The Concept and the Fact

By Robert J. Ballon

Interfirm relationships involving either competitors or buyers-suppliers are the essence of business. Such relationships are conducted through discussion, i.e. the exchange of words among people, often using terms without confirming their meaning. The contention in this article is that the *keiretsu* concept is too general to help understand what many Westerners believe to be a key problem in trade-friction issues. More to the point, what is at stake is competition, although this term also requires explanation.

> "Alleged keiretsu-imposed barriers to [market] access are not the problem today. It is instead established firms' advantages as effective market rivals. Few potential foreign entrants are likely to make the investment required to establish their presence in markets in which they face known risks of competitive rivalry that preclude profitable return on their investment. As Japanese have long recognized, the problem in Japan is too much, not too little, competition." (Haley 1990)

It is intriguing that the Japanese term keiretsu has become current English, as if nothing equivalent was known in the English-speaking world and that one has to cross the Pacific to encounter such a sinister entity. More is implied than terms such as "business group" convey. Keiretsu is "loaded" for most users of the term; for the trade negotiator who may feel entitled to deliver an ultimatum; for the reporter whose editor-in-chief expects loud headings; for the expatriate anxious for a sympathetic hearing at the home office; for the academic (like myself) who earns a living by explaining obscure, preferable controversial, problems. For all of us, keiretsu is a target preset to allow easy bull's-eye hits; the untranslated word harbors a threat. For greater impact on the non-Japanese reader, brush over the discontinuity between prewar *zaibatsu* and postwar keiretsu, or as was done recently in even as sophisticated a journal as the *Harvard Business Review* (July-August 1992), make keiretsu the obvious manifestation of a cartel economy ... and from that point on everything is clear.

In contrast, and in native English, pundits are loudly vocal about a new industrial system where physical force is supplanted by mental energy, individual effort subsumed in collective synergy, mass production ("Fordism") replaced by lean production ("Toyotism"), and mass markets by niche markets. Little of all this novelty, however, is new to the Japanese who have long made up for a lack of domestic natural resources by human resource development, and strive for affluence through international competitiveness.

In Japanese, the term keiretsu is not more loaded than the term business group of similar expressions; it does not clamor for sophisticated justification nor lame excuse. But for the business executive the question remains: Is keiretsu a term that adds some clearer understanding of what is the matter with Japan? The answer is: little if anything.

The consensus generally holds that there are three forms of keiretsu: horizontal (or financial), vertical (or industrial) and distribution.

Horizontal keiretsu

The Japan Fair Trade Commission (JFTC), for a number of years, has kept a wary eye on six "financial groups" (*kinyu keiretsu*). Each is assumed to center on a city bank, three former zaibatsu banks (Mitsubishi, Mitsui and Sumitomo) and three other banks (Fuyo—after Fuji Bank —Sanwa and Dai-Ichi Kangyo). Beyond these labels matters get muddled. Except for some historical considerations dating to the early postwar period that have little impact today, each bank has its own view of its role as anointed core of the group. No one, for example, assumes that the core banks assume similar policies, except in the promotion of fierce competition; nor is it known what happened to this core role when the Mitsui Bank recently merged with the Taiyo-Kobe Bank and changed its name to Sakura Bank. (Is there now a Sakura keiretsu in the making?) The Dai-Ichi Kangyo Bank also goes back to an older merger that simply generated a "larger" keiretsu ...

What decides membership in the group? Of course, only a small number of large companies are involved, varying between 25 and 50. (Note that none of the largest Japanese companies can claim the number of employees of some major Western companies: GM has several hundred thousand and Toyota 60,000; IBM has over 300,000 and Hitachi 75,000.) Since some members are also members of other financial keiretsu, it is not clear how changes in membership are decided or approved. In addition to the assumed role of the core bank, membership is signified by attendance at the monthly presidents' meeting (*shacho-kai*) and other regular meetings among various levels of management. Though these meetings are kept confidential, it is well known that their purpose is not control by the core bank, nor even some "group" control; they provide simply a ready forum for the broad coordination of policies helpful to interested firms. Clearly, the members are aware that changing economic circumstances affect all, and discussing such changes is enlightening.

On this basis, keiretsu watchers generate impressive numbers. For example, in 1990, the six groups counted 163 member companies, representing 17% of paid-up capital, 13% of total assets, and 16% of total sales of all domestic firms (JFTC 1992). In previous surveys, subsidiaries and affiliates were included, bringing the total of companies involved to close to 12,000, not quite doubling the percentages above.

The role of the core bank is, of course, to be the "main bank" for the two or three dozen member companies.

It plays that role for non-members as well. A common practice is to dispatch directors to clients in need. But another major bank (not included in the six financial keiretsu), the Industrial Bank of Japan, sends directors also to financial-group members. Interlocking directorate among members and non-members is common, accounting for the relatively small number of true "outside" directors in Japanese companies at large.

Membership Substance

Cross-shareholding had its origin in the breakup of the zaibatsu in the late 1940s, firms tried to protect themselves from takeover by cornering the shares previously held by zaibatsu holding companies. This is a general characteristic, like that of stable shareholding (*antei kabunushi*) practiced among companies from the time Japan liberalized its capital imports. It also reflects the predominance of institutional investors in the financial markets.

Intragroup transactions are sometimes assumed to be restricted by the group general trading firm (*sogo shosha*). However, the vast scope of these trading firms is certainly not confined to their 20 or 40 large member companies, even including their affiliates. Moreover, they will act as broadly and effectively for non-members and members of other groups. Their role is to provide intermediation services, one reason for the high share of intrafirm shipments in Japanese imports. It is also pointed out repeatedly that many major manufacturers have given up the intermediation of trading firms, if they ever used it, including the one in their keiretsu.

A "typical" example of intragroup transactions is found in the use of same-brand office computers among member companies. (See Table on page 16.) Here, Hitachi is considered to be a member of the three non-zaibatsu groups, and foreign competitors will not learn anything from Hitachi's keiretsu membership; they had better appreciate that the company has close to 1,000 related companies, mostly consolidated.

Information gathering and exchange is necessary for survival in all Japanese corporate activities. It is hard to imagine what keiretsu per se could offer beyond what each company seeks and contributes in innumerable trade and industry associations, business federations, government relations, etc. This hunger for information is not a fancy policy; it is vital. Remember that the Japanese economy suffers from a lack of domestic natural resources; it survives only on whatever the Japanese themselves can add, such as information. Thus, the general trading company (sogo shosha) and its worldwide information system; the life and nonlife insurance companies, in restricted numbers, that need informed access to clients; the main-bank system as privileged depository system for inside information; even the major general contractor who acts less as a builder, but more as an overall organizer of the building project. Admittedly, some are better informed than others. Such would certainly be the case among member companies, if the information had not yet been thoroughly thrashed out through active participation in associations, if not on the golf course.

In conclusion, financial keiretsu is a concept that contributes little to understanding the nature of interfirm relations even among member companies. To insist on its workings harks back to the past, the early postwar decades up to the 1970s, when the keiretsu "one-set" approach to industrial organization (from mining to consumer financing) was a key characteristic.

Vertical keiretsu

The six financial groups just mentioned are also described as horizontal (at least for their large member companies). This is in contrast to the numerous "industrial groups" (*sangyo keiretsu*) described as vertical where the strengthening of mutual ties is a key

Previously, 80% of home electrical appliances were sold through keiretsu shops. With the emergence of new varieties of discount stores, keiretsu handled goods have dropped 40%.

feature of the 1980s and 1990s. What is involved here is most meaningful for its direct impact on the current operations of the economy.

A basic feature of these industrial groups and one that Westerners do not expect is that they bring small/medium enterprises (SME) to the fore. According to the Japanese definition of "large" enterprise (based on capitalization, ¥100 million plus, or number of employees, 300 or more; smaller numbers in the distribution sector), of the more than 2 million companies, 30,000 are large, and of the more than 6 million establishments, 10,000 are large, in 1991 engaging 6.6 million out of a labor force of 55 million. Excluding the great number of SMEs in the distribution sector, an overall characteristic is their complementarity with large enterprises which results from two practices that often coincide.

The parent-child company syndrome (*oyako-gaisha*) refers to any enterprise of some size spinning off smaller subsidiaries and affiliates. Countless reasons are given: unloading redundant personnel (in place of firing them); maintaining a functional rather than divisional structure by establishing different corporate entities for new product lines; supporting a different corporate entity outside the jurisdiction of the parent's enterprise labor union; if need be some window-dressing is employed like playing with different fiscal years, etc.

A pro-active buyer-supplier relationship rejects one-off transactions in favor of continuous ones through so-called relational contracts where obligations are not specified in substantive terms. In manufacturing, construction, and services, the relationship covers subcontracting SMEs in some hierarchical fashion, the parent company limiting transactions to primary subcontractors, and primary subcontractors to secondary ones. The purpose is to recognize each for what he does best. For example, the automobile manufacturer is best at assembly and marketing; his subcontractors are best at parts and components. Large manufacturers and general contractors find a major competitive advantage in procuring what they need as much as practical from outside rather than producing it internally.

Cosmetics and toiletries sold through the keiretsu system.

Industrial keiretsu is a misleading concept if it ignores the specific nature of Japan's SMEs and obscures the fierce competition that prevails within each keiretsu and among keiretsu.

Distribution keiretsu

Much of what large manufacturers expect from upstream suppliers will be sought downstream from distributors. This is especially the case in consumer electric appliances, cosmetics, and automobiles, where the manufacturer's purpose is some price control, better after-sales service, and direct feedback from customers. The practice is now badly battered by expanding discount stores.

In this context, the term keiretsu has little technical meaning, except maybe to indicate a vertical dimension different from integration. It is more important to determine, for example, what Matsushita (also the core of an industrial group) expected from and achieved through its distribution keiretsu (25,000 stores) and what is left of it today; or what the department store obtains from "persons on loan" sent by manufacturers and wholesalers to staff their counters; or that basic characteristic of Japanese-like marketing that considers the distributor as a partner in "pushing" the product onto the consumer rather than an hindrance forcing the consumer to "pull" the product through channels. If the complexity of the distribution system is held to be an entry barrier, there is certainly much more to consider than the distribution keiretsu.

There are other instances of business groups not referred to as keiretsu (at least by the Japanese), including cartels mostly found among SMEs, if not resulting from "voluntary" export restraints. Mention should be made of the powerful federation of agricultural cooperatives (*nokyo*) and its innumerable and all-encompassing business activities; or the many local cooperatives of SMEs, including some sponsored by large buyer-manufacturers, qualifying for official aid in terms of financing, research, training and development. In the same vein, it would be wise to also bring up trade and industry associations. Clearly, if the term keiretsu is to be used in preference to business group or like neutral terms, it does not stand for an institution. It is rather an organizational principle for important business transactions; it is contextual and therefore verifiable only in particular instances.

For all three standard forms of keiretsu, the term may be a helpful tool for the academic to describe postwar economic history: how some Osaka textile trading companies became general trading companies; how subcontracting passed through a painful period of exploitation of the weaker by the stronger; how relentless economies of scale (the major objective of mass production) progressively gave way to economies of scope (to obtain small-batch high-quality production); etc. But for the international business executive who faces at home and abroad similar and other practices (conglomerates, holding companies, universal banks), the contemporary use of the term keiretsu could be counterproductive for two reasons: (a) it tends to obscure the specific problems of the industry in which he is active, in particular the role of SMEs, and (b) it may leave him unprepared for the fierce competition among individual firms, large and small. To erect keiretsu as an archetypical entry barrier is playing with words.

Severe competition

"The industrial system [...] explains why there are few foreign entrants into the core of the Japanese business system, even though it is difficult to find explicit entry barriers, and furthermore why long-term interfirm relationships co-exist with severe competition. Long-term relationships are technological or engineering linkages with dense information exchange and coordination, but at the same time these relationships are accompanied by strong potential competition from other technology sources. The core of the Japanese industrial system has information barriers, but not special institutional barriers, and therefore new innovative information and technologies can penetrate it." (Imai 1990)

In the West, you either compete or cooperate; in Japan you do both simultaneously and as a result competition is intensified. This is where misunderstandings arise largely because of an apparent contradiction: competitive strategies and cooperative structures, as was expressed by the title of a recent book on the Japanese enterprise system (Fruin 1992). There is a specific flavor to competition in Japan.

The Japanese word for competition, *kyoso*, is a Western import. The term was made up by the translator of a Western economics textbook in the latter part of the last century; he felt that the standard term *shobai gataki* (business rivals) was not adequate as more was involved in the West. Semantics could be understood as follows:

—The Western flavor of competition is result-oriented: Survival of the fittest is final. This feeling still prevails today; in learned writings and official documents by the Japanese, concern is readily expressed by the compound "excessive competition" (*kato-kyoso*).

—The Japanese flavor of, say, rivalry is more process-oriented; it includes time as an explicit dimension. It is like in sports competition: The current victor may be tomorrow's loser, and he could not be today's winner if it wasn't for the loser. The process is compounded by some incrementalism.

Such rivalry, for example, prevails among suppliers (subcontractors), when in the association formed under the parent's auspices, they are briefed on the parent's business prospects and technological development, and discuss openly what they can do about it all together.

The Toyota Group 13 companies, strongest of the vertical keiretsu

The Toyota Group	
Toyota Motor Corporation	
Toyoda Automatic Loom Works, Ltd.	Manufacture and sales of spinning and weaving machines, automobiles and industrial vehicles
Aichi Steel Works, Ltd.	Manufacture and sale of speciality steel and forged steel products
Toyoda Machine Works, Ltd.	Manufacture and sale of machine tools and auto parts
Toyota Auto Body Co., Ltd.	Manufacture of auto and special vehicle bodies and parts
Toyota Tsusho Corporation	Import, export and trading of raw materials and products
Aishin Seiki Co., Ltd.	Manufacture and sale of auto parts, household appliances and industrial equipments
Nippondenso Co., Ltd.	Manufacture and sale of electric auto components, air-conditioning equipment, household and other electric appliances
Toyoda Boshoku Corporation	Manufacture and sales of cotton thread, cotton cloth, synthetic products, auto parts and household appliances
Towa Real Estate Co., Ltd.	Real estate development, management, sales and rental
Toyota Central Research & Development Laboratories, Ltd.	Basic technical research for the Toyota Group
Kanto Auto Works, Ltd.	Manufacture of auto bodies, auto parts, equipment and materials for housing construction
Toyoda Gosei Co., Ltd.	Manufacture and sales of synthetic resin, rubber and cork products

There, the parent makes public his ranking of suppliers. Expectedly, access to this circle is arduous, commonly estimated to take one to two years. The same supplier, however, may belong to more than one such association. Differing from much Western practice, information among Japanese tends not to be the basis of one-to-one bargaining power, but a highly competitive and collective asset. Less specific but no less real is the value of trust without which the vital flow of information is not possible between parent and subcontractors, between buyers and suppliers. The true quality of Japanese-like competition is trust.

Table
Computer Sources for Major Business Groups

Group (Computer Manufacturer)	No. of Firms in Group	Total No. of Computers	No. of Computers Made by Same-Group Firms	No. of Other Domestic Computers	No. of Foreign Computers
Mutsui (Toshiba)	24	88	1 (1.1%)	35 (39.8%)	52 (59.1%)
Mitsubishi (Mitsubishi)	28	150	18(12.0%)	42 (28.0%)	90 (60.0%)
Sumitomo (NEC)	21	116	53 (45.7%)	—	63 (54.3%)
Fuyo (Hitachi, Oki)	29	143	45 (31.5%)	50 (35.0%)	48 (33.6%)
Sanwa (Hitachi)	40	180	60 (33.3%)	50 27.8%)	70 (38.9%)
Dai-Ichi Kangyo (Hitachi, Fujitsu)	45	214	151 (70.6%)	3 (1.4%)	60 (28.0%)

Note: Refers to general-purpose and office computers, and does not include terminals and personal computers.
Source: Nihon Keiei Kenkyujo, "Komputaa Yuzaa Chosa Nempo" ("Survey of Computer Users"), 1989, quoted by Imai (Yamamura 1990), 191.

The role of trust in business

Trust is not only a social norm; it is also an asset in which people invest for self-interest (Sako 1992). In Western business, trust is mostly implicit, and when abused, brought to court; it was long considered as independent from competition, but today that may be changing, for example in the context of strategic alliance. In Japanese business, trust is the glue of division of labor; it is made obvious and readily sanctioned by society; it means accepting indebtedness to someone and recognizing mutual dependence in action—that is the social norm—and consequently self-interest is that of a collective self. Trust inspires a strong team spirit that supports Japanese rivalry and intensifies it. The often quoted hallmarks, long-term view and expansion of market share, are propositions made practical through mutual trust among "players," namely the buyer-supplier relationship or subcontracting. The imperative of "Quality, Cost, Delivery," rather than "lowest price," requires complementarity between both parties.

This mutual commitment to the relationship is in a context of plurality: not many, but several customers and several suppliers; each supplier competes against other suppliers making similar components. Intensive personal networks, flexibility in execution and constant technological upgrading are required. Not surprisingly, robots, computer-aided design and computer-aided manufacturing are in wide use; and as pervasive as ever is the practice of payment by promissory notes (*yakusoku tegata*). Self-interest, the capital asset of trust, is to be safeguarded by risk sharing and mutual development.

Of course and contrary to the spot transaction, it requires some intensive exclusivity, but less than in internalized integration. Hence, the very practical consequence is that the foreign supplier often knocks at the wrong door: the procurement office. This is where daily business transactions are carried out after the procurement decision has been taken. The door for new business is frequent contacts with the engineers at research centers and production sites (Yaginuma 1993). At the other extreme of business transactions, it confirms the fact that a strategic alliance among firms can materialize only through personal networks of individuals.

No wonder, the trite advice to foreign businessmen active in Japan is continuity and patience (a tedious process) notwithstanding the drive for results. It may not be particularly efficient, but from all available evidence, it is effective.

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