

Keiretsu: Past, Present and Future

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Abstract: This article presents the questions about changing of the integrative Japanese corporate structures - keiretsu, which is now a topic for many discussions. It was analyzed a number of Japanese and European economist's points of view about the influence of keiretsu on the economic development. It is proved in this article that even in the conditions of increasing instability of the economic environment; the vertical keiretsu structure is more efficient form of organization than the vertically integrated corporations in the United States.

Key words: Keiretsu • Inter-company mergers • Integrated corporate structure • The vertical keiretsu • economic development • Competition • Management structures • Corporate governance

INTRODUCTION

The Japanese model is characterized by a long-term investment strategy in the industry and the close relations between the industrial and financial sectors. The distinctive feature is a tendency for cooperation. Economic units are closely connected to each other through the mechanism of cross-shareholding, forming a corporate group. Business entities in the group are independent not only from outside investors, but also from banks, which are outside the group. The mechanism of capital mobilization in each group is going on a collective basis by the group's bank.

In connection with the variety of forms of inter-firm integration processes in the Japanese economy, there are several different classifications of keiretsu, which creates a certain ambiguity. There are differences in the identification of horizontal keiretsu, which called in Japanese literature – “industrial shudan” or industrial groups. Some Japanese economists, such as Maruyama Yoshinari, called such structures – “financial keiretsu” and Western economists, such as David Venstein and Yishai Yafeh, called the association of this kind “horizontal bank keiretsu”. Kinzl Rene and Mark Shudar identify “keiretsu bank”, which, in their opinion, are the “heirs” of the former zaibatsu and “nonbank- keiretsu” (manufactured shudan), which they belong “Matsushita”, “Toyota” and “Hitachi” [1]. At the same time, Namiki

Nobuaki considered that “Toyota group” can be refer to “vertical keiretsu” and “Mitsubishi” and “Sumitomo” calls “horizontal keiretsu” [2, p.3]. R. Hart and S. Kawasaki believe that development of keiretsu systems allowed to reduce the costs of transactions of inter-firm interaction arising from natural and specially supported the asymmetry of information [3]. K. Miyashita and D. W. Russell said that the distinguishing feature of the keiretsu is the institutional relationship with the bank [4].

History of the Formation of Japanese Type Financial-industrial Groups: More than 30 years (late XIX - early XX century), the Japanese economy was dominated by the pyramidal organizational structure consisting of “industrial -commercial-banking conglomerates of closed type”. In the 1920s - 1930s the small and medium-sized businesses, which make up a large part of the Japanese economy, consolidated into cartels or other associations, which representing their interest. Since 1938 year the government issued a series of laws, which aimed at restructuring the economy in order to consolidate the strategic industries. For example, in 1943 year the Japanese government made a law by which the independent small businesses have been virtually removed from the Japanese economic sphere. The remaining small and medium-sized enterprises have switched to subcontracting relationships with large enterprises, forming keiretsu [1]. However, the formative

process of the Japanese corporate model has been destroyed at the end of World War II by the occupation authorities.

The main objective of economic reforms, which was undertaken by occupation authorities, was the dissolution of the concerns and the introduction of the principles of economic democracy. Before the liquidation commission, established in 1947 year, was tasked with eliminating fragmentation of holdings and serried elite groups of owners to ensure the independence of companies that were part of corporations. The property of the concerns was rated at book value at prices of 1945 year, wittingly underestimated in terms of inflation. The sale was organized in several ways - at par value and at auctions, each part of shares for implementation, was to be sold within 10-14 days. The reformers have set the task as soon as possible to redistribute shareholder ownership, which was done in the conditions of inflation virtually free, regardless of the market securities. The managers of Japanese companies faced to the threat of takeovers.

The companies began negotiations about the "cross-ownership" of shares to overcome the difficulties of issuing new shares and to avoid the threat of takeover. The first stage of the reorganization, which was undertaken by companies in order to stabilize the stock ownership, was the delegation of stock ownership for investment companies. In this case, the purchasing price was paid by the company and the investment companies provide the names of the shareholders. The second step was the request of managers, addressed to people, who was outside the company, to own its shares on the basis of an informal contract. In the third stage, the top management has delegated to other financial institutions the holding of the issued shares and its affiliated companies, which they used to own, in exchange for deposits of these financial institutions. This process is known as "the adoption of measures to ensure the constant shareholders".

In 1954 year, it was conducted a large-scale inter-firm merger, which culminated in the formation of "Mitsubishi Shoji" ("Trading company of Mitsubishi"), which firstly held a mass distribution of shares to third parties and then transferred these shares in the possession of the group "Mitsubishi". Other companies followed by "Mitsubishi Shoji", trying to prevent the advance of the possibility of buying shares. The same business group (keiretsu) or association (shudan), as well as banks - partners in business operations, were became the constant shareholders. Therefore, the process of "ensuring the

constant shareholders" promoted at the same time for the role of keiretsu and the strengthening of the process of enterprise groups' formation.. In 1964 year, Japan joined the Organization for Economic Cooperation and Development (OECD). It was appeared the opportunity for foreign capital to buy up shares easily. This was particularly concerned about by the Japanese automobiles companies, which feared about the absorption of giants "General Motors" and "Ford". Therefore automobile company "Toyota jidosha kogyo" has taken a number of "measures to ensure the constant shareholders". Gradually the whole economy became involved in this process: the shares, which were given to constant shareholders, were withdrawn from open markets. As a result, in the post-war period the financial- industrial groups were developed in the Japanese economy, which had a large private commercial bank at the head of each and industrial company were clustered around.

The largest group includes the "Sumitomo", "Mitsubishi", "Mitsui", "Fuyo", "Sanwa" and "Dai Ichi Kangin". The revival of Sumitomo was in April 1951 year, a group of "Mitsubishi" - by 1954 year, a group of "Mitsui" - by October 1961 year. These groups are almost completely restored the inter-firm linkages of the pre-war Japanese zaibatsu. Later, some groups were formed, which included the company, which were before the war, an affiliate member of several zaibatsu. These groups include a group of "Fuyo" (January, 1966), the group "Sanwa" (February, 1967) and the group "Kangin Dai Ichi" (January, 1978) [5]. Thus, even before the war the tendency, existed in the Japanese economy, for creation of integrated corporate structures, as well as the post-war measures to ensure the constant shareholders led to the formation of integrated corporate structures of Japanese style – keiretsu and shudan.

The Influence of Keiretsu on Economic Development:

Most of the early researches on the problem of vertical keiretsu, negatively evaluated this type of grouping. It was believed that the vertical keiretsu are the product of a primitive two-tier structure of the Japanese economy, where large industrial corporations, using a monopoly position, make a profit on suppliers and subcontractors, or use them as a damper when the market conditions change. This kind of research, which was led by Japanese economists, is for the most part to a period of high economic growth in Japan. Later, some American researchers have presented a number of arguments that confirm the theory of "two-tier structure of the economy".

Most of Japanese economists and some their colleagues from West believed that keiretsu do not have a significant impact on the economy, in any case, they say, keiretsu have no more impact than some forms of business organization, which is common in other countries, such as vertical integration, concerns and close ties between firms and banks. Moreover, for example, P., R. Dvorak *et al.* [6] and P. Abrahams and G. Tett [7] in his researches discussed the possibility of the collapse of keiretsu system.

One of the first researchers, who offered a positive view on the vertical keiretsu, was B. Asanuma. He suggested that the "vertical keiretsu - this is not an object of exploitation and mutually beneficial form of business organization, through which the company standing on different levels of integration, shared costs involved in making a "special" to invest in their own production, for "grinding" to each other" [8]. It is statistically justified by the example of the automobile industry, the companies that make up the vertical keiretsu, which share the burden of risk.

The result of subsequent researches was the theory that vertical keiretsu are a hybrid (or intermediate) form of vertical integration (which, according to the researchers, was characteristic of the United States, particularly in the automobile industry).

L. Branstetter suggested that stable vertical keiretsu ties promote the technological cooperation and the cross-flow of technical knowledge through the boundaries of the firm due to the fact that investment in research and development are returned in the form of profits not only for the firm to make investments, but also to other members of the group, who did not spend the financial cost on research and development [9].

S. Suzuki and R. Wright [10], T. Hoshi *et al.* [11] considered that keiretsu reduced the cost of financial distress. In addition, the management structure of keiretsu solves the problem by reducing the information asymmetry (S.D. Prowse [12; 13] and T. Hoshi *et al.* [14]) and also provides effective control of the top management (E. Berglöf and E. Perotti [15], S. N. Kaplan [16] and S. N. Kaplan and B.A. Minton [17]). Consequently keiretsu companies have higher financial capabilities than independent company (J.E. Hodder and A.E. Tschoegl [18]) and for diversifying the keiretsu more than independent entities (E., Guo *et al.* [19]). System management organization in keiretsu promotes mutual monitoring and information exchange between corporate members (R.J. Gilson and M.J. Roe [20]).

The most serious discussion among economists is about the keiretsu issue of the impact on competition. On this issue, there are several positions.

One group of scientists believes that the keiretsu creates entry barriers for newcomers and hinder the competition. The supporters of this point of view believe that not only the Japanese government, but the U.S. government should more strictly monitor the implementation of the provisions of the antitrust laws.

Another group of economists deny that keiretsu creates entry barriers and hinder the competition. This group of economists believes that the creation of inter-firm relationships within the keiretsu is very important and it is the secret of success of the Japanese economy. According to this view, it cannot be a coincidence that the best companies in Japan are usually members of a keiretsu, providing them the benefits of sharing the burden of risk and information. "The close links between large companies and their suppliers provide savings on transaction costs, enhance the technology transfer process and increase the tendency to produce specific investments" [21]. The researchers believe that the form of business organization, based on the type of keiretsu, is more effective than vertical integration in its pure form, as it allows providing a consistent supply and at the same time preserves the flexibility of the structure.

There is also a group of researchers who believe that the keiretsu are not limited, but on the contrary, encourage the competition. The head bank mitigates the problem of asymmetric information between lenders and borrowers and offers affiliates a kind of guarantee in times of financial problems. Contrary to popular belief, the horizontal keiretsu are not limited, but on the contrary, increase the level of competition [5].

However, recent trends demonstrate to a complete restructuring of the Japanese economy. In this regard, there is a change of traditional forms of a major Japanese business organization.

Current Trends in Keiretsu: Currently, almost all industries - finance, telecommunications, manufacturing and technology - try to form a holding company in order to highlight the divisional offices in subsidiaries to reduce costs and to increase efficiency. One of the most important objectives of the formation of holding companies is the separation and the sale process of unnecessary divisions. The intention of the Japanese government demonstrated as the introduction of pure holding companies in order to provide a horizontal

Japanese keiretsu greater flexibility in the management of companies due to the introduction of different pay systems and by getting rid of unprofitable divisions.

The first "pure" holdings were corporation "Daiei Inc.", which owns the country's largest supermarket chain and Telephone and Telegraph Corporation "MTT", as well as the Corporation "Toshiba" [22]. "Daiwa" was divided into ten subsidiaries under the control of a holding company. The important aim of the restructuring was the refusal of the payment system, "according to seniority". The fifteen divisions of "Toshiba" united in eight subsidiary companies, led by the holding, provided that the subsidiary companies greater freedom in decision-making questions and increased reporting of income. As part of the restructuring, "Toshiba" was the reducing of the administrative staff with seven hundred to three hundred [2, p.10].

The liberalization of holdings suggests that the holding company has a right to exist as long as it reaches the extreme concentration and size that significantly affect in the industry. "The Japanese Commission for a fair deal" set a limit, a kind of "ceiling" on the activities of holding companies. The new forms of the "Japanese Commission for a fair deal" can improve the five-percent threshold.

In 2000 year, the "big six" has become a "big four": "Sumitomo Bank" merged with "Sakura Bank" within the group "Mitsui", "Fuji Bank" merged with the "Bank of the Dai Ichi Kangyo" and "Industrial Bank of Japan" to create a new financial- industrial group "Mizuho". It seems that bank mergers were the first link in the chain of mergers among companies in the horizontal keiretsu. The merger "Sumitomo Chemical Company" and "Mitsui" will lead to the formation of the largest chemical companies in Asia. In the steel industry is a member of the group "Fuyo" "Japanese steel company" ("NKK") and "Kawasaki Steel Company" ("Kawasaki Steel"), a member of the "Dai Ichi Kangin", formed a strategic alliance.

Despite the fact that there are still various forms of keiretsu in Japanese economy, the practice shows that the relationship between companies belonging to the group diminish with reduction in the percentage of cross-shareholdings in the mid 90 's.

Japanese model with its institutions of stable shareholders of the head bank performed itself well in the first postwar decade. In the last decade, two factors undermined the stability of the model. On the one hand, it acts progressing towards the internationalization of economic activity, the deployment of a network of branches of Japanese companies in other economic

conditions and other types of entrepreneurial culture. On the other hand, there is the growing instability of the economic environment (from sharp fluctuations in exchange rates and world prices and ending with the reduction of life cycle of goods and technologies). In these circumstances, it is extremely important when getting a flexible response to changing conditions, long-term strategy cannot justify itself. At the same time, it is the reducing of the role of the head bank as a constant lender and the guarantor of its financial stability. The function of the bank as a chief inspector is also getting weak.

Restructuring processes have led to partial collapse of the Japanese system of corporate governance. All this created a certain vacuum in corporate governance and Japanese capital markets are not yet ready to fill it, despite the rapid growth, it needs to go a long way until institutional investors will be able to exert real pressure on the company and develop an active market for mergers and acquisitions.

The need for a change of national economic institutions in Japan today is debatable. The most of economists think that the change in the economic model is necessary, though it brilliantly proved itself in the post-war development policy. Another group of researchers, mainly sociologists and political scientists believe that as soon as the economy and political situation stabilize, the institutions have changed back to the old forms that are proved as best "Asian values".

Nowadays, the search of the optimal production and management structures in the system both corporate and group management leads to the emergence and development of organizational forms based on different combinations of small, medium and large businesses. The vertical keiretsu, which is proven by many economists, is more efficient form of organization than the vertically integrated corporations in the United States, which having all the benefits of vertical integration and a relatively flexible corporate structure. In the same horizontal keiretsu is now regrouping of authorities. It is shown by mergers and acquisitions in recent years the increasing level of competition in world markets. The process of redistribution within the boundaries of companies' mergers and acquisitions has the potential to significantly reduce non-production costs and improve the static efficiency of the business of the company. The effectiveness of the business combination is achieved not by simple summing the potential of the participants. In this case, there is a certain synergy.

Obviously, keiretsu is a form of economic entities' integration and the time tested and proven the effectiveness of its existence and in near future keiretsu should not disappear.

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