

A Japanese Company's Perspective

By Sasaki Yasuo

Keiretsu have long been a target of criticism. But do these business forms really merit condemnation? In the following article I will answer this question using the experience of the automotive industry to provide an overview. I will also try to offer a rough sketch of the form they will take in the future.

The birth of keiretsu

It was some 75 years ago that the seeds of Japan's automotive industry were sown and began to germinate. Automobile production technology was, of course, underdeveloped in Japan at that time, as was the technology to produce metals, rubber and glass and other materials specifically needed in car manufacturing. Accordingly, the origins of Japanese car production were centered around the shipbuilding sector, which possessed advanced expertise. Some years later, General Motors and Ford employed superior automotive technology to begin manufacturing cars in Japan and in almost no time had conquered the market. From the outset GM and Ford endeavored to cultivate parts makers. These parts manufacturers then developed close relations with the two firms and corporate groups were formed.

At the beginning of the 1930s Toyota Automatic Loom Works, Ltd., having planned to enter the automotive industry itself, established an automotive division and set about cultivating parts makers just as GM and Ford had done. In 1937 this division constructed a plant in Koromo (present-day Toyota City) and became an independent company, Toyota Motors. Far removed from industrial zones, the Toyota City of that time was located in a silkworm collection and distribution area and it was hardly thought possible that parts manufacturers could be cultivated. The difficulties are easy to picture when one thinks of

the circuitous route from, for example, family-run businesses that made small pocket heaters for people to warm themselves (that can only be seen in local museums these days) to maturation into world class companies able to produce high quality automotive parts.

Through a difficult cultivation process, the number of parts makers gradually increased. Toyota, devising a manufacturing system that would permit growth in the Japanese car market (much smaller than its American counterpart) with its demand for diversity, strove to become a skilled manufacturer that could produce many varieties of high-quality models. During that period Toyota spunoff its electrical components, body parts, and special steel manufacturing divisions as independent, specialized manufacturers in quick succession. This is how the current 13 companies that would form the corporate group referred to as the Toyota group were born. Ten of these are manufacturing companies and, although referred to as the "Toyota group," Toyota does not hold more than an average 28.1% of the 10 companies' shares. Parts manufacturers were gradually added to the group as customers.

With mass production as their nucleus, GM and Ford became powerful corporations by merging with advanced technological parts manufacturers and other carmakers one after another in order to handle the huge U.S. market. Let us refer to the American market as a Mass Production Market and Japan's as a Small Lot Variety Market. In a market suited to mass production the majority of manufacturing functions are brought in-house, resulting in carmakers with a high degree of individual independence. In a market suited to small lots of a variety of products, on the other hand, the majority of functions are



Pocket heater by Toyota Automatic Loom Works, Ltd. No one could have foreseen that this tiny manufacturer would turn into the huge corporation of today.

obtained externally, resulting in car manufacturers with heavy dependence upon subcontractors. In other words, the latter market is suited to the creation of keiretsu. If various subcontractors were added to the 13 Toyota group companies and each incorporated into Toyota as a specialized division, the result would be a GM or a Ford. If the divisions that carry out the same functions as the Toyota group companies were split off from GM or Ford and made independent, the result would be the Toyota group. There is no need to ask which is essentially closed or open.

As can be seen from the preceding, keiretsu itself was not the goal, but was created from the initial industrial base and market characteristics. If the U.S. car market had originally been small, keiretsu would have appeared in the U.S. 20 or 30 years earlier than in Japan and the beginning section of this discussion would not have been necessary. In fact, as seen above, the group of specialized parts makers cultivated in Japan by American car manufacturers were essentially keiretsu. Moreover, European markets are similar to Japan's when seen individually and keiretsu have long existed there.

U.S. car manufacturers reigned internationally until the end of the 1960s and it was thought that the American market would forever be suited to mass production. However, the oil crises of the '70s redrew the

Photo: Kojima Puresu Kogyo Kabushiki Kaisha

face of the U.S. car manufacturing industry because characteristic elements of a Small Lot Variety Market began to be inserted into the structure of the U.S. marketplace. This was a change of major importance, coinciding with the start of a period when it became necessary to consider the global environment, including resources. As a result, U.S. carmakers were surrounded by unexpected hardships throughout the '70s and '80s.

However, at the beginning of the 1990s the United States began to make changes that demonstrated to the world that it was not a nation of idlers. Carmakers began to incorporate Toyota's manufacturing methods, known as lean production, and are now themselves beginning to plant the seeds of keiretsu that they sowed in Japan more than 70 years ago. Internal manufacturing divisions are now splitting off from the main corporate bodies. On the other hand, the U.S., which has criticized keiretsu, has clearly fallen into a painful paradox. As with technology and products, however, this is a temporary predicament that derives from the rapid homogenization of markets on a global scale.

Keiretsu characteristics

The first and foremost characteristic of a keiretsu is its inherently competitive character. The companies which comprise these groups are firms which have competed successfully in the manufacturing process up until now. Even after joining a keiretsu, these companies conduct their business amid heavy competition. This is because car manufacturers order the same parts from several companies or because carmakers themselves have systems through which they can bring the manufacturing of those parts in house. With the current round of changes, other keiretsu companies and foreign corporations will enter the market and social competition will probably increase in intensity and severity. The reason this is possible is

because the door is inherently open to come and go freely and all keiretsu companies hold the key that is granted to those who have gained entry by beating the competition. The "closed nature" of keiretsu is given as a reason for criticism, but the actual situation completely contradicts this.

A second characteristic is the ability, through close relations between car manufacturers and parts makers, to selectively analyze even the parts to be purchased at the design stage. As a result, it is possible at this stage, or even concurrently at the product concept stage, to comprehensively cut costs. The same may be said about improvements in the quality of parts.

A third characteristic is that each keiretsu firm is able to plan future investments to a very high degree and thus guarantee high economic efficiency for the entire group. A fourth characteristic is that because parts makers are able to achieve complete coordination between their products and other parts on the parent company's production line they can spontaneously add ideas that are not in the design blueprint provided by the parent company. In Japan this is not considered a contractual change requiring cost compensations. The phrase "the actual item, on the scene" illustrates both the tangible and intangible

results of the practical application between parent company and subcontractors of close teamwork (concurrency) during design and at the factory, a concept Japanese companies believe is indispensable. The idea that theoretical design is always perfect is the product of the doctrine of intellectual omnipotence and what Japanese companies most detest. In fact, the products of companies who lack this type of teamwork pass onto customers products without complete coordination between parts.

I will refer to these Japanese-style keiretsu as Flexible Keiretsu Relationships. The keiretsu that are sprouting in the United States carefully confirm the details of the business relationship and its conditions in the contract and effect deliveries of parts that are exact replicas of those in the design plans. Let us call the American-style keiretsu with these characteristics Brittle Keiretsu Relationships.

The characteristics of the Japanese-style keiretsu discussed above might produce the following question: In a Japanese-style keiretsu, company ties have nothing to do with stock purchases nor finely-detailed contracts between companies and probably are made possible by the sense of obligation, personal sacrifice, and



Thousands of parts are required to manufacture a single car.

Photo: Toyota Motors/Toyota Kaikan

sense of camaraderie that distinctively binds Japanese together. If this is so, isn't it the case that they would never become open?

Certainly, the acts of bestowing and receiving favors are respected in Japan. For this to be practical in many cases requires individuals to make sacrifices. However, specific limits naturally exist in order for this to become possible. When those limits are exceeded the unity of the group is pulled apart. When there was absolute control of authority and a strict class system from the 17th century until the middle of the 19th century many peasant revolts certainly occurred. Until Japan's economy entered a period of high growth many companies were subject to unceasing labor disputes. Even today labor relations are fundamentally confrontational. This is no different from Europe and the U.S.

In order for the companies in a keiretsu to continue their union there are also certain limits. Japanese also have the desire to maximize personal profit. The limits that can restrain those desires are regulated in conjunction with the various conditions surrounding the individual. When a parent company and its subcontractors decide to place their fates together in a keiretsu it is only possible because all the parties involved make the business decision that it will yield the most profit for their own companies. In recent years many companies have been faced with and disagreed about

the choice between actions based upon pure economics and actions based upon mutual, longstanding relationships. Most companies then chose the path of seeking additional business outside the keiretsu.

In addition to economic problems, environmental and safety problems have become even more important issues for the automotive industry and huge investments will be needed to deal with them. Carmakers have begun to think that it is extremely logical to team with other companies on a global scale in order to cope with these conditions, particularly from the standpoint of the economics of time and capital. These kinds of changes in the corporate environment are proceeding, exceeding the internal operational limits of keiretsu company groups.

Next, as far as the indistinct ties between companies are concerned, whether appropriate or not, I would like to draw upon one example to illustrate the factors that make this possible. Traditional Japanese-style houses have open verandas. This is a type of exposed hallway installed outside the rooms. Open to the weather, there is no boundary between a room and the outside world and both are undifferentiated and linked indistinctly. A person can bring nature into the room and at the same time can harmonize with nature. Furthermore, one can come and go between the individual space of the room and the outer space of the world beyond without thought. Japanese believe that this is the realization of harmony with nature, which at times stands in opposition to man.

Even without stock acquisitions and detailed contracts the actions that tie together two

companies that at times find themselves in contradictory positions are based upon this type of thinking. Great merits are created from this. The characteristics of Japanese-style keiretsu cited above also fit this example.

Western philosophy believes that when two contradictory forces compete, higher value is created. Coincidentally, the value that is created in the end is the same as that born of harmony. A compromise between Japanese harmony and Western sublation is best. Even if that Utopia is not possible, both sides can have a close relationship if only they recognize the differences between their value-creation methodologies. One example of success can be seen in the operations of New United Motor Manufacturing, Inc. (NUMMI), the joint venture company in the U.S. between Toyota and GM that I had a hand in founding.

Next, what about group actions governed by a sense of camaraderie? Japanese Buddhist doctrine believes that people are all riding a great vehicle together, moving in the direction of truth. On the vessel individuals strive to compete among each other in order to advance. It is thought that it is most important to identify and refine the self. At the same time the individual must harmonize with the whole. That harmony involves making the most of and obtaining the maximum from the relationships between the individual and others. This relationship can be referred to as symbiosis, or "live and let live." In companies, activities based upon original ideas and proposals from individuals and quality control activities carried out by groups are undertaken actively, without contradictions.

For keiretsu as well, the entire group and individual companies harmonize easily. Companies that strive for symbiosis with harmony as the axis on the large vehicle known as a keiretsu can then ride together with other keiretsu, regardless of whether they are from overseas. The preceding is the belief of Japanese Mahayana Buddhism and Mahayana means a



Intensive, large-scale assembly of the parts produced by the various group manufacturers is undertaken at domestic and foreign plants: body welding (left); assembly (right).

Photo: Toyota Motors/Toyota Kaitan



Photo: Toyota Motors/Toyota Kaikan

Toyota Motors is linked to 310 sales outlets nationwide by a computer network.

great vehicle that is open to all people, who can board together at any time.

Changing aspects

Due to the strong yen, a serious recession, trade problems, a maturing market and other factors, changes have begun to occur to keiretsu in Japan. A perfect constant that exceeds the continuum of time and space does not exist. In that sense, keiretsu that have universal merits will also change their working methods in accordance with the conditions of the given environment around them. The new slogan is "if we only fulfill the conditions, keiretsu do not matter." By doing so, companies can make the most effective use of the management resources they have cultivated. The final result is a commonality of parts and materials. This not only ties in with reduced development costs, it enhances subcontractors' business opportunities and also offers opportunities to learn new ways of management thinking outside the keiretsu. Moreover, two-way transactions with overseas companies pick up.

This change is not simply something that was provoked by the categorical imperative of cost cutting due to the strong yen. It is foreseen that we will soon be facing more major environmental changes and, similar to the changes to American companies we saw above, companies internationally will be forced to face them with the will to survive. In addition, these changes are not a general restructuring of the parts industry, but should be seen as a shift to growth outside the

keiretsu. As I mentioned previously these changes promise subcontractors a variety of opportunities and at the same time they will be forced to endure severe trials. To expand a bit further, this will call for further review of subcontractors' technical prowess, originality, management strength, and the extent to which they can strengthen the above-mentioned teamwork with the parent company.

For companies with true ability it is no longer a question of within or outside the keiretsu or the country. The companies that endure these tests will survive as always, enjoying even further business prosperity. Japanese companies that are unable to bear up will be weeded out and in the case of foreign companies of this sort, it will be impossible to do business in Japan. In essence the keiretsu system is based upon the principle of the market mechanism that if a product is inexpensive and of good quality it can be purchased from anyone. That intrinsic element has now coincidentally manifested itself. An awareness is now taking hold that the time has arrived for the Japanese automotive industry to genuinely put that principle into practice for keiretsu.

The future

What shape will keiretsu take in the future? As seen above, actual competitive mechanisms will begin to operate actively with the deepening and broadening of relations between keiretsu and increased market entry by overseas makers. Because both parent companies and subcontractors have

determined that operating only within one's own keiretsu is no longer linked to one's own profits, keiretsu will rapidly open up to the outside. Reaching outside as with American-style keiretsu will then further extend to transactions and joint research and development between parent companies that have competitive relationships. This has of course started happening in the United States and can also be seen in Japan, as with Toyota and Nissan. If these keiretsu extend their operations on a global scale, not just internally in America, great profits will be produced not only in the U.S., but around the world, and this increase in profit will flow back to the U.S.

The American electronics industry is also striving to establish cooperative relationships that include a wide range of companies in the same industry around the world and extending to broad sectors. Let us refer to these new keiretsu that are springing up in the U.S. as Borderless-Multifaceted Keiretsu Relationships. As long as these new keiretsu that are appearing are outward-oriented they will merit praise not condemnation.

These keiretsu include mutual support relationships between competing companies. Competition will remain in other areas, but mutual dependence will create an arena in which companies live together and work toward putting harmony into practice. This is the world of symbiosis and live and let live for which Japanese companies had previously strived. In this fashion the ideology of harmony and symbiosis and live and let live that the world is headed toward is taking concrete form as an extension of keiretsu in the industrial world. As seen previously, the ideal form of keiretsu is being sublimated in the U.S., where keiretsu have always been denounced in loud voices. As a Japanese company employee I find it great fun rather than ironic that the U.S. is one step ahead of Japan.

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