
Mitsui headquarters building (1903)

Growth, "The scrambling for manufacturers' orders was countered by the shosha's ability to conclude barter trade, a practice encouraged by the Japanese government and even rewarded with further allocations of foreign exchange ..." To maintain their competitiveness, trading companies diversified the kinds of products they handled in order to facilitate barter trade.

In the early 1950s the government went a step further and began issuing import licenses that were linked to the export of designated products, such as ships, rolling stock and machine tools. That policy gave further incentive to trading companies' diversification and, except for some growth industries, effectively shut out "one-line" manufacturers from handling their own imports and exports.

In the immediate postwar period the shosha also played an important role in the domestic market by providing trade credit to companies that, because of a chronic shortage of capital, were struggling to get off the ground. In effect the shosha became a buffer between banks and manufacturers, borrowing short term from the former to make advanced payments to or allow deferred payments from the latter. The role of the sogo shosha as financial intermediaries has continued to the present day and remains of great value to banks and manufacturers alike.

Strong competition in the market, the need to diversify and the extended position of some trading companies led to mergers and an eventual thinning-out of the trading company ranks. The many companies that had once made up Mitsubishi Shoji Kaisha were allowed to merge in 1954 to become the reformed Mitsubishi Corporation. And four years later, the disbanded Mitsui re-emerged as the new Mitsui & Co. Ltd. By the mid 1960s there were 13 large trading companies remaining: Mitsubishi, Mitsui, Sumitomo, Marubeni, C. Itoh, Nissho, Iwai, Toyo Menka, Nichimen, Kanematsu, Gosho, Takashimaya-Iida and Ataka. The merger of Nissho and Iwai, Kanematsu and Gosho, Marubeni and Takashimaya-Iida, and C. Itoh's acquisition of Ataka eventually reduced the number to nine.

By 1959, the recovery of the Japanese economy was virtually complete and a new phase of expansion was underway. The early 1960s saw a shift in the industrial structure of Japan with the rapid growth of such industries as steelmaking, shipbuilding, petrochemicals and automobiles. Accompanying that growth was a surge in demand for many basic raw materials, such as iron ore, coal, copper and nickel. Maintaining the health of these industries required obtaining long-term stable supplies of raw materials from abroad. Thus the sogo shosha undertook a new function—that of organizer of natural resource development projects.

Rapid economic expansion throughout the 1960s and the increased affluence of the Japanese people that resulted, also led to the growth of a mass consumer market. Again, the sogo shosha expanded their functions to include development and distribution of consumer goods, housing construction, marketing consulting and engineering.

Since the end of the 1960s the role of the sogo shosha in trade, finance, project organization, transportation, distribution, etc. has remained largely un-

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Mitsubishi's Brunei LNG project—an example of sogo shosha's ability to organize

Brunei Coldgas Limited, the other company formed by the partners for this project, purchases the liquefied gas from Brunei LNG Limited and transports it to Japan in seven custom-made carriers specially designed and built for this project and chartered from Shell Tankers (UK) Limited. Each of these French-built carriers has a capacity of 75,000 cubic meters and is equipped with highly sophisticated LNG tanks specially developed to ensure the LNG is maintained at a constant −160°C during its six-day journey to Japan.

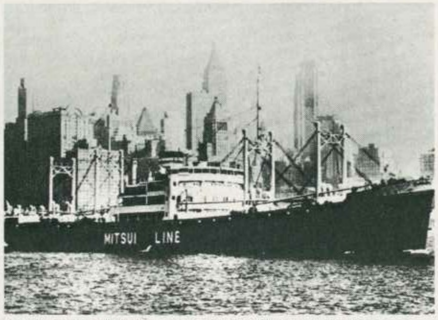
Financing was another critical factor in this large-scale project. However, Mitsubishi's long-standing and close relationships with numerous international financial institutions, as well as its excellent credit rating in international capital markets, ensured that the substantial amounts of funds required could be raised without a hitch.

changed, though as a long-term trend, their operations in the domestic market as a percentage of their total trade have been on the decline and are likely to continue a downward trend. Noting this phenomenon, some observers have predicted that the liberalization of Japanese trade, the growing strength of Japanese manufacturers and the shift to high technology exports, which require technical expertise and extensive sales and after-service networks, will combine to eventually bring the shosha down. *Nikkei Business*, one of Japan's most widely read business magazines, claimed in a recent article that the "winter" (or twilight) of the sogo shosha was upon us. What the article failed to mention was the fact that the same predictions have been made over and over again since the early 1960s and have not come true. Nor are they likely to come true in the near future. To understand why, consider some of the principles of the sogo shosha's business and their flexible response to change.

Survival of the Cheapest

Just as scale has certain advantages in manufacturing, so it does in trade. One of the reasons the sogo shosha have been able to survive at all is because they are able to provide a vast array of trade services to manufacturers at less cost than would have been possible otherwise. As exporters, the sogo shosha, through their overseas office networks, provide small- and medium-sized manufacturers with established channels to conduct international marketing operations. Exporting through the sogo shosha also allows large manufacturers wide coverage of small markets that do not warrant the establishment of their own sales and service network. While Japan's auto manufacturers handle their own exports to the United States and Europe, for example, the sogo shosha work to develop smaller markets where these companies are not yet well represented.

The large-scale operations of the sogo shosha are also advantageous to companies purchasing raw materials, since sogo shosha buy large quantities of raw materials on behalf of many manufacturers and are therefore able to obtain considerable discounts, which they pass along to their customers. Companies exporting manufactured goods to Japan also benefit from lower landed costs, as the sogo shosha are able to gather an array of shipments into large single lots in order to reduce transport costs. Companies conducting trade through the sogo shosha further benefit from the extensive experience and know-how the sogo shosha have accumulated throughout their long history and the good reputation they enjoy in Japan and elsewhere.



Asakayama-Maru coming into New York Port (around 1915)

The sogo shosha normally enter into trading transactions as principal—obtaining title of the goods to be traded from the supplier and selling the goods to the buyer at a margin. They may also act as agents, arranging for a transaction on a commission basis. Because they must provide trade services to customers at competitive prices, the sogo shosha receive margins or commissions that are only a small percentage of the value of their trading transactions—somewhere in the range of 1.5 to 5.0%. After subtracting selling, general and administrative expenses from gross profit, the sogo shosha end up with a tiny fraction of their gross annual trading transactions. Net profit for the nine largest sogo shosha in fiscal 1981 was US$500 million, or 0.1% of total transactions, unthinkably small for most Western businesses.

The scale of the sogo shosha and the low cost of the services they provide, however, are only part of the story of why these companies continue to play a pivotal role in Japan's foreign and domestic trade.

Trade Finance and Risk Avoidance

Trade includes not only the flow of goods but also the flow of capital to pay for them. Western firms generally handle their own exports and imports and rely on commercial banks for trade financing. In contrast, many Japanese firms rely on the sogo shosha to handle both the movement of goods *and* capital in domestic and international markets.

As mentioned earlier, in the immediate postwar era, the role of shosha as financial intermediaries was greatly expanded because of the acute shortage of capital at the time. They acted as a buffer between banks and manufacturers, assuming the

Mitsui & Co. Ltd.

OFFSHORE TRADE

Mitsui & Co. Ltd. is an active proponent of offshore trade. One area in which it has been particularly successful recently is chemical products, especially fertilizers and plastics.

Fertilizers traded on international markets can be broadly divided into two types, solid fertilizers and liquid fertilizers. In the area of solid fertilizers, Mitsui is purchasing solid fertilizers such as urea and ammonium phosphate from America's fertilizer industries, as well as from state-run enterprises in the Soviet Union and East Germany, and then selling these products to government-related organizations in India, the People's Republic of China, Indonesia, Burma and Sri Lanka, as well as private companies in Malaysia, Colombia and the Philippines.

Mitsui's subsidiary in Singapore, Southern Terminal Pte. Co. Ltd. plays a vital role in these transactions. Here an 80,000 ton terminal has been constructed by Mitsui as an intermediate offloading point and temporary storage base for solid fertilizers bought and shipped in huge quantities aboard large-size carriers for subsequent bagging and retransport in smaller quantities via smaller vessels. This maneuver enables Mitsui to buy in bulk at a considerable saving in shipping costs etc., and make deliveries to user countries in amounts their receiving terminals are capable of handling.

Mitsui's offshore trade in plastic products involves purchase of synthetic resins such as polystyrene, widely used in the production of parts for electrical home appliances, from major manufacturers in the United States for sale to the PRC. Since the PRC has shifted emphasis in its economic plans from heavy to light industries, where plastic products like polystyrene are so important, Mitsui's offshore trade in this field is expected to increase in future.

One final example of Mitsui's endeavors in the area of offshore trade is its recent supply of an order valued at approximately ¥10 billion from Australia's top electric power agency, the New South Wales Electricity Commission, for eight 25,000 kw gas turbine generators. The Australian commission ordered these generators as part of emergency measures to deal with rapidly increasing demand for electric power in the Sydney, Eraling (near New Castle) and Port Kembla regions of New South Wales. Purchase was conditional, however, on the fact that these generators be installed and producing the required amounts of electricity within six months.

Upon receiving this order, Mitsui immediately put its international network into action to locate and purchase the type and size of generators needed by the Australian commission. Four of the eight turbine generators came from America's risk of a loan if a company failed. The sogo shosha were fitted to that function because they were intimately involved in the trade of products in many different industries and thus had considerably greater insight than banks as to the credit worthiness of individual manufacturers.

The sogo shosha's involvement in both the flow of goods and money is greatly advantageous to both buyers and sellers alike. To understand why, consider the case of a trading company importing a shipment of Brazilian iron ore to a Japanese steel manufacturer. After the iron ore shipment has been loaded on a carrier headed for Japan, the Brazilian exporter (probably a wholly-owned subsidiary of the Japanese trading company) sends the bill of lading and other relevant shipping documents to the sogo shosha in Japan. Upon receipt of these papers, the sogo shosha issues an import draft, payable in 90 days, to the Brazilian exporter.

After the arrival of the iron ore carrier in Japan several weeks later and clearance of the shipment through customs, the sogo shosha will present the steelmaker with documents of delivery and a bill, which the steelmaker pays with a promissory note, normally due in 90 days, but often extended to 120 days or more. Import credit in the form of deferred payment reduces the steel company's financial burden, freeing capital to either produce and sell its steel products or to invest in plant and equipment. The sogo shosha may also handle the export or domestic sale of the steelmaker's products. After receiving an order, say for H-beams, the shosha pays the steelmaker with a 90-day promissory note and collects from the end user with a 120 day promissory note. For the steel company, the difference of 30 days credit to the end user helps promote the sale of steel products and for the end user, 120 days of credit frees funds for other uses.

Trade credit provided by the sogo shosha in the domestic market is particularly important to industries characterized by a large number of small processors. The textile industry, which involves literally thousands of small manufacturers like spinning companies, weavers, knitters, dyers, fabric finishers and so on, is a case in point. Because textile goods change seasonally, manufacturers of say, summer wear, must begin production six months in advance. Small processors down the line, in turn, must begin production at least a year in advance. Such a long lead time would be an unbearable financial burden for many of these small manufacturers were not the sogo shosha involved at every phase of production, purchasing the goods of one processor and selling them to another. With each transaction the sogo shosha extend trade credit and thereby ease the capital flow for manufacturers.

"It is no exaggeration," as one observer put it, "to say that the sogo shosha are wallowing in debt. And yet banks provide them not only with long term funds and capital but also with short-term capital almost without collateral." Indeed, the sogo shosha are some of the largest customers of banking institutions. In fiscal 1981, total outstanding debt of the nine largest traders was a whopping US$33,700 million, as opposed to the US$4,300 million they held in equity.

The sogo shosha are able to borrow funds almost without limit because of their superb credit history and their well-honed ability to manage risk. Unlike some Western trading companies that speculate in the market to increase their margins, the shosha work as risk averters. Except in cases where it is necessary to make purchases on their own account in order to maintain an appropriate level of trading stock, the sogo shosha avoid the risk of commodity price fluctuations by matching sales and purchase contracts. Strict limits are set for the maximum value of any uncovered sales or purchases. The sogo shosha also strictly regulate their foreign exchange holdings in order to minimize the risk of currency fluctuations. Risk is also held to a minimum through the extensive use of various kinds of export insurance programs available from the Japanese government.

The incentive for the sogo shosha's avoidance of risk is their slim margin of profit; since any transaction involves a small portion of un-insurable risk, given the scale of their transactions, a sogo shosha's entire year's earnings could literally be wiped out by a single major blunder or accident. Well-defined trading limits for managers at each level of the organizational hierarchy and credit evaluations of companies with whom they do regular business, are among some of the measures the sogo shosha take to ensure that such blunders don't occur. The promissory note system also acts as a kind of early warning system when borrowing companies are in trouble, since tell-tale signs of approaching insolvency are requests for longer and longer credit terms.

The financing provided by the sogo shosha, however, is not just limited to trade credits. These giant traders may also purchase equity, make direct loans, guarantee a client's obligations or help secure financing from other institutions.

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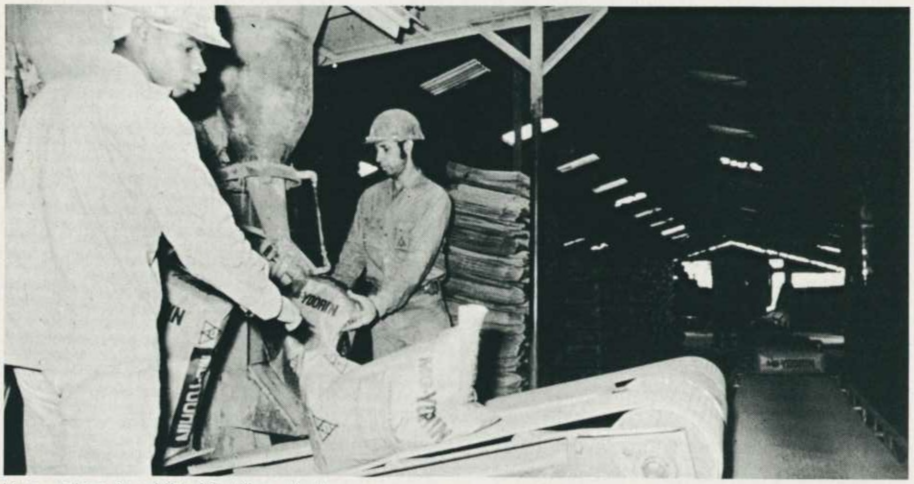

Line workers in a Mitsui fertilizer plant

A storage tank for liquid fertilizer

General Electric (GE) Corporation and the remaining four from AEG Kanis GmbH of West Germany. In addition, Mitsui made all the installation arrangements, ensuring that the work was assigned to a firm with the expertise to do the job quickly and efficiently.

Table 1. Investments by the Nine Largest Sogo Shosha (End of March 1981)

Unit: ¥1 billion (% increase over previous FY)

Domestic Investments		
Subsidiaries	282.1	6.8
Other	732.3	3.6
Sub-total	1,014.4	4.5
Overseas Investments		
Trading Subsidiaries	355.2	6.9
Subsidiaries	271.3	11.5
Other	122.2	11.6
Sub-total	748.7	9.3
Total Investments	1,763.1	6.5

In nearly every case the financial role of the sogo shosha is directly related to expanding trade.

Domestic and International Investment

As of March 31, 1981, the six largest sogo shosha ranked among Japan's 10 top overseas investors. Outstanding overseas investments amounted to more than ¥748,700 million (US$3,554 million), and accounted for roughly half of Japan's total investments abroad (see Table 1). In the domestic market, the sogo shosha were even more active, with total outstanding investments reaching about ¥1,014,400 million (US$4,815 million).

The objective of the sogo shosha's investments is the expansion of their trade volume and the strengthening of their commercial ties with manufacturers. They thus have interest in everything from iron ore mines, chemical plants and synthetic fuel development companies, to storage and distribution centers, bakeries and retail noodle shops. Most often the investments made by the shosha are tied to their handling the export of finished goods, in the case of manufacturing, or the import of raw materials, in the case of natural resource development projects. Investments in services are also made to improve trading efficiency. Marubeni, for example, established the Marubeni Food Distribution Center to provide new channels of distribution for fresh fruits and vegetables. Because the center streamlines distribution and speeds the transportation of perishable foodstuffs, supermarkets in Japan have been able to sell goods like California melons at less than half the conventional market price.

The investment activities of the sogo shosha, in fact, are often translated into cheaper prices for Japanese consumers. Keitaro Hasegawa brought the point home in an article entitled *Sogo Shosha wa Hinan Sareru Beki Ka* (Should the Sogo Shosha Be Criticized?), appearing in the September 1979 issue of *Voice*, with an example of how the sogo shosha's investment in poultry farming and the rapid increase in the number of hens per breeder that resulted, helped make the price of an egg in Tokyo cheaper than it is in most major cities around the world.

Direct investment in the domestic market by the sogo shosha has been a major boon to overseas manufacturers looking to export their goods to Japan as well. Backed with exclusive agency contracts, Nissho Iwai, for example, has set up wholly-owned subsidiaries, like Nissho Iwai Business Automation, Nissho Medi Science and Nissho Electronics, to handle the sales and after-servicing of sophisticated electronic machinery imported from the United States and Europe. Another example is Mitsubishi Corporation's joint venture, MSK-Tokyu Kikai, which handles the sales and servicing of Massey-Ferguson tractors produced in Great Britain. To date, MSK-Tokyu has marketed more than 26,000 tractors in Japan and sales are continuing to expand steadily.

In fact, though Japan has a growing trade surplus with the United States, Europe and other countries, this is not reflected in the sales figures of the sogo sho-

Nissho Iwai Corporation

INVESTING IN THE FUTURE OF PAPUA NEW GUINEA

Nissho Iwai Corporation is one of Japan's largest overseas investors. The company's major overseas joint ventures extend to more than 95 companies in 30 countries, where they are helping to create either new sources of supply or new demand for goods. A case in point is Nissho Iwai's forest resource development investment in Papua New Guinea.

Japan is the world's largest importer of lumber and Nissho Iwai is one of its leading suppliers. The company's Papua New Guinea connection dates back as far as 1963 when it first began exporting that country's logs to Japan. In order to secure stable, long-term supplies of lumber, in 1970 Nissho Iwai and the Development Bank of Papua New Guinea acquired the Stettin Bay Lumber Company Pty. Ltd. (SBLC) from an Australian firm on a joint venture basis. Owned 75% by Nissho Iwai and 25% by the Development Bank, SBLC is located practically in the center of Papua New Guinea's island of New Britain. The company currently owns 1,000 square kilometers of New Britain forest land, from which it produces 130,000 cubic meters of logs and 19,000 cubic meters of sawn timber annually, making it the largest logger in Papua New Guinea and one of the largest in Southeast Asia. At the same time, new markets have been developed so that over 20% of SBLC's exports are sold in non-Japanese markets.

In addition to owning a 25% share in a successful and growing business, Papua New Guinea has benefited in numerous ways as a result of this joint venture. For example, in addition to the benefits derived from increased employment, Papua New Guinea's economy has also received a considerable boost from SBLC sha, which import more than they export (see Table 2). Moreover, imports of manufactured goods, while still a relatively small percentage of total imports, are growing at a steady pace as Japanese industry shifts from the export of low value-added manufactured goods to higher value-added goods.

Imports of low-grade steel products from Korea and Taiwan and exports from Japan of higher grade steel products like OCTG are a good example of that general trend. The sogo shosha have helped accelerate imports of manufactured goods through their direct investments abroad, particularly in Southeast Asia.

Overseas investments in manufacturing by the sogo shosha are made at the later stage of the international trade cycle, when changes in market conditions affect the competitiveness of the sogo shosha's exports. For example, a strong yen translates into higher prices for export from Japan. To offset declines in market share, the sogo shosha may induce manufacturers to produce their products in the export market by offering to invest in joint ventures. Other major reasons for direct investments abroad include the potential to take advantage of cost differences in production inputs, transportation considerations, legal requirements (ie. the banning of certain import items or the prohibition of certain raw material exports that have not had value added to them), or the creation of a new export market.

A case in point was Malaysia Steel Pipe Co. Ltd., a Nissho Iwai joint venture established in Singapore in the early 1960s to cash in on that country's aggressive plans for industrialization. Malaysia Steel Pipe has made a significant contribution to Singapore's economy and pays a handsome 12% annual dividend to Nissho Iwai. More importantly, the company has purchased over 100,000 tons of Japanese steel hoop through Nissho Iwai since its founding and relies on the Japanese trader to handle its exports to countries in Southeast Asia.

Table 2. Trading Transactions by the Nine Largest Sogo Shosha (End of March, 1982)

Unit: ¥1 billion	FY 1981	Percent of Total	FY 1980	Percent of Total
By type of commodity				
Fuels	8,901.55	11.1	7,815.89	10.8
Metals	19,657.07	24.5	18,454.55	25.4
Machinery	17,196.14	21.5	14,424.89	19.9
Chemicals	13,584.80	16.9	12,381.70	17.1
Foodstuffs	9,905.25	12.4	9,083.00	12.5
Textiles	5,917.37	7.4	5,464,50	7.5
Other	4,950.00	6.2	4,957,20	6.8
Total	80,112,18	100.0	72,582.73	100.0
By type of trade				
Export	17,025.73	21.2	14,640.19	20.2
Import	19,209.44	24.0	17,623,75	24.3
Offshore	10,741.38	13.4	8,706.63	12.0
Domestic	33,135.62	41.5	31,612.16	43.5
Total	80,112.18	100.0	72,582.73	100.0

By far, the sogo shosha's largest investments abroad are in their wholly-owned trading subsidiaries. In the United States, for example, the paid-up capital of the sogo shosha's trading subsidiaries amounts to roughly US$1,615 million. These companies are not only importers of goods from Japan and elsewhere, but exporters of goods produced in their host countries. Incredible as it may sound, trading subsidiaries of the sogo shosha in the United States handle roughly 12% of America's total annual exports. Similar figures could be cited for other countries. That should put to rest the notion that sogo shosha are only serving the interests of Japan.

Resource Development

As a country lacking most of the major raw materials needed to fuel its industrial economy, Japan must depend on overseas sources for stable supplies. The role of the sogo shosha, from their inception, has been to import raw materials from abroad and export intermediate or finished goods. In the years immediately

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activities aimed at improving the country's infrastructure. SBLC has already built a 400-kilometer public road, a primary school, 100 homes for its employees, a 26-kilometer national road including three 60-meter span bridges, and an 18-kilometer provincial road into the Bilomi Forest, where 280 thousand cubic meters of timber resources await development. Moreover, to ensure that Papua New Guinea never depletes its valuable forest resources, Nissho Iwai and SBLC are energetically engaged in the reforestation of large segments of fertile land. Nissho Iwai and Sanyo Kokusaku Pulp Co. Ltd. jointly undertook a US$9 million pulp reforestation project with the government of Papua New Guinea during 1981 on roughly 12,000 hectares of forest site owned by SBLC. An eight-block site in the Hoskins area of New Britain that had previously been deforested was planted with pulpwood including a type of eucalyptus tree and—for the first time in New

Bilomi bridge in Papua New Guinea built by Stettin Bay Lumber Co. Pty Ltd., Nissho Iwai Corp.'s joint venture firm

Guinea—the giant ipilipil, a tree native to Hawaii that grows to a diameter of 30cm within five to eight years after planting. The reforestation project also involved the building of a 300,000 cubic meter mill to process chips for export. All told, this is truly a monumental investment in Papua New Guinea's future.