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 dustrialization. A typical approach to this question would be to list ie industrial establishments set up by trading companies and discuss ieir subsequent growth. The next section adopts this approach. But ieir contribution is broader and more important as technological, nancial and marketing intermediaries. Sections 3 to 5 discuss the ay in which trading companies contributed to Japanese industriali- .tion as intermediaries.

2. Industrial Investment

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

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

1. *Far Eastern Economic Review,* February 1980, p. 39.

2. For further discussion on Suzuki's involvement in industrialization, see tsura 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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& Co., 1877-1927," in Herman Kroos (ed.), *Proceedings of the Business History Conference*, Indiana University, 1975, second series, vol. 3.

3. C. Itoh, Itohchu Gurupu (C. Itoh Group), 1973.

4. Takahata Seiichi, "Watashi no Rirekisho" (My Personal History), in *Watashi no Rirekisho*, No. 48, Nihon Keizai Shinbun-sha, 1973.

separated from Mitsui Bussan and became Tama Shipyard (subse-
quently 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 Jinken, 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 Jinken. 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 ayon producers in prewar Japan were set up by trading companies, nd that these two companies became the major synthetic producers n the postwar period. During the Pacific War, Toyo Rayon began xperimenting with nylon production with the know-how acquired n rayon production as a base, and after the war, it became the first ompany to produce nylon. Teikoku Jinken was unprepared for ylon, but began production of polyester early, and split that market vith Toyo Rayon. As will be explained in the next section, both Toyo Rayon and Teikoku Jinken were assisted by their ties with rading companies in the import of the technology necessary to roduce the synthetic fibers.

Mitsui Bussan was not alone in undertaking import substitution nvestment. Iwai was also a vigorous investor of this type. For xample, in 1918 it established a company to manufacture soda ash nd caustic soda (Nihon Soda Kogyo). Katsuijiro, who headed the ompany at that time, saw great opportunity in soda production ince its prices were high due to the reduction of imports from the

West during the First World War.[5] 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

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5. Iwai Sangyo, *Iwai Hyakunen Shi* (Iwai's First One Hundred Years), 1964, pp. 315-23.

anufacturing company's shares was necessitated by strategic con-
derations. For example, trading companies often acquired, or
tablished partial control over manufacturing companies in fields in
hich they wanted to increase sales, when they faced financial
oblems, or when they needed an investor to finance plant
:pansion.

A trading company might prefer not to undertake industrial
vestment, if the same objective could be achieved without it. In the
rly years of the Meiji era, Masuda Takashi, the man who built the
undation of Mitsui Bussan, insisted that the company should stick
the agency business and that the company should avoid using its
pital for industrial investment since that slowed down the turnover
capital.[6] It became increasingly clear over time, however, that in
der to maintain or enhance its position in trading, a trading
mpany must undertake industrial investment. Otherwise, it would
ely be pushed out from trade channels. For this reason, Mitsui
ssan has invested in numerous manufacturing companies.

3. Intermediation in Technology Transfer

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

In closing the technological gap between the West and Japan,
ding companies played by far a more important role by importing
v, 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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7. Mitsui Bussan, *The 100-Year History of Mitsui & Co., Ltd., 1876-1976*, 1977, p. 99.

8. Mitsui Bussan, *Kaiko-roku* (Reminiscences), 1976, p. 324.

9. Marubeni, *The Unique World of the Sogo Shosha*, 1978, p. 48.

10. Mitsui Bussan, *Chosen to Sozo* (Challenge and Creation), 1976, p. 209.

olyester technology from ICI, Nissho got wind of the information
rst and used its trading relations with ICI to explore the possibility
f a licensing agreement.[11] In the case of Showa Denko's diversifica-
on into polyethylene production, Marubeni played a pivotal role by
nporting necessary technology from Phillips Petroleum.[12] Marubeni
so mediated a licensing agreement between Hitachi Shipbuilding
ıd Engineering and a Swiss company, L. De Roll (now Von Roll), a
ajor company in the field of waste disposal plants.

Mitsubishi Shoji has also been busy with mediating licensing
greements for member companies. In the prewar period, it helped
itsubishi Electric tie up with Westinghouse for the production of
ectric generators; aided Mitsubishi Kakoki (established in 1935) in
ıporting necessary technology from Krupp and several other
ıropean machinery producers; mediated for Mitsubishi Aircraft in
awing up licensing agreements with various European and Ameri-
n aircraft producers (Henriot, Hispano-Suisa, Junkers, Rohrbach,
ırtiss Aeroplane and Motor, etc.); and helped Mitsubishi Shipbuild-
g produce diesel engines under license from a Swiss company,
ılzer Brothers, motorboats under license from a British company,
ıornycroft, and various other marine-related products under license
om European companies.[13]

In the postwar period as well, Mitsubishi Shoji has been active in
ediating licensing agreements between Mitsubishi companies and
estern manufacturers. When Mitsubishi Heavy Industries tied up
th American and European manufacturers to produce new
achines (such as bottling machines and power shovels), Mitsubishi
oji acted as its contact abroad. From the late 1950s to the early
60s, when petrochemicals became an important industry in Japan,
tsubishi Shoji imported polyethylene technology for Mitsubishi
trochemical from BASF, and imported polypropylene technology
om Montecatini. For Edogawa Kagaku (now Mitsubishi Gas-
emical) it imported polycarbonate (plastic) technology. More
ently, the company imported technology related to satellites for

11. Takahata Seiichi describes the role of Nissho in Teijin's introduction
polyester technology in *Ekonomisuto,* 28 September 1971, p. 85.

12. Marubeni, p. 53.

13. Mitsubishi Shoji, *Ritsugyo Boeki-roku* (Record of the Promotion of
de), 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.

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14. *Ryowa,* January 1980, pp. 180-203.

15. Mitsui Bussan, *The Mitsui Story,* n.d., p. 59.

16. Mitsui Bussan, *Chosen to Sozo,* p. 410 and p. 419; and Togai Yoshio, *Mitsui Bussan Kaisha no Keiei-shi teki Kenkyu* (Historical Study of Mitsui Bussan), Toyo Keizai Shinpo-sha, 1974, p. 72.

4. Financial Intermediation

In order to understand the financial intermediation of trading ompanies, one must understand the dual structure of the Japanese ıanufacturing industry. One sector consists of large companies: for xample, in the field of consumer goods, there are such giants as 'oyota Motor, Nissan Motor, Sony and Matsushita Electric Indusrial, and in the field of intermediate and investment goods, litsubishi Heavy Industries, Nippon Steel and Mitsui Toatsu Chemials. The other sector consists by far of a larger number of small and ıedium-sized companies, which range from midget companies :lying on family labour to companies employing a few hundred ersons. One interesting feature of Japanese industrialization was ıat these small and medium-sized companies made an important ontribution to exports and the increase of productivity. Trading ompanies have been especially important to this sector of the anufacturing industry.

One might argue that the existence of small and medium-sized ompanies is by no means a phenomenon unique to Japan. In the anufacturing industry, there can be ample room for them if, for ample, there is no economy of scale in production. What makes e Japanese case unique is that such companies have played a large le in the manufacturing industry. In 1955, they numbered about 0,000, or 99.6 percent of the total, and accounted for about 73 rcent of the workers and 56 percent of the output in the Japanese anufacturing industry.[17] As the economy grew and the heavyemical industry gained importance in the following years, their ative importance declined. Yet even in 1970, their share of ployment and output were about 68 percent and 50 percent, spectively. These shares are considerably higher than, for example, the United States. In 1967, the share of employment of American mpanies of comparable size was about 40 percent.[18]

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

17. Ministry of International Trade and Industry (MITI), *Chusho Kigyo 'usho* (White Paper on Small-Scale Enterprises), 1973, p. 51.

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
tionalism of its own. However, since the country was modernizing
economy, it became imperative that communities also modernize
they wished to preserve their identities. To accomplish this,
mmunities expected certain people to act as organizers and set up
ctories and other modern economic organizations where people in
e community could earn a livelihood. When such community need
as met and combined with the spread of education and money econ-
ny which has taken place during the Tokugawa period, many
oduction centres comprising small and medium-sized companies
nerged in Japan.

The other reason for the existence of large numbers of small and
edium-sized companies is the existence of other organizations
ich enabled them to overcome a number of disadvantages
ociated with small size. One disadvantage lay in obtaining
cessary funds at reasonable rates of interest. Since the capital
rket 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
l purchasing. Large companies were in a better position than small
npanies to establish trading networks to undertake these activities
cause their volume of trade was much larger. The existence of large
ding companies was extremely beneficial to small and medium-
ed companies in overcoming these disadvantages. The remainder of
s section will deal with the financial role of trading companies in
ition to small and medium-sized companies, and the next section
h their role in marketing and purchasing.

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

One problem for banks was that they were supervised by the
istry 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.[21]

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21. *Chuo Koron Keiei Mondai,* Fall 1977, Special Number on General Trading Companies, p. 152.

Trading companies did not face the same regulations banks did, d thus could establish contacts with small and medium-sized mpanies freely. Through buying from and selling for them, trading mpanies came to possess knowledge of their credit worthiness, and ːre willing to take the risks involved in granting them unsecured ːdits and loans. Because small and medium-sized companies go nkrupt from time to time, a premium was necessarily added to the :e of interest at which they borrowed. Since trading companies did fairly good job at avoiding unsound companies, however, the ːmium was low enough to be attractive to many of them.

The outcome of the involvement of trading companies in ancial transactions was that they functioned in roles that normally uld be fulfilled by financial intermediaries. A financial inter- diary shifts money from one place to another and reduces the gap interest rates among regions or sectors, thus contributing to a ter allocation of capital. In the Japanese setting, trading com- ɪies borrowed money from banks, and lent it to the small and dium-sized companies which had high growth potential but could obtain capital because of the imperfection of the capital market. ːh a function is usually performed by banks in foreign countries; aggressive banking been allowed, Japanese banks would have formed the same function. In a high growth economy, however, ling companies seem to be in a better position to locate growth nts or identify companies with growth potential because of their ːibility and intimate trading relations with various firms.

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

One interesting recent development in the area of trading panies' contributions to export is that they have begun to use ign banks for export promotion. In plant export, foreign buyers lly 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
nportant means. Mitsui Bussan, for example, spent a large amount
f money on a telegraph system, becoming a major customer for
oreign telegraph companies (such as Western Union). Today,
verseas offices are connected by a modern communications net-
ork. The Japan Foreign Trade Council describes this network as
ollows:

> 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,
id frequent air travel by employees.

In international trade, it is also important to set up an efficient
stem 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
hen there is demand, trading is impeded. In order to prevent this
om occurring, trading companies have invested in physical distribu-
on, established close relations with companies in this field, and
veloped manpower with the necessary expertise. In many cases,
e costs of transportation (for example, in the case of trampers),
orage, and insurance are negotiable, so large trading companies have
ten been in a favourable position to minimize costs, for their
perience and the volume of goods they handled gave them
nsiderable bargaining power. In cases where it appeared more
vantageous to own the means of transportation or warehouses,
ding companies have often made the necessary investment.

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

22. Japan Foreign Trade Council, "The Sogo Shosha: What They Are and
w They Can Work for You," 1978, p. 5.

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.[23] 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 hampered 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 o the Middle East in the mid-1970s.[24] The hot and dry climate, and he presence of oil money, raised the market potential for non-lcoholic beverages in this region. With the help of a sogo shosha, roducers of mandarin oranges (who had been suffering from over roduction) succeeded in exporting canned juice to this market.

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

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

24. Mitsui Bussan, *Chosen to Sozo,* 1976, p. 25.

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.[25] 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.[26] 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 one. 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

26. This point was made by Abe Fusajiro, president of Toyo Boseki, in his tribute to Kita Matazo, which appeared in Nippon Menka, *Kita Matazokun Den* (Biography 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 stablishment of manufacturing companies in Southeast Asia and ertain other developing regions, it is possible to infer that trading ompanies were also an important investor in the Japanese manufacuring industry. As discussed earlier (see Section 2), trading ompanies have undertaken numerous investments and contributed apital and entrepreneurship. This aspect of their contribution to apanese industrialization must be clearly recognized. At the same me, however, it must be admitted that their relative importance as ıdustrial investors was not as great as in the case of some developing egions of today. Most Japanese manufacturing companies were stablished and grew without financial and entrepreneurial contribuons from trading companies.

The role of trading companies as intermediaries in the transfer of chnology was relatively more important. Their offices abroad osely monitored the situation of technology in the West, and ıssed relevant information to their customers, or searched for the nds of technology their customers required. In the course of these tivities, trading companies often mediated a number of important ensing agreements. Yet, it must be acknowledged that they were nstrained in this role, because in order to become a really effective termediary, it was imperative that they possess sophisticated chnical knowledge, and this was often beyond the comprehension trading companies. Nevertheless, many manufacturers depended trading companies because of their information networks, ntacts with Western manufacturers, and negotiation skills.

Intermediation in the capital and goods markets was a more nificant contribution to Japanese industrialization. In financial ermediation, trading companies were greatly assisted by the policy the Ministry of Finance which made banks adopt conservative ding policies. In this respect, the role of financial intermediation lects the uniqueness of the Japanese situation. Yet, in almost any ıntry, government regulations exist (to protect depositors), sing commercial banks to adopt more or less conservative policies; many countries there is thus the need for organizations able to lertake risky investments. In the Japanese case, because trading ıpanies were involved in actual transactions, they were often ılly situated to find companies to which such investments should lirected.

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.[27]

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27. What made it possible for sogo shosha to emerge in Japan is discussed in Yoshihara Kunio, *Sogo Shosha: The Vanguard of the Japanese Economy*, Tokyo, Oxford University Press, 1982, Chapter 5.