes even managerial—to the member in trouble, at a far greater cost and risk than required by normal business reciprocity. Similarly, in a buyer-seller relationship, the buyer will often accept a somewhat higher price if the seller is in the same keiretsu and is in business difficulties; in the reverse case, when the buyer is in difficulty, the seller is willing to sell at a lower price or take other measures. Also, in spite of lower overall profits, keiretsu member firms pay employees significantly higher wages than non-keiretsu firms and, despite their higher debt/equity ratio, have a far lower record of bankruptcy.

While the primary result of keiretsu membership is to stabilize corporate performance, keiretsu also often share risks and profits, especially when embarking on expensive new ventures (e.g., Mitsubishi's drive into satellite telecommunications). Keiretsu members have a much larger voice in the business community than they would if they were independent, access to greater



political leverage when necessary, are extremely unlikely to be taken over by a hostile raider, and have a small but significant security net for their sales. Most important of all, however, is the tremendous flow of information—political, commercial, technical, etc.—that comes through their membership of the group.

However, in view of the fact that the supply chain has been squeezed as dry as is possible, the vertical keiretsu are finding their social contract breaking down and their key relationships changing from those of tied-in subcontractors, to subcontractors in the Western sense, free to bid for business anywhere. Will this mean the end of the vertical keiretsu? This is unlikely, though, as the vertical production keiretsu are becoming less rigid and more dynamic, moving from one key long-range contracting relationship to several such relationships. By contrast, some of the vertical distribution keiretsu are in trouble, particularly those selling mass consumer goods. So the retail market has already become much more open and will continue becoming more and more free of keiretsu domination.

As most of the U.S. rhetoric about keiretsu refers in fact to the horizontal groups, it is worth emphasizing that these are in no way unique to Japan—financial/industrial combines are common throughout Europe and Asia. So much so that it is the U.S. which is the odd man out. In Germany, Deutsche Bank alone owns more than a quarter of the equity in the leading auto, machinery and retail companies; Dresdner Bank and Allianz Insurance provide similar examples.

Prabhu Gupta
Chairman of ADVANCE: Management
Training Ltd.
U.K.