SOGO SHOSHA AND JAPANESE INDUSTRIALIZATION

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1. Introduction

The ‘sogo shosha fever’ seems to have spread throughout the world. Brazil, Mexico, Korea, Thailand, and Taiwan have set up their own versions of sogo shosha, while the United States, Malaysia, and several other countries are considering doing the same. Their motives for replicating the Japanese organization are, however, varied. In the case of industrial countries, such as the United States, there is a need to create organizations to link small and medium-sized companies to the export market, whereas in the case of developing countries, the focus is on bringing foreign trade, which has been dominated by foreign companies, under their control, and on increasing exports. But both the industrial and the developing countries agree on one point—the sogo shosha are efficient conduits of international trade.

Foreign journals are also lavish in their praise of sogo shosha. For example, a British weekly, The Economist, has published articles on Japanese trading companies from time to time since the mid-1960s, and has attributed the success of the Japanese export drive to the existence of sogo shosha. Forbes, an American business journal, wrote complimentary reports in 1972 and 1978. The most recent praise came from the Far Eastern Economic Review, which wrote:

If one factor had to be singled out for the explosive growth of Japan’s economy since World War II, it would undoubtedly be the nation’s unrivalled virtuosity in foreign trade. At the center of this worldwide web of trading, marketing and financial operations sit the nine giant sogo shosha

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(general trading companies), which orchestrate Japan’s complex and diverse international commerce.¹

This paper examines the role trading companies played in Japan’s industrialization. A typical approach to this question would be to list the industrial establishments set up by trading companies and discuss their subsequent growth. The next section adopts this approach. But their contribution is broader and more important as technological, financial and marketing intermediaries. Sections 3 to 5 discuss the way in which trading companies contributed to Japanese industrialization as intermediaries.

2. Industrial Investment

The theory that commercial capital does not turn into industrial capital seems to be incorrect, for when the investment behaviour of trading companies is examined, it becomes clear that numerous industrial investments have been undertaken. Towards the end of the e-war period, Mitsui Bussan, for example, had a number of manufacturing subsidiaries and also had large holdings in many established companies. Relatively well known among its subsidiaries are Yuasa Battery Manufacturing, Onoda Cement Manufacturing, Toyo Rayon, Sanki Kogyo, Toyo Carrier, Tama Shipyard, and Toyo Precision Machinery and Engineering. It also held large shares in Nippon Steel Works, Electrochemical Industries, Nippon Flour Mills—companies of Mitsui zaibatsu.

In the 1910s and 1920s, Suzuki was far more aggressive than Mitsui Bussan in industrial investment. When it was at its peak, Suzuki had about fifty subsidiaries and affiliates in the manufacturing industry, spreading over such industries as textiles, cement, coal, steel, and chemicals. Teijin (formerly Teikoku Jinken), Kobe Steel, Mitsui Toatsu Chemicals, and Honen Oil—Japan’s representative manufacturers today—were either created by Suzuki’s investment or grew out of its subsidiaries. Probably, no trading company ever exceeded the scale of Suzuki’s industrial investment (relative to equity capital). By the late 1910s, it had ceased to be a simple trading company, evolving in the direction of becoming an industrial-commercial combine.²

2. For further discussion on Suzuki’s involvement in industrialization, see Tsuda Yoshio, “The Role of Sogoshosha in Japanese Industrialization: Suzuki
Today, all sogo shosha have numerous manufacturing subsidiaries or affiliated companies. For example, in mid-1975, C. Itoh had 108 companies in its group (C. Itoh Group), out of which 31 companies were in manufacturing (7 in textiles, 2 in machinery, 9 in foods, 3 in plywood, 8 in chemicals, 1 in metals and 1 in paper).\(^3\) In addition, C. Itoh held minority shares in many other manufacturing companies. Among C. Itoh’s industrial investments at that time, the largest went to an oil refinery called Toa Oil: C. Itoh spent 4.7 billion yen to acquire about 60 percent of its shares.

Many manufacturing investments by trading companies were undertaken to set up new companies. One such investment was made by Suzuki to establish an ammonia factory by importing technology from abroad. In the early 1920s, Suzuki bought the patent for the method of fixing nitrogen from the air invented by a Frenchman, G. Claude, and began ammonia production based on this patent. After Suzuki became bankrupt in 1927, the company was taken over by Mitsui to become Toatsu Chemicals, which subsequently merged with Mitsui Chemicals to become Mitsui Toatsu Chemicals, a leading chemical company today. Suzuki’s import of the ammonia production technology, which cost a fortune (£500,000)\(^4\) made an important contribution to the development of the Japanese chemical industry.

Trading companies entered into the manufacturing industry also as a spin-off effect of trading activities. For example, Mitsui Bussan added shipbuilding and ship repairing to its activities, and constructed a shipyard in 1917. The purpose of establishing this industry was to repair a fleet of ships it possessed (about twenty ships totalling about 100,000 tons in the early 1910s) to facilitate its transportation requirements, and also to build new ships (all shipyards were, at this time, operating at the maximum capacity due to the war boom, and it took a long time to get a new ship built). In the mid-1920s, Mitsui Bussan concluded a licensing agreement with a Danish firm, Burmeister and Wain, to manufacture diesel engines, and then attached an engine plant to the shipyard. In 1937, the shipyard was

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separated from Mitsui Bussan and became Tama Shipyard (subsequently Mitsui Engineering and Shipbuilding).

A more common pattern of entry into manufacturing was through import substitution, that is, production of a product formerly imported. An example of this pattern is Mitsui Bussan's establishment of Toyo Rayon in 1926. The company had been importing rayon from a British company called Courtaulds, and had developed a marketing network in Japan. Using this as leverage, Mitsui Bussan hoped to begin rayon production. At first, it negotiated with Courtaulds and then with Du Pont for a technological licensing agreement, but since neither was much interested, it decided to import the necessary machinery, employ foreign engineers, and begin production on its own. Apparently, rayon technology was embodied in machinery to a large extent, and it was not absolutely necessary to buy patents. Until the mid-1920s, Teikoku Jinen, under the financial support of Suzuki, had made some progress in rayon production without relying on foreign companies. What Toyo Rayon did then was to follow the path of Teikoku Jinen. It faced difficulties at the beginning, but within several years (by the early 1930s), it had become a successful rayon manufacturer.

In this connection, it is interesting to note that two of the major rayon producers in prewar Japan were set up by trading companies, and that these two companies became the major synthetic producers in the postwar period. During the Pacific War, Toyo Rayon began experimenting with nylon production with the know-how acquired in a rayon production as a base, and after the war, it became the first company to produce nylon. Teikoku Jinen was unprepared for nylon, but began production of polyester early, and split that market with Toyo Rayon. As will be explained in the next section, both Toyo Rayon and Teikoku Jinen were assisted by their ties with trading companies in the import of the technology necessary to produce synthetic fibers.

Mitsui Bussan was not alone in undertaking import substitution investment. Iwai was also a vigorous investor of this type. For example, in 1918 it established a company to manufacture soda ash and caustic soda (Nihon Soda Kogyo). Katsujirou, who headed the company at that time, saw great opportunity in soda production since its prices were high due to the reduction of imports from the
West during the First World War. He is the one who made the decision to produce soda domestically. Unfortunately for him, the war ended soon, and in 1920 the postwar depression set in, so it was rough going until the early 1930s when the economy began to improve again. Today, the company, known as Tokuyama Soda, is a leading soda manufacturer in Japan.

In studying industrialization in developing regions such as Southeast Asia, one gets the impression that a typical pattern for a trading company’s entry into manufacturing is through a tie-up with a foreign company. At first, the trading company becomes an agent for the foreign company, and when it becomes advantageous to establish a production base in the market, the trading company sets up a joint venture with the foreign supplier. In a way, this is an ideal tie-up, for the foreign company supplies technology and the trading company, marketing know-how. For example, most Japanese industrial investments in Southeast Asia are joint ventures, and their partners are often Chinese and Southeast Asian trading companies (or merchants).

Did Japanese trading companies also tie up with foreign suppliers? Though this pattern was much less common in Japan, there were a number of such cases. For example, in the pre-war period, Mitsubishi Shoji set up a joint venture with Associate Oil (an American company) for oil refining, and Mitsui Bussan tied up with Carrier Engineering (an American company) for the production of airconditioners. In the postwar period, Coca-Cola and Pepsi-Cola set up bottling plants with Mitsubishi Shoji and C. Itoh, respectively, and Mobil Oil established a refinery with Mitsui Bussan.

A large part of trading companies’ industrial investments have been directed to already existing companies. In some cases, this was forced on the trading companies. Such situations arose when manufacturing companies to which credits or loans were extended faced financial difficulties and the trading company converted part of the credits or loans to equity capital. Sometimes, when the financially-troubled company was rehabilitated with assistance from the trading company, the latter withdrew by selling its holdings. Often, however, trading companies retained holdings, and used the company as a supply base. In other cases, the acquisition of a

5. Iwai Sangyo, Iwai Hyakumen Shi (Iwai’s First One Hundred Years), 1964, pp. 315-23.
manufacturing company's shares was necessitated by strategic considerations. For example, trading companies often acquired, or established partial control over manufacturing companies in fields in which they wanted to increase sales, when they faced financial problems, or when they needed an investor to finance plant expansion.

A trading company might prefer not to undertake industrial investment, if the same objective could be achieved without it. In the early years of the Meiji era, Masuda Takashi, the man who built the foundation of Mitsui Bussan, insisted that the company should stick to the agency business and that the company should avoid using its pital for industrial investment since that slowed down the turnover of capital. It became increasingly clear over time, however, that in order to maintain or enhance its position in trading, a trading company must undertake industrial investment. Otherwise, it would likely be pushed out from trade channels. For this reason, Mitsui Bussan has invested in numerous manufacturing companies.

3. Intermediation in Technology Transfer

Japanese trading companies have functioned as a conduit of technology transfer from the West to Japanese manufacturers. When technology was embodied in machineries—which was typical of technological imports in the early years of industrialization—trading companies collected information on machinery producers as well as technological changes in the West, and helped Japanese manufacturers import necessary machinery. For example, in the Meiji era, Mitsui Bussan imported spindles from Platt Brothers in Britain for the largest-scale spinning companies. More recently, trading companies have gathered relevant information for capital intensive manufacturers in Japan and acted as consultants as well as purchasing agents when manufacturers needed to import machinery. Since machinery accounted for a large part of production and determined the quality of output, the extent to which they were chosen had an important bearing on the business.

In closing the technological gap between the West and Japan, trading companies played by far a more important role by importing advanced machinery than by mediating in technological

6. Mitsui Bussan, Mitsui Bussan Shoshi (Short History of Mitsui Bussan), 1, p. 38.
licensing agreements. Especially in the early years of Japanese industrialization, they widened the technological spectrum of Japanese manufacturers by informing them about various technological opportunities available in the West, and took the initiative to materialize the interests they developed as a consequence, thus contributing to the technological progress of Japanese industry. This function of trading companies, however, can be considered as marketing intermediation (discussed in Section 5), and will therefore not be discussed further here. The remainder of this section will deal only with the role of trading companies in mediating technological licensing agreements.

One group which trading companies assisted in importing technology was their subsidiaries and affiliates. In Suzuki's case, for example, technology import led to the establishment of the ammonia factory. In most cases, however, technology was imported for subsidiaries and affiliates already established. For example, Mitsui Bussan noticed the superiority of diesel engines over steam reciprocating engines in the early 1920s, and drew up licensing agreements with Burmeister and Wain, a major diesel engine manufacturer in the West, for its shipyard.\(^7\) In the postwar period, Mitsui Bussan imported the floating glass process for Central Glass, from a British company, Pilkington, and helped its diversification into sashes.\(^8\) Also, Marubeni mediated licensing agreements between Yutani Heavy Industries and a French company, Poclain, and enabled Yutani to become a major producer of hydraulic shovels.\(^9\)

Trading companies have also mediated in technological licensing agreements for the companies with which they had close business relations. In the postwar period, Mitsui Bussan established contact between Du Pont and Toyo Rayon, and enabled the latter to import nylon technology. In particular, the good reputation Mitsui Bussan established among Western manufacturers in the prewar period was a decisive factor in Du Pont's decision to accept Toyo Rayon as a trustworthy licensee.\(^10\) In the case of Teikoku Jinken's import of

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ologyester technology from ICI, Nissho got wind of the information and used its trading relations with ICI to explore the possibility of a licensing agreement.\(^\text{11}\) In the case of Showa Denko’s diversification into polyethylene production, Marubeni played a pivotal role by importing necessary technology from Phillips Petroleum.\(^\text{12}\) Marubeni so mediated a licensing agreement between Hitachi Shipbuilding and Engineering and a Swiss company, L. De Roll (now Von Roll), a major company in the field of waste disposal plants.

Mitsubishi Shoji has also been busy with mediating licensing agreements for member companies. In the prewar period, it helped Mitsubishi Electric tie up with Westinghouse for the production of electric generators; aided Mitsubishi Kakoki (established in 1935) in importing necessary technology from Krupp and several other European machinery producers; mediated for Mitsubishi Aircraft in drawing up licensing agreements with various European and American aircraft producers (Henriot, Hispano-Suissa, Junkers, Rohrbach, Artiss Aeroplane and Motor, etc.); and helped Mitsubishi Shipbuilding produce diesel engines under license from a Swiss company, Sulzer Brothers, motorboats under license from a British company, Cormyncoft, and various other marine-related products under license from European companies.\(^\text{13}\)

In the postwar period as well, Mitsubishi Shoji has been active in mediating licensing agreements between Mitsubishi companies and Western manufacturers. When Mitsubishi Heavy Industries tied up with American and European manufacturers to produce new machines (such as bottling machines and power shovels), Mitsubishi Shoji acted as its contact abroad. From the late 1950s to the early 1960s, when petrochemicals became an important industry in Japan, Mitsubishi Shoji imported polyethylene technology for Mitsubishi Petrochemical from BASF, and imported polypropylene technology from Montecatini. For Edogawa Kagaku (now Mitsubishi Gas Chemical) it imported polycarbonate (plastic) technology. More recently, the company imported technology related to satellites for

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13. Mitsubishi Shoji, *Ritsugyo Boeki-roku* (Record of the Promotion of Trade), 1958, the part on machinery.
Mitsubishi Heavy Industries and Mitsubishi Electric from American companies (such as Rockwell and McDonnell-Douglas). 14

In a relatively small number of cases, trading companies acted as organizers of industrial projects and functioned not only as intermediaries for technology transfer, but also as investors. Such cases lie between establishment of a new company (as in Suzuki's establishment of the ammonia factory) and pure technological intermediation. In such cases, the projects depend significantly on the import of technology from abroad, and trading companies undertake investment as well, but unlike Suzuki in the ammonia case, the trading company is not the sole investor. For example, when Mitsui Aluminum was set up in 1968, Mitsui Bussan acted as its organizer and contributed slightly over 20 percent of its equity capital. At the same time, it located suitable technology abroad and finally succeeded in drawing up a licensing agreement with a French company, Compagnie Pechiney. 15

In mediating in the transfer of technology, the bulk of the activities of trading companies has been related to imports, which reflects the fact that Japanese industrialization has progressed by importing technology from abroad. Furthermore, as Japan's technology level rose with industrial progress, some companies developed technologies which could be exported. Trading companies arranged the exports of some such technology. For example, in 1926 Mitsui Bussan sold the patent for Toyota's powerloom to Platt Brothers (from which it had imported a large number of spindles). More recently, Mitsui Bussan exported Toyo Rayon's synthetic fiber technology to E.N.I. of Italy (in 1971) and the technology of Nippon Steel Works to a Spanish company for production of large-sized steel forgings (in 1976). 16 In the future, since Japanese industry is now one of the most advanced in the world, technology exports will rise, and the opportunities for trading companies to export technology from Japan will increase. Up to this point, however, imports have been the major function of trading companies.

4. Financial Intermediation

In order to understand the financial intermediation of trading companies, one must understand the dual structure of the Japanese manufacturing industry. One sector consists of large companies: for example, in the field of consumer goods, there are such giants as Toyota Motor, Nissan Motor, Sony and Matsushita Electric Industrial, and in the field of intermediate and investment goods, Mitsubishi Heavy Industries, Nippon Steel and Mitsui Toatsu Chemicals. The other sector consists by far of a larger number of small and medium-sized companies, which range from midget companies relying on family labour to companies employing a few hundred persons. One interesting feature of Japanese industrialization was that these small and medium-sized companies made an important contribution to exports and the increase of productivity. Trading companies have been especially important to this sector of the manufacturing industry.

One might argue that the existence of small and medium-sized companies is by no means a phenomenon unique to Japan. In the manufacturing industry, there can be ample room for them if, for example, there is no economy of scale in production. What makes the Japanese case unique is that such companies have played a large role in the manufacturing industry. In 1955, they numbered about 10,000, or 99.6 percent of the total, and accounted for about 73 percent of the workers and 56 percent of the output in the Japanese manufacturing industry.17 As the economy grew and the chemical industry gained importance in the following years, their relative importance declined. Yet even in 1970, their share of employment and output were about 68 percent and 50 percent, respectively. These shares are considerably higher than, for example, the United States. In 1967, the share of employment of American companies of comparable size was about 40 percent.18

The availability of cheap labour has been one major reason for the importance of small and medium-sized companies in Japan. This explains why a great majority have specialized in labour-intensive production. In contrast, production in small and medium-sized companies in the United States has tended to be more capital

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18. Ibid., p. 53.
intensive. In the United States, capital intensity in small and medium-sized companies may be slightly lower than in large companies, but the difference is at most 20 to 25 percent. In the Japanese case, capital intensity in the companies which employ four to nine workers is about one-fifth that of those which employ a thousand workers, steadily increasing as the size of employment increases.¹⁹ For the very small companies which employ less than four workers, no data are available, but it is a safe guess that their capital intensity is even lower.

The export market has supported the relatively large number of small and medium-sized companies in Japan. In the 1950s and 1960s, they exported such labour-intensive products as garments, toys, plastic goods, rubber products, and ceramic ware to the United States and Western European countries, which were at a disadvantage in labour-intensive production because of higher wages. In the period 1956-58, small and medium sized companies accounted for about 60 percent of Japanese exports and were the chief foreign exchange earners.²⁰ In a way, Japan found in the production of labour-intensive exports an outlet for over-population.

As Japanese wages rose, it became increasingly clear that the cheap labour argument had to be modified. Large companies enjoy economy of scale in production and various monopolistic advantages (such as lower interest rates), but suffer from a number of disadvantages, such as higher wages (direct and indirect) and difficulties in organization control. These disadvantages can be overcome by smaller organizations, and if the increase in cost due to a smaller scale of production and loss of the monopolistic advantages can be outweighed by the savings (made possible by overcoming the disadvantages), smaller organizations will be preferred. The vitality of small and medium-sized companies in Japan even today has to be attributed to such cost advantages, but one wonders why this has been the case in Japan more than in other industrial countries.

One reason is social. About one hundred years ago, when Japan started modernization, the country was integrated enough to function as a nation state, but there were many social divisions, and each community had its own identity. Legally, barriers to mobility and economic exchanges within the country were removed, but

¹⁹. Ibid., p. 59.
²⁰. MITI, Chusho Kigyo Hakusho, 1963, p. 3.
cial barriers remained high, and each community had a sort of nationalism of its own. However, since the country was modernizing its economy, it became imperative that communities also modernize as they wished to preserve their identities. To accomplish this, communities expected certain people to act as organizers and set up stories and other modern economic organizations where people in the community could earn a livelihood. When such community need was met and combined with the spread of education and money economy which has taken place during the Tokugawa period, many production centres comprising small and medium-sized companies emerged in Japan.

The other reason for the existence of large numbers of small and medium-sized companies is the existence of other organizations which enabled them to overcome a number of disadvantages associated with small size. One disadvantage lay in obtaining necessary funds at reasonable rates of interest. Since the capital market was imperfect, it was extremely important that their advantages in fund raising vis-a-vis large manufacturing companies not too great. Their second major disadvantage lay in marketing and purchasing. Large companies were in a better position than small companies to establish trading networks to undertake these activities because their volume of trade was much larger. The existence of large trading companies was extremely beneficial to small and medium-sized companies in overcoming these disadvantages. The remainder of this section will deal with the financial role of trading companies in relation to small and medium-sized companies, and the next section with their role in marketing and purchasing.

If small and medium-sized companies had been satisfied with the use of their own funds, there would have been no financial role for trading companies to play, but as it was, the latter acted as conduits for the flow of money from banks to small and medium-sized companies. These companies could borrow a certain amount from banks on their own by offering their assets as collateral, but not nearly enough to meet their demand for capital. In a high growth setting, there were many opportunities to exploit, and companies were willing to pay the prevailing rate of interest, or a rate slightly higher. But banks were not willing to lend money beyond a certain percentage of the value of the collateral.

One problem for banks was that they were supervised by the Ministry of Finance, which strongly discouraged them, in the interest
of depositors, from undertaking risky (that is, unsecured) lending. The Ministry did not want to see a repetition of the experience in the pre-war period when banks often went bankrupt and runs on banks occurred; thus the Ministry urged banks to establish a conservative lending policy. The Ministry had the power to impose penalties on banks which were recalcitrant (it had set up a web of regulations for banks under the pretext of protecting their depositors). As a consequence of such guidance by the Ministry, major banks dealt mainly with large companies (where risk of bankruptcy is slight), and when small and medium-sized companies asked for loans, they requested collateral and gave loans amounting to a certain percentage of its value.

A second problem was that major banks were not allowed to set up branches freely, and thus their contacts with small and medium-sized companies were limited. This would not have caused major problems if local banks had been more willing to take risks, but since they were under stricter supervision (since small banks tended to face financial troubles more often), they requested even larger collateral from small and medium-sized companies. Given the fact that major banks have staffs more qualified to undertake credit evaluation, if they had been allowed greater freedom, they might have been a little more amenable to requests from small and medium-sized companies. As it was, however, a large part of the latter’s demand for capital was left unfulfilled.

In spite of the fact that small and medium-sized companies needed capital, banks maintained a ‘surplus fund’. The Japanese have almost always put their money in banks (and post offices) rather than in stocks. Banks used their deposits to make loans to the companies which could offer collateral, and made some unsecured loans to large companies, yet still had a large surplus.

In the 1950s, banks were slightly more aggressive in making unsecured loans, but as certain trading companies reemerged as healthy, dynamic companies, banks recognized that the trading companies were much better in risk management, and therefore used them as intermediaries. This relationship is reflected in the fact that in the 1960s, banks decreased their bad debts whereas the percentage of bad debts of trading companies increased.\footnote{Chuo Koron Keiei Mondai, Fall 1977, Special Number on General Trading Companies, p. 152.}
Trading companies did not face the same regulations banks did, and thus could establish contacts with small and medium-sized companies freely. Through buying from and selling for them, trading companies came to possess knowledge of their credit worthiness, and were willing to take the risks involved in granting them unsecured credits and loans. Because small and medium-sized companies go bankrupt from time to time, a premium was necessarily added to the rate of interest at which they borrowed. Since trading companies did a fairly good job at avoiding unsound companies, however, the premium was low enough to be attractive to many of them.

The outcome of the involvement of trading companies in financial transactions was that they functioned in roles that normally could be fulfilled by financial intermediaries. A financial intermediary shifts money from one place to another and reduces the gap in interest rates among regions or sectors, thus contributing to a better allocation of capital. In the Japanese setting, trading companies borrowed money from banks, and lent it to the small and medium-sized companies which had high growth potential but could not obtain capital because of the imperfection of the capital market. Such a function is usually performed by banks in foreign countries; if aggressive banking been allowed, Japanese banks would have formed the same function. In a high growth economy, however, trading companies seem to be in a better position to locate growth opportunities or identify companies with growth potential because of their flexibility and intimate trading relations with various firms.

One advantage trading companies had over banks was that they were more perceptive in forecasting demand because they were involved in day-to-day transactions. If, for example, there were a missing opportunity for exporting a certain product (as in the case of silk, cotton fabric, matches, etc., in the Meiji era), trading companies investigated which companies had the best potential as suppliers, and gave credits and loans to promising companies. Banks, on the other hand, especially local banks, did not have intimate knowledge of the marketability of products made by small and medium-sized companies and, thus, were not in the position to evaluate effectively their own growth potential.

One interesting recent development in the area of trading companies' contributions to export is that they have begun to use foreign banks for export promotion. In plant export, foreign buyers usually prefer to pay in installment over several years since sums
involved are large, but Japanese manufacturers hesitate to accept such a system because they bear the foreign exchange risks involved (the Japanese yen has been floating since early 1973, and normally it is difficult to hedge the risk beyond six months). When a trading company is involved as the organizer of plant export, it can arrange financing for foreign buyers and make it possible for Japanese manufacturers to obtain immediate payments (thus, avoiding the foreign exchange risk). Large trading companies have high credit standings in financial circles throughout the world, and can become intermediaries between foreign banks and purchasers of plants in developing countries, the area to which most plant export is directed.

5. Intermediation in the Goods Market

The large, modern companies which emerged in the trading sector became a tremendous blessing to Japanese industrialization, for thanks to them, wide, long-range distribution channels were created through which various kinds of information crisscrossed and numerous deals were consummated. Within Japan, they made possible the movement of goods from one place to another, thus contributing to a better allocation of resources. This function was especially important in the early Meiji years when the Japanese economy was not well integrated and there was a large discrepancy in prices. In international trade, they made it possible for Japanese manufacturers to export to places where there was a potential demand and to import necessary goods with proper timing and in sufficient amounts.

In order to establish such distribution channels, the first job of trading companies was to set up offices where there was a market or source of supply. They first established a few bases in Japan, and then gradually expanded their networks domestically and internationally. As Japanese industrialization progressed, it became particularly important to establish trading networks abroad. Already in the 1930s, Mitsui Bussan and Mitsubishi Shoji’s overseas offices essentially covered the world. In the 1940s, because of the Pacific War and Japan’s subsequent defeat, trading companies lost all foreign assets, but beginning in the early 1950s, they began to move abroad again, and today, the average sogo shosha has about one hundred offices abroad.

Offices spreading throughout the world had to be connected by
ome means. In the prewar period, the telegraph was the most important means. Mitsui Bussan, for example, spent a large amount of money on a telegraph system, becoming a major customer for foreign telegraph companies (such as Western Union). Today, overseas offices are connected by a modern communications network. The Japan Foreign Trade Council describes this network as follows:

One sogo shosha lends an entire floor, thousands of square feet of floor space, to its communications center. It is jammed with telex and facsimile machines and computer terminals linking 187 offices scattered throughout 77 countries. Another sogo shosha has over 3,500 employees reporting from around the world through computer-linked exclusive lines. It is linked between Tokyo and New York by 11 lines, and New York offices are linked to London by six lines.22

his telecommunications system is supplemented by telephone, mail, and frequent air travel by employees.

In international trade, it is also important to set up an efficient system of physical distribution, for if the cost of distribution is high, if there is no means of transportation or no storage place at a time when there is demand, trading is impeded. In order to prevent this occurrence, trading companies have invested in physical distribution, established close relations with companies in this field, and developed manpower with the necessary expertise. In many cases, the costs of transportation (for example, in the case of trampers), storage, and insurance are negotiable, so large trading companies have often been in a favorable position to minimize costs, for their experience and the volume of goods they handled gave them considerable bargaining power. In cases where it appeared more advantageous to own the means of transportation or warehouses, trading companies have often made the necessary investment.

For trading companies to function as intermediaries, they must assess an experienced staff. In international trade, language barriers had to be overcome first. In addition, it was important to have intimate knowledge of the products involved and to be able to establish contact with possible suppliers and buyers. When the trade was not on a letter of credit basis and Japanese exporters assumed risks of default, the credit status of potential buyers had to be

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evaluated for them. In order to build up a large staff of traders who could handle this type of work, trading companies hired competent people and assumed the costs of training them.

Trading companies have also made efforts to win the trust of customers. With this in mind, one area to which they paid close attention was that the terms of contracts be executed, no matter what happens between the time of signing the contract and that of delivery or receipt. Especially in the early phase of economic development, business morale was generally low, and there were many merchants who wanted to make short-term gains when prices moved in their favour, despite initial promises. All of the sogo shosha of today established business principles at the beginning to prosper along with their customers, and highly valued the trust they received in turn.

What they have tried to accomplish by extending their networks to various parts of the world, establishing communications networks to link them, setting up efficient distribution systems, creating large staffs of experienced traders, and gaining trust from customers, was to create trade channels which a large number of people could find useful and dependable. Since the trading sector is fragmented abroad, trading companies are usually too small to be useful or too risky to inspire much confidence. In Japan, several trading companies have succeeded in building large, modern organizations, and have served as useful intermediaries for many manufacturers.

Trading companies may be compared with banks. Both play the role of an intermediary: banks handle money, whereas trading companies handle goods, and both match up supply and demand. The more confidence people place in them, the more effectively they can function as intermediaries. When they do function effectively, those who deal with them are either enhanced in economic welfare or move closer to their maximum potential. In one respect, large trading companies have been more active in intermediation. Because capital flow was subject to strict regulation by the government, the international networks of banks have tended to be weak. International trade was regulated much less severely in the case of trading companies, allowing them greater degree of freedom than banks in

23. Many foreign merchants also broke their promises when things became unfavourable, and lost the trust of their customers. See Mitsui Bussan (1951), p. 50.
foreign operations; thus, they were able to establish more extensive networks.

Japan’s advantage over other industrial countries is, then, the existence of effective intermediaries in the goods market. Trade channels, especially the ones connecting Japan and foreign countries, are more efficiently used because they are open to many manufacturers; they function as if they are ‘public highways’, and thus distribution margins are lower. At the same time, because the channels are extended to various parts of the world as integrated units, numerous exchanges have taken place which would have been tampered if the channels had been disconnected and information had not passed through from one end to the other.

In order to understand how intermediation by large trading companies operates, consider the case of the export of orange juice to the Middle East in the mid-1970s. The hot and dry climate, and the presence of oil money, raised the market potential for non-alcoholic beverages in this region. With the help of a sogo shosha, producers of mandarin oranges (who had been suffering from over production) succeeded in exporting canned juice to this market.

What role did the sogo shosha play in making this export possible? The first important contribution was transmission of the information to orange producers that their products might be marketable if canned as orange juice. Before this, also, the sogo shosha made the necessary preliminary market research, studying the tastes of the people in the area, the availability of substitutes, f.o.b. prices in Japan, transportation costs, tariffs, etc. When it was found that Japanese orange juice might enjoy substantial demand, such information was transmitted to Japanese orange producers.

This kind of information was valuable in promoting export, but before actual trade could take place, further problems had to be solved. The first problem was to find an importer who had a good distribution network in the area, enough capital to act as a primary distributor, and who at the same time was trustworthy (that is, could not cause a lot of trouble on purely technical grounds). When such an importer was located, the sogo shosha presented its proposal with a persuasive case for its economic viability. Without the intermediation of the sogo shosha the deal would not have been consummated, for the producers and the importers would not have

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come to know each other; even if by some chance they did, they might not have trusted each other because of the uncertainty involved in shipping over such long distances.

The export of canned orange juice is just a single example. There have been numerous other commodities which have been exported from Japan as a result of the efficient intermediation of trading companies. For example, textiles were first exported to China, and then to Southeast Asia, South Asia, the Middle East, Africa, and Latin America by trading companies. As early as the 1930s, Japanese companies were busy convincing local distributors in these areas of the advantages of Japanese textiles. More recently, they skillfully persuaded numerous distributors and manufacturers in both developed and developing countries to use Japanese products, such as steel, chemicals, and machines. Undoubtedly, some of these exports would have been effected anyway because of the price advantage Japanese manufacturers enjoyed, but a large portion of the exports were due to the marketing skills, efficient physical distribution systems, and reputation for reliability which trading companies possess.

The contribution of trading companies has also been important in imports. As pointed out earlier, Japanese industrialization relied on the importation of raw materials and up-to-date machines. It may seem that import is an exceedingly simple activity but in fact a great deal of skill is involved in importing necessary products with proper timing and in sufficient amounts. Unless these requirements are met efficiently, the manufacturing industry in a country like Japan, where the dependency on foreign countries is high, tends to suffer. In the Japanese case, trading companies enabled manufacturers to take various precautionary measures (such as stock-purchase when prices were expected to rise, and postponement of purchase when they were expected to decline) by transmitting relevant information to them. In some cases where the price of a raw material continued to rise, driving Japanese manufacturers into difficult positions, trading companies were successful in locating cheaper substitutes. Or, as in the case of the cotton industry, because trading companies imported raw cotton from such diverse sources as China, India, the

25. The first major export of cotton fabric was organized by Mitsui Bussan. See Mitsui Bussan (1951), p. 75; and Yamamoto Jotaro-o Denki Hensan-kai, Yamamoto Jotaro-o Denki (Biography of Venerable Yamamoto Jotaro), 1942, pp. 132 and 308.
United States, East Africa, and Egypt, Japanese spinners were able to develop a blending method to minimize the cost of cotton for a certain quality of yarn. These services to Japanese manufacturers helped them improve their efficiency, and have contributed indirectly to their competitiveness in the international market.

Some activities of trading companies went beyond the normal definition of intermediation. In many cases, financing accompanied intermediation. For example, when a Japanese manufacturer was short of capital to increase production of a product for which demand had increased abroad, the trading company which sought to handle the export advanced credit and made the trade flow possible. Or, if a foreign importer was short of capital, the trading company performed a similar function so that import could be realized. In these cases, the role of the trading companies as financial intermediaries cannot be neatly separated from their roles as intermediaries in the goods market, but it is useful to keep them separate, for in a large number of cases, finance was either not involved at all or was subservient to intermediation in the goods market.

Even when finance is separated, combination deals, counter-purchases, and plant export still constitute more than simple intermediation in the goods market. Combination deals are cases where the country to which a good is exported from Japan suffers from lack of foreign exchange, and, therefore, allows import only on the condition that the Japanese exporter buys goods equivalent in value in return. If the Japanese exporter is a manufacturing company, purchasing is usually limited to inputs for production, so it is highly unlikely that the condition can be met. If a sogo shosha is involved, however, it can buy enough goods from the country to offset the export, and then market them either in Japan or abroad. In such a case, two transactions must take place in order to realize the profit. In the past, the ability of sogo shosha to undertake this type of deal was useful in exporting Japanese products to developing countries and Socialist countries which tended to suffer from lack of foreign exchanges.

Counter-purchase is sometimes involved in plant export. When a plant is exported to a developing country, for example, its output

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26. This point was made by Abe Fusajiro, president of Toyo Boseki, in his note to Kita Matazo, which appeared in Nippon Menka, *Kita Matazokun Denography of Kita Matazo*), 1933, p. 2.
capacity may be greater than the domestic demand; hence, for the plant to be a viable economic proposition, a certain portion of the output must be exported. Usually, in such instances, the country in question is inexperienced in export marketing, and thus, requires the prime contractor of the plant to promise to market the excess. This condition is extremely difficult for Japanese manufacturers to meet, since they usually do not handle the output of plants. When such a condition is imposed, the involvement of sogo shosha becomes valuable.

What exactly is plant export, and what other roles do sogo shosha play? Plant export is usually understood to be the export of manufacturing plants, but it can include the export of non-manufacturing facilities, such as power plants and telecommunications systems. Plant export differs from conventional export in two respects: (1) more than one manufacturer is required to supply plant equipment; and (2) designing and construction (and/or assembling) on site are necessary. This requires someone to coordinate the work, and in Japanese plant exports, coordination is often done by the sogo shosha.

The sogo shosha qualified well for the organizing role in plant export. Their global networks promptly pick up information on the planning of new projects abroad, making it possible for groups of Japanese manufacturers to prepare in advance. When certain machines cannot be obtained at competitive prices in Japan and this jeopardizes the chance of winning a project, a sogo shosha may use its network to locate better suppliers abroad. Also, in comparison to Japanese manufacturers, sogo shosha have far richer experience in operating abroad, a sine qua non of plant export where on-site construction is involved. Experience becomes especially important in that plant export usually goes to developing countries where the methods of rational business planning used in Japan cannot be easily transferred.

In 1976, plant export amounted to about $8 billion, becoming an important single component of Japanese exports (about 10 percent of total exports). This is a rather large figure, considering that in 1973, when plant export was already receiving considerable attention, the value was only about $2 billion. Plant export is expected to increase further in the future in view of the fact that developing countries, including China, are increasing industrialization.
6. Concluding Comments

Considering the large role trading companies play in the establishment of manufacturing companies in Southeast Asia and certain other developing regions, it is possible to infer that trading companies were also an important investor in the Japanese manufacturing industry. As discussed earlier (see Section 2), trading companies have undertaken numerous investments and contributed capital and entrepreneurship. This aspect of their contribution to Japanese industrialization must be clearly recognized. At the same time, however, it must be admitted that their relative importance as industrial investors was not as great as in the case of some developing regions of today. Most Japanese manufacturing companies were established and grew without financial and entrepreneurial contributions from trading companies.

The role of trading companies as intermediaries in the transfer of technology was relatively more important. Their offices abroad closely monitored the situation of technology in the West, and passed relevant information to their customers, or searched for the means of technology their customers required. In the course of these activities, trading companies often mediated a number of important licensing agreements. Yet, it must be acknowledged that they were restrained in this role, because in order to become a really effective intermediary, it was imperative that they possess sophisticated technical knowledge, and this was often beyond the comprehension of trading companies. Nevertheless, many manufacturers depended on trading companies because of their information networks, contacts with Western manufacturers, and negotiation skills.

Intermediation in the capital and goods markets was a more significant contribution to Japanese industrialization. In financial intermediation, trading companies were greatly assisted by the policy of the Ministry of Finance which made banks adopt conservative lending policies. In this respect, the role of financial intermediation reflects the uniqueness of the Japanese situation. Yet, in almost any country, government regulations exist (to protect depositors), urging commercial banks to adopt more or less conservative policies; many countries there is thus the need for organizations able to undertake risky investments. In the Japanese case, because trading companies were involved in actual transactions, they were often situated to find companies to which such investments should be directed.
Intermediation in the goods market was perhaps the most important contribution to Japanese industrialization. Trading companies have endeavoured to build efficient, wide, long-range channels by establishing offices wherever there was either a demand for Japanese goods or supplies of raw materials for Japanese industry; by setting up communications systems to link them; by developing contacts and expertise in the field of physical distribution; and by building up staffs of experienced traders. Through such channels, information crisscrossed between Japan and major business centers throughout the world, and goods were traded with distant places.

In the capital market, large intermediaries frequently emerge in almost any country. In the goods market, however, intermediation is much more difficult because the trading industry is more competitive and because manufacturers tend to usurp the functions of trading companies as they grow in size. Still, there is a need for large, efficient intermediaries in the goods market as there is in the financial market. In Japan’s case, such intermediaries have emerged, and as a result, numerous exchanges have materialized which would not have taken place otherwise.  