Sogo Shosha: Meeting New Challenges

By Ichiishi Iwao

As *sogo-shosha*, meaning general trading company, can now be found in English-language dictionaries, some readers might be familiar with the term. In Japan, trading companies, ranging from those that employ tens of hundreds of people to those operating on a single telephone line, number over several thousand to tens of thousands. Among them, only those that trade in huge volume and wide varieties; have extensive markets, including exports, imports, domestic consumers, and triangle trades; and engage in a wide range of functions—trading, marketing, organizing, financing, consulting, resource development and investment—satisfy the criteria to be called sogo-shosha. Within sogo-shosha, the nine traders indicated in the table (see page 17) are often referred to as the nine majors. Although their origins differ—some emerged as core traders of the prewar financial conglomerates, such as Mitsui and Mitsubishi, while others started as speciality traders for certain merchandise, such as steel and textiles—for the most part all have gone through the same process.

Since the Meiji era began in 1868, Japan has vigorously absorbed Western technology and concentrated on industrialization. In line with this, these nine sogo-shosha have played a vanguard role in the economic development of the country, importing technologies and resources, initiating local industries in manufacturing and processing, and developing overseas markets for these industries. Throughout this period, they have progressed through upgrading their operations in response to environmental changes and customer needs. In this sense, the history of sogo-shosha is that of continual reformation.

In this article, I shall outline the current assignments and future roles of sogo-shosha, using the history of their development as background. (Note that people nowadays tend to use the term "shosha," instead of "sogo-shosha," to refer to what I described above. Thus, I will follow in that fashion hereafter.)

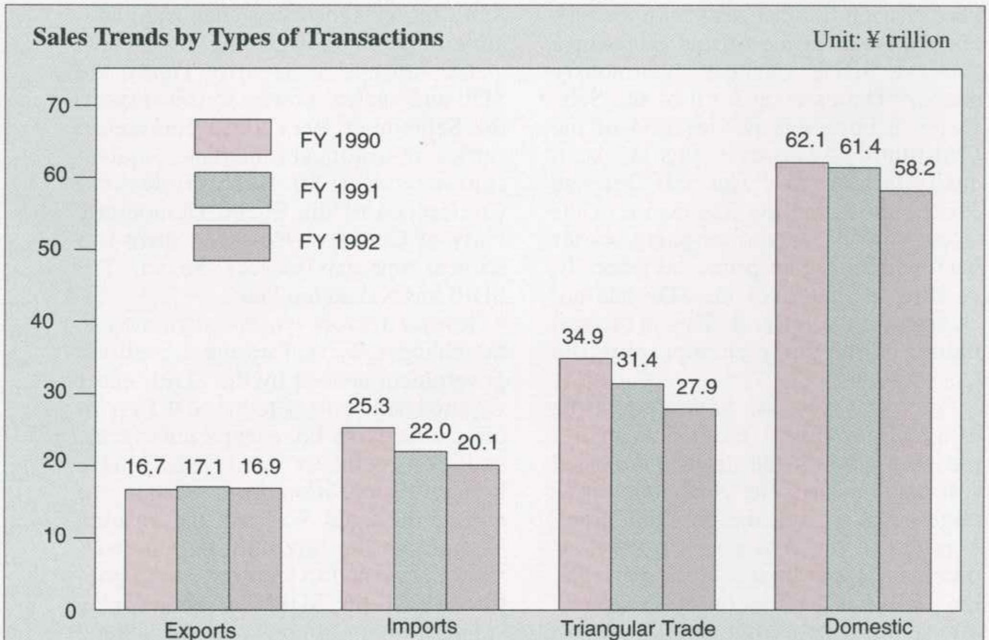
Function of shosha

Shosha do not manufacture things and have no production facilities. Their assets are, in essence, human resources and their earnings are based on value added by each employee who analyzes and utilizes information obtained through the company's organizations and networks. Simply speaking, the basic system of the shosha business is to trade products between producers and users to earn margin.

Meanwhile, shosha, in cooperation with producers, explore appropriate markets for each product; conduct surveys on competitive price, ability and production capacity; and improve products for greater user satisfaction. These are values added by shosha, the source of their profits. Of course, this is a very simplified outline of shosha activities, and actual transactions involve far more complicated processes including organizing and financing activities in addition to the basic function of trading. An article describing an actual transaction of a shosha reported by the *Nihon Keizai Shinbun* on September 22, 1994 provides a good illustration of their multiple functions:

"Nissho Iwai, together with Badger, a major U.S. engineering company, and Sunkyong Engineering & Construction Ltd., a South Korean constructor, received an order for the largest petrochemical plant in Thailand.

"The plant is designed to produce benzene, paraxylene, and toluene with an annual capacity of 640,000 tons, and will be located in a coastal industrial district about 300 kilometers away from Bangkok.



Source: Japan Foreign Trade Council, Inc. (total of 55 regular member corporations)

"The total amount of the order is approximately ¥50 billion ($500 million). Nissho Iwai is responsible for total co-ordination and financing, Badger for engineering, and Sunkyong for construction.

"Financing involves institutional financing by export credit agencies in Japan, the U.S. and South Korea, and project financing by a bank consortium composed of 14 commercial banks from the U.S., Europe, Japan and other Asian countries.

"The total cost of the project will be covered by a combination of both institutional and project financing."

Looking back, following its defeat in World War II, the nation was in need of goods and placed priority on the increase in supply. Thus, rather than accommodating to consumer tastes by offering a variety of kinds and standards, standardization to raise productivity was enforced throughout industry, from manufacturing to agriculture. Production increased every year, and a rapid expansion of the domestic market was accompanied by growing exports.

Shosha trade volume also showed a one-way growth. The companies were able to reap profits from generally thin margins, successfully covering costs. (As shown in Table 2, shosha's profit margin is noticeably lower than that of other industries.) The increase in sales volume was the key solution. Under the notion that "bigger companies are better companies," shosha began vigorous competition for higher sales. As competition escalated, companies tended to indulge in senseless battles for higher market shares at the expense of profits. The prevailing idea was that dominant market shares would prove advantageous to the company's reputation, financing from securities markets, recruiting staff, and obtaining information and business opportunities.

Now, however, the trend has changed. With a halt in volume expansion in the economy, conventional values have collapsed and shosha are standing at a turning point. In this situation, it appears that shosha currently need to solve two problems: strengthen their earning power, and further globalization.

Strengthening earning power

As clearly seen in Table 2, shosha's earnings have stagnated in recent years. Gross profits have declined after peaking in 1990-1991, while operating profits began declining even earlier—since 1990—partly due to increases in operating costs. Compared to other industries, for example, only three of the nine shosha were included in the top-100 for corporate income rankings in Japan for the fiscal year ending March 1993—55th for Marubeni, 81st for Mitsubishi, and 94th for Nissho Iwai. (This despite the fact that all nine shosha were within the top-11 in sales ranking that included all Japanese corporations except those in the financial sectors.)

For your reference, actual figures were as follows: reported corporate income for the three shosha (Marubeni, Mitsubishi and Nissho Iwai) totaled ¥129.8 billion, compared to ¥406.9 billion for Toyota, an automaker ranking number 1; ¥168.4 billion for Nintendo, a game machine maker ranking 6th; ¥90.1 billion for Ito Yokado, a retailer ranking 27th; and ¥85.8 billion for Seven-Eleven Japan, a retailer ranking at 32nd.

Reasons for the relatively weak earnings of shosha can be explained by the fact that their methods of operation are partly becoming limited. As the industry has entered maturity, customers are no longer fully satisfied with the existing functions of shosha. In addition those industries traditionally related to shosha have also matured, while the focus of the economy is shifting toward new areas.

Therefore, shosha are moving toward extending their operations into financing, organizing and project co-ordination—as seen in the aforementioned case of Nissho Iwai for the petrochemical plant project in Thailand. They are also paying attention to new industries that are gaining economic importance, for instance, the space telecommunications industry, or trading in various commodities highly consumer-oriented.

Two shosha groups have already entered into the space telecommunications business: Japan Satellite System Inc.(C. Itoh, Mitsui, Sumitomo and Nissho Iwai), capital set at ¥27.5 billion (about US$283 million); and Space Communications Corp. (Mitsubishi Corporation and other Mitsubishi Group companies), capital at ¥60 billion (about US$618 million).

Both companies are currently operating two telecommunications satellites, and both have plans to launch a third.

Also, historically shosha have positioned themselves closer to producers than to consumers. They have focused on bulky businesses such as securing raw materials and marketing products for producers and manufactures and have limited exposure to downstream consumer businesses as it was difficult to gather enough volume to cover operating costs. However, times have changed: Consumers are spending lavishly these days, reflecting a change in the lifestyle of the general public, while imports of consumer products have been accelerating, reflecting widening price gaps between domestic and overseas markets due to a stronger yen, as well as dismantling of excessive government regulations.

It should not be long before we see imported Japonica rice, or tea, grown overseas using Japanese seeds and agricultural technology. In such cases, shosha are likely to be involved in some way. A parallel move can be seen in recent tie-ups or cooperation between shosha and large-scale retailers, such as

Table 1
Nine Largest Trading Companies

C. Itoh & Co., Ltd.
Kanematsu Corp.
Marubeni Corp.
Mitsubishi Corp.
Mitsui & Co., Ltd.
Nichimen Corp.
Nissho Iwai Corp.
Sumitomo Corp.
Tomen Corp.

Marubeni and Daiei. Shosha are expecting to benefit by large retailers' sales networks and marketing power, while the latter are looking to the former's ability in international commodity supply. Such cooperation is expected in many fields, including apparel, food, clothing and services.

There are always risks involved in entering new fields, and space telecommunications and consumer businesses are not exceptions. Shosha need to enhance expertise in risk control measures, such as thorough prior investigation. Nonetheless, it is still possible, given their limited risk toleration, to see an industry-wide restructuring of shosha triggered by these expansions to new business fields.

Globalization

For shosha, increasing internationalization is a necessity, but to accomplish this requires great thought. All nine shosha have 100 to 150 overseas branches throughout the world which, due to differences in politics, law, language and religion in each country, cannot be handled with a single criteria from headquarters in Japan. It is essential not just to develop Japanese specialists for each region, but also to employ competent local staff on a permanent base.

Overseas operations have usually been dominated by staff sent from Japan, with local employees placed as assistants. The Japanese staff return home after several years, to be replaced with newcomers, a process which is continuously repeated. For local employees, this means new bosses every few years, a condition which does not allow for company activities to take root nor for recruiting competent local staff.

Taking these negative aspects under consideration, shosha have started to increase the number of local staff in both quality and quantity. Fortunately, in most overseas areas, the status of Japanese shosha has been rising. This, coupled with revised personnel policies, has enabled them to recruit talented local staff. It is now not unusual for overseas employees to be promoted to managerial and executive positions, or even to higher executive positions in the Japanese headquarters.

Also, to strengthen relations for the long-term, shosha are trying to contribute to local communities, donating to local universities, setting up special lectures, and assisting those who study in Japan. These activities are rather quiet and slow, but can develop into firm locally-rooted operations.

Meanwhile, in response to a stronger yen and less competitive Japanese exports in recent years manufacturers have been accelerating their moves to shift their production overseas. Particular emphasis has been placed on expansion to China and other Asian countries.

Currently, Japanese manufacturers are reportedly producing 6.2% of their total products overseas, compared to 25.8% for American manufacturers. I believe the figure for Japan will rise closer to that of America. This situation provides shosha a wide range of potential involvements, including direct investment (shareholding), raw material supply, and marketing their products in overseas markets.

Amid the general trend of increasing globalization and borderlessness, as far as they have profound knowledge and experiences in overseas business shosha are facing huge potential business opportunities.

Conclusion

All-in-all, shosha must beef-up and create functions to strengthen earning power and enhance internationalization. Also, these functions need to be continually renewed in response to environmental changes, otherwise they will become obsolete. Shosha, which have already transformed themselves from traditional "traders" or "merchants" into "composite trading firms," will likely be transformed into "global composite enterprises."

During the process, corporate splits and spinoffs are likely to increase. A possible future form for shosha is that of a group of companies, with a small but highly efficient core company as the central nerve, satellited by many operating companies each having different specialties in goods and functions. As long as each employee performs to the best of their ability and with a challenging mind, shosha appear to be headed for strong survival and prosperity.

Table 2
Average Value of the Nine Largest Trading Companies

Fiscal year (Apr.-Mar.)	1988	1989	1990	1991	1992
Sales (¥1 billion)	10,925.2 (100)	14,429.5 (132.1)	14,069.6 (128.8)	13,244.2 (121.2)	12,358.4 (113.1)
Gross profit on sales (¥1 billion)	146.1 (100)	158.1 (108.3)	179.5 (122.9)	181.5 (124.3)	169.4 (115.9)
Gross profit ratio	1.34%	1.10%	1.28%	1.37%	1.37%
Operating profit (¥1 billion)	38.2 (100)	40.0 (104.7)	53.4 (139.8)	49.7 (130.1)	35.1 (91.9)
Foreign investment* (¥1 billion)	128.0 (100)	147.5 (115.2)	182.1 (142.2)	180.7 (141.1)	216.8 (169.3)
Number of employees	5,773 (100)	5,880 (101.9)	5,938 (102.9)	5,982 (103.6)	6,039 (104.6)

*Amount is earmarked balance on Balance Sheet.
Source: Compiled by Brain-Trust Co.

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