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Introduction to Joint Venturing in Japan*

Francis T. Vaughan

I. WHY A JOINT VENTURE?

It would seem natural that a foreign company wishing to establish operations in Japan would want to use a wholly-owned subsidiary in preference to any other vehicle of operations, provided that the scale of its operations here were sizeable. However, many foreign businessmen find that they are engaging in wishful thinking in their desire to use a wholly-owned subsidiary.

Time and again responsible officials of the Japanese government have stated that equity investment by foreign capital should be limited to 50% or less. Despite four rounds of capital liberalization, the last of which took place in August, 1971, and concomitant press releases which stated that investment of foreign capital in Japan is now 93% liberalized, the restrictive policy of the government concerning foreign investment still stands.

Indeed, it can safely be stated that liberalization, in the Japanese understanding of the word, means something different from the meaning commonly attributed to it by English-speaking people. As with many other things in Japan, the word has a peculiarly Japanese connotation. For example, in order to qualify as an investment in a liberalized field, the investment has to be in a newly established enterprise; and a newly established enterprise is unable to expand its activity beyond the particular industry in which it is initially permitted to operate, unless the approval of the proper minister is obtained. Another condition is that the proposed investment must not have an exceptionally detrimental effect on the interests of Japan. Liberalization? Yes, but in a very restricted manner. Perhaps it was a situation like this Mr. Stone was thinking of when he said you

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could add a negative to most Japanese sentences without really changing the meaning.\(^1\)

Although there are no accurate up-to-date figures to check what it all means in reality, there are statistics which show the general trends in recent years of foreign capital investment in Japan. The Japan Times, in a special supplement on liberalization (August 12, 1971), stated that the fact that there have only been 28 cases of investment in this nation by foreigners authorized as "automatically approved" since the first round of the capital liberalization program in 1967 is eloquent testimony to the fact that the liberalization measures adopted by Japan over the years have been hardly attractive to foreign investors.

According to a government survey of foreign capital affiliated enterprises, there were 729 such enterprises in Japan as of June 30, 1969.\(^2\) From the 653 enterprises which completed a government questionnaire we note some interesting trends. Among these 653 enterprises, some 81 of them were considered as newly established, and it is by comparing these with the total that certain trends can be deduced.

Of the total 653 some 30% were more than 95% foreign-capitalized, whereas among the 81 newly-established enterprises only 19% fall into that category. If we take 50/50 equity holding by foreign and Japanese parties we find that of the total only 26% fall into that category, whereas among the newer enterprises that category accounts for 50%. For a third method of comparison we find that of the total around 60% were joint ventures, while some 80% of the newer enterprises were joint ventures.

In the early 1960's and prior thereto it was possible (and relatively easy) for foreign enterprises to set up wholly-owned subsidiaries in Japan using yen funds (so-called "Yen base companies"). However, after 1963 this method of entering Japan was abolished, and anyone desiring to enter had to obtain Japanese government validation, an achievement not easily obtained. Furthermore, the extent to which foreign capital could participate in particular industries was severely limited. This trend has continued until today, as is evidenced by the small number of liberalized industries allowing 100% foreign capital investment (228 in all, out of a total of 850


liberalized industries, and many of the 100% liberalized fields are not very attractive to foreign investors). In general, it can be said that the Japanese Government prefers an investment of 50% or less by the foreign party.

Once the foreign investor has grasped the full significance of the situation outlined above, if he allows himself to do so, the Japanese environment will become a little less frustrating. He can refer to it as government interference in private enterprise, as anti-foreign, or whatever he wishes, but if he realizes early that the Japanese government will be much happier if he engages in a JV with a Japanese partner then he can enter the Japanese market with a certain feeling of being welcome, or at least of not being totally undesirable. He will, of course, have to cope with a certain amount of government interference and "administrative guidance" later on.

II. CHOOSING A PARTNER

The foreign investor's first problem of initiation to the world of Japanese business having been successfully overcome, he can now concentrate on the more concrete task of choosing a partner. Depending on the particular field of industry in which he is engaged he will have a number of prospective partners available. Of course, these partners will be much more interested in his technology than they will be in his equity participation, but he can use that technology to achieve his ends, and this is the course foreign businessmen are following today. In the past they were happy to license their technology to the Japanese, but they found that by doing so they were not always getting full value for it. The government desired that the royalties not exceed five percent. Furthermore, the Japanese companies used the technology to improve their products and then exported those improved products into the home markets of the foreign licensors. American businessmen, in particular, have realized this, their trade with Japan having changed from a healthy balance in favor of the United States to a several billion dollar surplus in favor of Japan. Nowadays, the policy of most United States businessmen is equity participation or no technology, and Japanese businessmen are gradually getting the message.

In choosing a partner the foreign investor will benefit from any reading he has done about the pre-World War II makeup of the Japanese industrial world. Prewar Japan was dominated by the *zaibatsu,* and while these were officially broken up by the American military occupation after the war the ties that bound them together
were never really broken. This is demonstrated by the fact that *The Oriental Economist* thought the present regrouping of these industries worthy of a series of articles throughout 1970.

In his book on business and politics in Japan, Chitoshi Yanaga deals at length with the various regroupings of the former *zaibatsu* or *keiretsu* as they are referred to now. While they lack the tight organization of the pre-war *zaibatsu*, the *keiretsu* of today are a power to be reckoned with. These groups consist of two kinds: those organized around the former *zaibatsu* and using the old names (Mitsubishi-28; Mitsui-22; Sumitomo-15) and those held together by large banks (Fuji, formerly Yasuda; Dai-ichi; the Industrial Bank of Japan). While the figures quoted above give an idea of the size of these groupings the reality is far more extensive, with each member of each group probably having as many as one hundred, or even several hundred, subcontractors working on its behalf.

In addition to the *keiretsu* there are many other industrial or industry-related groupings of influential executives in present-day Japan. To give an extreme case of the Japanese desire to group, there is the Tuesday Club (one of many under this title) composed of approximately six hundred former officials of the Ministry of International Trade and Industry (MITI) and its predecessor, the Ministry of Commerce and Industry, who are now employed as senior executives of large corporations.

To know the details of the various groupings, if that is possible, is to have the key to doing business in Japan. In choosing the relative merits of the various prospective partners, a foreign investor will do well to check the prominence of each in its respective group, if it belongs to a group. He will also do well to check each prospective partner's channels of contact with government and banking institutions. Looking at each of these aspects will give the prospective joint venturer a completely different picture and, in the long run, will probably make his choice much easier and a much less hazardous task. Connections with government, banking, and big business are essentials in the carrying on of business in Japan; if these contacts are solid, there is little likelihood that the prospective business venture will turn out to be a failure. Membership in the group does not automatically guarantee success, but it creates a feeling of stability which will pervade the new enterprise and may mean the difference between survival and demise.

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Some authors advocate choosing a partner seeking to diversify its business operations.\(^4\) It is felt that such a partner will have greater growth potential and will be much more compliant because of its lack of experience in the new field and its need for new technology. However, in its list of conditions for automatic validation, the government has stated that the Japanese partner to a JV should be already established in the particular field of industry. To choose such a partner, unless it had strong group support, would, I think, often add more difficulties to those already existing.

### III. NEGOTIATING WITH THE NEW PARTNER

Having set his sights on a particular partner, it now remains for the foreign businessman to approach that partner and work out a viable mode of operations with him. Very often, of course, the procedure will be the reverse, with the Japanese party first approaching the foreign party since, in general, the Japanese, through the good offices of the Japan External Trade Organization (JETRO), often seem to be much better informed about foreign technological breakthroughs and business in general than foreigners are about the Japanese scene. Whichever way the approach is made, it will prove beneficial to the foreigner to observe a number of rules of etiquette in negotiating in Japan.

First among those rules of etiquette is "hasten slowly." Foreigners usually come to Japan with a very fixed schedule and very definite targets for achievement, all very good in the framework of Western management concepts but not always workable in Japan. One recent case I had reason to learn of was that of a foreign firm which had already been approached by a Japanese firm in the United States. Certain preliminary understandings had been reached and it was decided to hold further discussions in Japan toward setting up a JV. The foreign firm drew up the schedule for final discussions and generously allowed one week of time for negotiating, drawing up, and signing the final contract. The reply of the lawyer whom they contacted in Japan about providing local counsel was that the Pacific is a very large place where one could wander around for a long time without reaching port. In other words, he was trying to tell them that their schedule was unrealistic in the Japanese context. The final negotiations for that particular JV lasted for more than a year.

While the above case may be a little bit extreme, similar cases are

not unheard of. Things do happen in Japan, and, if we are to judge by the post-war growth rate of the Japanese GNP, now just over $200 billion, things would seem to be happening very fast. However, it takes a long time to get a project off the ground, and much negotiation, patience, waiting, and more negotiation are necessary. No one in Japan seems to be able to make a decision on his own: he has to consult his colleagues, the trade associations, or perhaps the government, and he has to tell each one what the others said to him. Only after all that procedure has been gone through will a decision be reached. The foreign partner would do well to bear this in mind; otherwise he will be antagonizing his prospective Japanese partner, increasing his own blood pressure, and, finally, creating problems for the future JV if it ever comes into being.

The second rule of etiquette is the importance of getting to know one another, and, hence, the creation of mutual trust. In the West we tend to operate by the word of the contract irrespective of what we think of the other person. In Japan things are different: people work together on the basis of mutual trust and understanding and rarely use contracts. As a matter of fact, it is said that, after signing a contract, a Japanese puts it in the bottom drawer and never looks at it again. Contracts are simply not important. To overlook this aspect of Japanese thinking will prove to be a big mistake on the part of the Western businessman.

How to create mutual trust is another question. By observing the first rule of etiquette stated above one will have laid the groundwork for such trust. Japanese when they first meet like to talk about the weather and all sorts of trifles, not for the sake of killing time, but to break the ice for future discussions. A foreigner who schedules a conference for 9 A.M. on a Monday morning and at 9:01 launches right into the heart of the matter is likely to get a lot of blank stares from his Japanese partner, and what he says is unlikely to leave a deep imprint on his mind. After entering the conference room, it would be much more beneficial to spend five or ten minutes greeting each person of the opposite party and then have coffee and talk about trivia for the first hour or so. After that, substantive and fruitful discussion could take place in an atmosphere of incipient trust and openness.

In general, the foreigner should be open and frank with his Japanese partner. He should not be despotic in laying down certain

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5 N. Chie, Japanese Society ch. 2 (1970); see also J. Sawada, Subsequent Conduct and Supervening Events 162 (1968); D. Henderson, Conciliation
conditions; he will achieve just as much by putting the matter clearly and reasonably, even if firmly, before the Japanese partner and seeking his cooperation in implementing his wishes. More often than not, the Japanese will conform if he realizes that the foreigner is well-intentioned and that he is seeking mutual understanding and cooperation for the benefit of both parties and not simply for his own selfish profit.

If the various contracts for the joint venture are gone through by both parties and thoroughly discussed and agreed upon, not out of forced necessity but because both parties agree that this is the best thing to do, then a spirit of trust will have been created and a storeful of goodwill will have been created by the foreign partner which can be drawn upon time and again in the future. If, in their discussions, this is not achieved, then it would be almost better never to have initiated the JV, because, as is natural, problems are bound to arise in the future, and, if there is misunderstanding and distrust in the beginning, there is likely to be even greater misunderstanding and distrust as time goes by. The spirit of mutual trust and confidence is a sine qua non to the JV. If it is there, no problem is insoluble; if it is absent, almost no problem is soluble.

A third rule of etiquette for the foreign joint venturer is to allow the Japanese party to handle all negotiations with the government. Negotiations with the government? What does that have to do with a private contract? Let's just say that in Japan government and business are closely allied. One seldom does anything without informing the other. This is especially true in the case of foreign capital investment or international contracts of any nature. MITI, in particular, wishes to protect the interests of a "not yet fully developed" Japanese industry from the invasion of foreign "imperialistic" capital. It is a cardinal rule for all Japanese enterprises that they inform MITI of their intentions when they wish to tie-up with a foreign investor.

MITI will want to know all about the foreign partner and will want to oversee the formation of the contract. For this reason it may be necessary to consult with MITI several times during the negotiations, and the person to do this is the Japanese partner rather than the foreign partner. Few foreigners can fully understand and tolerate the attitude and guidelines of MITI, which are not written in any law but which nevertheless must be observed. To bring a

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foreigner to MITI can often do more damage than good. The
foreigner will probably blow his top at what he thinks is unnec-
sary government interference and may even refuse to comply with
MITI's administrative guidance. MITI will not necessarily force
him to comply, but if he doesn't it may not accept the contract even
for "automatic approval" if the field of industry is liberalized, much
less grant a validation if such is required. If the foreign party has
achieved an understanding with his Japanese partner, he need have
little to fear from letting him go to MITI alone, provided he is kept
abreast of happenings and that no final decisions or commitments
are made without his approval. It is often the case that MITI will
require a nensho, or memorandum, from the Japanese partner, agree-
ing to certain conditions. Such memorandums should never be
written without the knowledge of both parties.

As far as its relations with the government and, in particular,
with MITI are concerned, the foreign company should be aware of a
few cardinal rules which it must observe in its negotiations with
the Japanese partner:

1. The foreign company will not be allowed to have a great-
er percentage of directors than its equity warrants; in other
words, it will not be allowed to control the board of directors
if it has only a 50% equity interest.

2. If it is in a minority equity position it will not be allowed
to incorporate any rules which will give it a right of veto.\(^6\)

3. In licensing its technology to the joint venture, it will
not be allowed to include a clause limiting the area to which
goods may be exported except in very limited cases. It will not
be allowed to demand ownership of new technology; it will not
be allowed to demand grantback licenses where it does not
contract to grant licenses of new developments on its side.\(^7\)

As a general rule, the government will demand reciprocity and
equality in all matters relating to the JV, and possibly a bit more.
For a foreigner to think that because of outstanding technology or
strong financial position he will be allowed to dominate the new
company and also to obtain other privileges is wishful thinking as
far as Japan is concerned, and to try to do so only causes unnecessary
bad feelings and perhaps distrust.

Many foreigners try to make under-the-table agreements with

their Japanese partner which they do not report to MITI. Unless the Japanese party to the JV is very willing to enter such agreements, they really have no meaning and it is very doubtful if they would be upheld in a court. If the Japanese party ever reneges on such agreements, there is little the foreigner can do except get into a lot of trouble with the government by disclosing what happened because it should have been reported in the first place.

IV. STAFFING AND MANAGING THE JV

A difficult problem for the foreigner will be how to staff the JV. The Japanese partner will seldom have problems in this area and will probably propose to take care of all staffing problems himself. In this way he doesn't have to deal with the foreign party at all except to send him reports from time to time on how matters are developing. A number of such joint ventures were formed in the 1950's and are commonly known as "licensing joint ventures." They suited the Japanese thinking of how things should be done very well since the new JV usually ended up as a department of the parent company. However, they rarely paid handsome dividends to the foreign party. This kind of JV is no longer popular for obvious reasons.

A second and, to my way of thinking, an equally, if not more, undesirable type of JV is one based on the shukko system. Under this type of arrangement, personnel from the Japanese parent come to the JV on transfer for two or three years and then return to the parent company. If foreign personnel are in the JV the same is probably true. The net result of this is that the JV never will have personnel of its own, except perhaps the president, and for all practical purposes will not really exist as a viable entity.

To understand the above statements it is necessary to digress a little bit to deal with the attitude of Japanese employees toward their company. Most employees in Japan join the company after leaving school, whether it be middle school, high school, or college. After that their lives are bound up with the company, and, in their thinking, the company is number one, and then perhaps come their wives, families, etc. They belong to the company, look on it with pride, and are assured that under the prevailing seniority (nenko) system they will gradually climb the ladder of success and that the company will take care of them and their families. If they are not

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8 BUSINESS STRATEGIES FOR JAPAN, supra note 4, at 104.
very productive, they may fall off the ladder a little and be transferred to a satellite company, where they will again move up, although no longer in the mainstream. Any separation from the head office (honkan) is looked upon with disfavor, even an assignment overseas, which, from any Western way of thinking, would seem to enhance their chances of promotion. The result, therefore, is the uneasy feeling of the Japanese employee when he is transferred to a JV in which a foreign party is involved. To some it is like being sent to Siberia; they mourn their ill luck and can never really give of their best to the JV. Often they will be disgruntled, and the general morale of the JV may be very low.

For the reasons stated above, I think that great attention should be paid to the staffing of the JV. In the beginning, it will probably be necessary to have considerable help from the Japanese parent in finding suitable staff; it may even be necessary to employ the shukko system on a limited basis. However, as time goes on, it should be possible for the JV to employ its own staff, and interference of the parent in this field should be terminated as soon as possible. Hiring a permanent staff for the JV should not be the role of the Japanese parent; it should be the function of the management of the JV itself. By doing so, the management of the JV will choose people with whom they themselves can work, and they will gradually be able to build up a spirit of loyalty to the company and good morale.

Any foreign company intending to stay in Japan over a considerable period of time should make sure that its thinking on this is clearly understood from the beginning and that the Japanese partner will cooperate in carrying it out. Failure to do so will have a serious effect on the JV itself; it will probably lead to a certain amount of friction among the Japanese and foreign parents, and in the long run will probably result in diminished returns for both. The importance of loyal and harmoniously-working personnel to a Japanese company can hardly be overestimated. Suffice it to say that lacking such a situation no company can survive very long in Japan.

Depending on the nature of the products to be handled by the JV, it will be relatively easy or difficult to put together a group of men to manage the company. The president of the company will usually be Japanese, since this is one of the positions that the Japanese strongly push for, and probably justifiably so, since the company is to be a Japanese company. The directors will be split according to the equity holding ratio of the partners to the JV, with the position of representative director or general manager going to
the foreign party. Holding one of these positions gives the foreign party a considerable amount of control over the running of the company as the day-to-day operating of the company will usually be the task of the representative director or the general manager. Very often in Japanese companies the position of president carries very little extra authority, since a great deal of his job is usually to put his seal on decisions already reached at middle and top management levels.

A fact which may surprise the foreign partner is the number of directors the Japanese partner will suggest. Among leading industries in Japan, the average size of the board is 14.4 members, much higher than the corresponding figure in the West. The foreign partner may think this is ridiculous and object. However, if he is intelligent and does his homework, he will find that many of the positions on the board of directors are merely honorary positions with little salary, and, hence, there is no need to worry unduly about a few extra heads. The foreign partner’s only problem will be to select an equal number of directors from his side to compete with the Japanese; he may be forced to pack the board with lawyers, accountants, and other professionals based in Japan, instead of sending people over for every meeting to ensure that his voting power will be upheld.

A position to which the foreign partner should pay great attention is that of auditor. The position of auditor in a Japanese company is usually only nominal, often being filled by a non-professional with little financial background, and bears little weight in day-to-day running of the company. However, in view of the fact that Japanese accounting practices are notorious for their lack of uniformity and expertise, the foreign partner will be well advised to see to it that this position is upgraded and that standard methods of accounting are used in addition to monthly progress reports and cash flow statements.

Insisting on competent auditors is also a means of ensuring for the foreigner his rightful share of dividends and royalties, which a number of joint ventures have failed to obtain, not always because of blatant fraud, but more often because of outdated and incompetent accounting methods.

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9 T. Adams & N. Kobayashi, The World of Japanese Business 281 (1968); see also R. Ballon, Top Executives and Company Presidents in Japan (Sophia University Socio-Economic Institute Bulletins No. 27, 28).
Having taken care of the directors and auditors, the next most important thing will be to find men for heads of the various departments and sections. It may be necessary to draw on outside sources for some of these men, as the Japanese parent may not be able or willing to provide them on a long-term basis, especially if the JV is expected to grow to a considerable size.

In choosing these men, it will be necessary to proceed with utmost care, because they will be the important decision makers in the company. Drawing from outside sources in itself presents problems because, depending on the number of different companies from which they are taken, the varying management philosophies will be increased. Each Japanese company has something unique in its management philosophy, and bringing together a number of men from different companies and moulding them into a homogeneous group can present enormous difficulties. It will take a wise president and representative director or general manager to combine the talents of these men, form them into a decision-making group on the basis of the Japanese ringisho system, and ensure that personal jealousies, prejudices, etc. will not interfere with the success of the JV. Sometimes it is said that such a task is impossible and that the joint venture will never have a good middle and upper management staff until the second generation of managers takes over, i.e., the men who joined the company straight from school and matured into management talent. However, the JV can't wait that long, so, in order to operate in the beginning, particular emphasis should be placed on the homogeneity of middle and top management so that they, by forming a cohesive group, may be able to create the morale and leadership necessary to guide and form the rank and file workers.

Special attention should also be placed on the selection of foreign personnel for the JV. Although it is not likely to occur, foreign personnel should, as much as possible, be kept out of line management and be confined to staff or advisory positions. The reason for this is that it is difficult to understand the Japanese ringisho method of decision-making, whereby decisions are formulated at middle or lower management level, and, through a series of discussions and placing of seals, these decisions find their way up the ladder right to the top where they are given the final go ahead and implemented. A foreigner directly involved in this process of decision-making may cause unnecessary disharmony. If, on the other hand, he is involved in a staff or advisory position, he can communicate
his thinking privately to an individual or individuals on the decision-making ladder who are in a position to influence the final outcome.

A foreigner with weight of years and experience is probably more suited for this kind of position than one who is young, because years and experience count much with the Japanese elders of the joint venture. Relations between foreigners and Japanese in a JV will always cause a certain amount of friction, but choice of proper men, properly initiated, will help to avoid many of the inherent problems and, in the long run, may contribute much to the success of the venture.

V. SOLVING OPERATIONAL PROBLEMS

Having gotten management and personnel together, the problem now remains of how to run the JV. The uninitiated foreigner may find that many of the things taken for granted in Western business practices are quite different in Japan. These problems may not arise too seriously in the JV because of the participation of Japanese on an equal footing with the foreigner, but most of them are bound to come up for heated discussion at one time or another. Among these problems are likely to be the following: market share v. profit; to owe v. to own; and living with the Japanese distribution system.

Market Share v. Profit

In the world of Japanese business, market share is regarded as the measure of success. For this almost everything else will be sacrificed, including the financial stability of the company. To be able to hold or increase one's market share is a sign of the prosperity of the company and enables the company to keep its status among its competitors. To loose one's market share, on the other hand, is an ill omen which may cause the resignation of many top personnel.

In the West, and particularly in the United States, while market share is important, there is another more important factor, the profitability of the company. Western companies plan to increase their market share, but they seldom succeed, except perhaps in the very early stages of market penetration. One of the main reasons for the Westerners' insistence on profit is their consciousness of the reaction of their shareholders.

Trying to find a happy medium between these two quite different philosophies will not be easy. To the Japanese, doing business
solely for the sake of profit has a bad connotation, whereas, to the Westerner, not to do so is stupidity. Both have their good points and also their bad points. The Japanese can point to the failure of Western goods to penetrate overseas markets as a failure of the profit-approach system, which results in their goods being overpriced. The foreigner can point to the numerous bankruptcies among Japanese companies, placing emphasis on the famous Yamaichi failure in 1964, as being the result of poor internal financing, which, in turn, resulted from profit levels which did not allow the building up of substantial retained earnings. The joint venture may have to follow a compromise approach that allows for slightly lower market penetration than the Japanese would have liked, and slightly lower profits than the foreigner would have wished for. In general, foreign affiliated enterprises tend to be more profitable than other Japanese enterprises, which probably means that the foreign partner usually succeeds in convincing his Japanese partner of the need for profit, although maybe not quite as much as he would like.

To Owe v. To Own

Closely allied to the problem of market share and profits is the problem of corporate financing. If the Japanese partner is given free rein in running the JV, he will probably, before too long, bring it on to a par financially with the average Japanese company, which has a debt/equity ratio of about 6:1; in some cases the debt/equity ratio runs as high as 11:1, as was the case with Idemitsu in 1966. In the United States, on the other hand, the debt/equity ratio of the average company would be about 2:3; should it fall below 1:1 the particular company would be considered a poor financial risk and would have great difficulty obtaining loans from financial institutions, unless it were considered a vital industry.

The foreign party will find it hard to agree with his Japanese partner on the financial management of the company, because to him, with his Keynesian background, the general financial policies of Japanese companies are heresy. However, he may soon come to realize that the Japanese method of financing is not as bad as it seemed at first sight. If he pursues the matter, he will find that, while about ten thousand Japanese companies go bankrupt every year, very few of these are large companies. As a matter of fact,

10 FOREIGN ENTERPRISES, supra note 2, at 29.
11 BUSINESS STRATEGIES FOR JAPAN, supra note 4, at 58.
80% of all bankruptcies occur in enterprises with less than five million yen (U.S. $17,000) in capital. If he studies further, he will find out that within the particular company groupings mentioned earlier there is much mutual cooperation and the members will seldom allow an individual company to go bankrupt, mainly because of the interwoven stockholding relationship that exists in the groupings. He will also find that banks in Japan are much more liberal with loans than those in the United States or Europe, and that banks and business in Japan, although not as closely joined together as they were in pre-World War II days, still have many common interests. When a bank makes a sizable loan to a Japanese company, it often insists on placing one of its employees on the board of that company, or at least in a responsible managerial position. In this manner the bank can carefully watch what the company is doing, and the company is unlikely to object, first, because it needs the loan and, secondly, because it is receiving free financial advice; this may not be popular in their outdated accounting department, but it will probably be of immense value to the company in the long run. If the foreigner delves even further and touches upon the economics of the situation, he may come to agree with Abbeglen that borrowing is a cheaper way of financing than issuing shares: interest on loans can be written off as an expense, whereas dividends are paid out of after-tax profits, the net result at the present approximately 48% tax rate on corporate profits being that company costs for a 10% loan would be almost the same as paying 5% in dividends on the same amount of equity investment, except that in the former case 10% would be more than adequate, whereas in the latter 5% in dividends may not attract many investors.

Having found out all this, he may change his mind a little bit and admit that there is some merit in the Japanese system, although he is hardly likely to go so far as to admit that the 11:1 debt/equity ratio of Idemitsu in 1966 is a healthy sign. Further, if he studies the behavior of other foreign enterprises in the Japanese mar-

13 BUSINESS STRATEGIES FOR JAPAN, supra note 4, at 63.
ket and compares their financial behavior with that of Japanese enterprises, he will find that, while there are notable differences in capital composition, foreign companies' financial behavior in Japan is much closer to that of Japanese companies than it is to that of their parents in the West, and few, if any of them, go bankrupt. Of course, everyone, except the government, knows that there is one big difference: loans by Japanese or foreign banks to foreign affiliated companies in Japan are usually guaranteed by the foreign parent with a branch of the lending bank overseas. This situation helps to keep foreign affiliated companies in Japan independent from the bank control and guidance that is a daily occurrence with their Japanese counterparts. Perhaps the financial situation of the JV won't be so bad after all, especially if viewed from the alternative methods of financing — increasing capital or lending directly from the foreign parent — either of which would subject the company to considerable government surveillance insofar as government validation would be required for each capital increase or loan, a procedure not likely to prove enticing to the foreign partner.

Yes, it is necessary to own your company rather than have it controlled by banks or other financial institutions, but why not own it using a little bit of Japanese know-how, backed by foreign capital from abroad.

Living with the Distribution System

Ripley's "Believe It or Not" section in The Japan Times (October 9, 1971) says:

The Memorial in Liège, Belgium, to Vincent de Beuron, who defended the city against an enemy siege in 1468, is a steep stairway of 407 steps symbolizing his efforts to lift the spirits of the people.

I think such a memorial would be fitting for any foreigner who could master the Japanese distribution system, except that the stairway in this case should not be an evenstep, straight stairway but one with large steps (symbolizing the trading houses), medium-spaced steps (symbolizing the medium-sized wholesales), shorter than medium-sized steps (symbolizing the smaller wholesalers), very many short jagged steps interspersed here and there (symbolizing the ringisbo system of decision making in operation within each institution at each level), and, finally, a number of twists and turns to accommodate obligations of giri and trying to avoid offending people. A few obstacle courses should most likely be added to indicate the

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14 FOREIGN ENTERPRISES, supra note 2, at 34.
traffic logjams that build up on the Japanese highways through which most goods must pass at one stage or another on their way to the ultimate consumer. The only question would be about the sufficiency of 407 steps to describe the system in detail.

It would be a considerable understatement of the facts to say that the Japanese distribution system is rather complex. The numbers alone are quite staggering, with 280,000 wholesalers and 1,390,000 retailers, a fact which puts the complexity of the system in focus.\(^{15}\) The basic system is as follows: the Japanese manufacturer disposes of his goods through a principal wholesaler, usually referred to as the *dai-ichi tonya*. Depending on the product, the principal wholesaler either sells directly to very large consumers, as in the case of heavy industrial goods, or he works through secondary, tertiary, and possibly many other levels of wholesalers before the goods finally reach the retail outlets and eventually the consumer. Because many of the intermediary wholesalers will be rather small and, in typical Japanese fashion, poorly financed, the *dai-ichi tonya* will be responsible for financing on a reasonably long-term basis and, hence, will need large amounts of capital to keep the system above water. The wholesalers, in turn, are often responsible for financing retail operations, advertising, in-house displays, etc. Of course, the operation never runs so smoothly because down the line of the distribution channel many other relationships of blood or *giri* enter in which sometimes prevent the choosing of the most efficient channel and, on occasion, even compel the acceptance of a very inefficient channel of distribution. Such is the operation of the fairly standard distribution system.

However, for the manufacturer that is not the end. Unless the primary wholesaler with whom he is associated is of abnormal size, it is unlikely that he will have access to the whole of the Japanese market; those parts not taken care of will have to be attended to by the manufacturer's own sales outlet, through which he will deal with various regional or local wholesale outlets. In addition, as in the case of one bean paste company, he will have his obligations of *giri* and blood to fulfill which will require him to take under his wing many relatives of the president, school friends, and former business associates, most of whom are a liability rather than an asset. Furthermore, he will have to put his own salesmen into the field to ensure that his product gets the attention and PR that it should get and which the wholesaler system will not normally provide. As

a method of physical distribution, the wholesaler system, especially that of the larger wholesalers, is extremely efficient, but as a method of selling it is not to be relied upon, at least for goods that need a lot of consumer-directed sales promotion.

When the foreign partner to the JV first hears of the intricate distribution network of the Japanese parent, which would be the logical outlet for the products of the JV, he will probably be flabbergasted. In the back of his mind he will most likely be thinking of the streamlined system of the West, in particular of the United States, where most wholesalers are located in the large cities and communications with retail outlets, which are less than half as numerous in relation to the population as are those of Japan, are excellent. He will also be very conscious of cost minimization and the critical path scheduling (CPS) techniques he learned at school and put into practice later. Perhaps in relation to his thinking on CPS he should also cast a thought on the other related word, GIGO (which means "if you put garbage in, you get garbage out"), because in relation to the Japanese scene that is probably what he may want to do.

There are few similarities between the Western system of distribution and that of Japan. The Western system is simply to get goods from the manufacturer to the consumer by the shortest, most efficient, and cheapest route and to get plenty of them there at the highest level of profit possible. If anyone doesn't perform up to certain high standards, he is dropped, and he understands even though he does not like it. The human element seldom enters the picture. There are good discounts for everyone involved and little sympathy for the loser. In Japan it is almost entirely the opposite. You go through a particular channel because of past relationships; you subsidize, advise, and in every way possible maintain good relations with each link in the chain, and, unless there are exceptional reasons, you rarely drop a link in that chain. The human element is everything, and profits are very thin, or, as is said in Japanese, "as thin as paper."

However, things in the distribution system of Japan are changing. It is no longer monopolized by a few large trading houses, as it was in the past. Big manufacturers have tried and succeeded in setting up their own distribution systems, partly along traditional lines, partly with the Western concept in view. Supermarkets, chain stores, and department stores have boomed and left their imprint on the distribution system by cutting out many of the middle men.
Even some foreign companies, such as Coca-Cola, have succeeded in establishing an independent distribution system. Still, with all this change, the traditional system is deeply entrenched and almost defies all efforts of modernization. The traditional system, and probably it alone, is the key to reaching most of the 1,390,000 retailers, more than 90% of which have four or less employees.\textsuperscript{16}

The foreigner would be well advised to look at both sides of the distribution system before pushing his Japanese partner too hard. He may think the JV can become another Coca-Cola, but he should also remember Heinz and Safeway, which tried and failed dismally.\textsuperscript{17} He can, however, do much to help his Japanese partner modernize and update his distribution system if he takes the correct approach and uses Japanese examples of modernization rather than United States examples. Starting the JV is a wonderful opportunity for doing this because later on it may prove too difficult. The foreign party should use the traditional system as the basic pattern, but do like many Japanese companies have done: knock off some of the unproductive elements, or should I say don't include them, introduce a more positive approach to consumer orientation, and, above all, consult and get the understanding of all concerned about what you have in mind so as to keep the human element alive and not to be branded as a "monopolistic distributor." If he does this the foreigner can be reasonably sure that his efforts and those of the JV in getting its products to the consumer will be successful. Don't underestimate the distribution system and treat it tenderly.

VI. "FREE" MARKET

At last the JV has finally managed to iron out all its problems and there is harmony in the group. The foreigner has now become an expert on Japan and gotten absolute concurrence from his Japanese partner on mutually agreeable and profitable methods of operating, staffing, etc. The products of the JV will go forth to the Japanese market and also to the outside world in exports, a point which is most pleasing to the Japanese government. The JV will be a booming success within a few years. For the foreigner's sake I hope it is a success, but not too much of a success in the sense of capturing too large a share of the local market too soon. If it does there may be problems.

While foreign capital affiliated enterprises account for 1.5% of

\textsuperscript{16} ADAMS & KOBAYASHI, supra note 9, at 190.

\textsuperscript{17} Id. at 194-95.
total sales in the Japanese market, the number of them that hit the headlines of the local newspapers would seem to be grossly out of proportion to their sales or their numbers. Furthermore, it is seldom the unsuccessful ones that we hear about, but rather the successful ones who engage in all sorts of "unfair" business practices. Examples of these are Coca-Cola with its exploding bottles and, to add insult to injury, its flaunting of Japanese government regulations in doing business without a license in a product "said to contain acids harmful to humans"; Revlon with its inflammable hair spray; Maxwell House with its mercury-contaminated coffee; Pepsi Cola with its unfair premium advertising on bottle caps; and numerous others.

In addition, the joint venture that is "too" successful, or potentially so, may come in for an excessive amount of attention from MITI. It may even be asked to write a *nensho* promising to limit its market share; of course, this never hits the headlines. It may be blackballed by trade associations as an "imperialistic" enterprise or numerous other things may happen, all of which are just ways of telling the JV or the foreign enterprise to go slow and not to be so greedy.

It's a free market, but foreign affiliated enterprises mustn't upset the equilibrium of the Japanese market by engaging in excessive competition (*kato kyoso*). There is a certain kind of logic in this reasoning, and it should be regarded as very empirical logic by the would-be foreign partner to a JV. Recognize the reality, act accordingly, and all will be well! Don't stand out too much because there is a saying in Japan, "*deru kugi ga utareru,*" meaning "the nail that stands out shall be stricken." Don't be that nail!

**VII. DON'T BE A SHORT-TIMER**

Most Japanese don't like to work for a foreign company, and many of them don't like to work for a foreign affiliated enterprise. The principal reason they give for this is that it lacks security, which, to them, is often synonymous with permanency. While a lot of this thinking is based on a certain innate prejudice of the Japanese toward foreigners and things foreign, it cannot be said to be entirely without foundation. A number of foreign companies have, unfortunately, not been models of permanency: they enter the Japanese market when the going is good, and when things begin to slacken they pull out and leave their Japanese employees and those associated with them the poorer for having known them. While the
number of such enterprises is few, they make the environment much less friendly for others who may wish to come after them or who may be there already, as people willing and highly paid to publicize these shortcomings of foreign enterprises are not few.

Foreigners wishing to enter into a JV relationship should think in terms of permanency. They should establish their JV with their Japanese partners in such a way that it will have all the trimmings or permanency. Many of the ideas stated in this article will be relevant in this respect. The JV should not become a "division" of the Japanese parent, but should be an independent entity with its own land and buildings, the first sign of permanency. Its employees should not be shukko system employees, but, as soon as possible, should be its own hired employees who are given all the usual fringe benefits that employees of ordinary Japanese companies enjoy. These should include, where feasible, housing or dormitory facilities and retirement benefits, as well as the usual company trips and family-oriented programs. If possible, the JV should try to become a member of its industry's trade association, try to become involved in local projects, and, in particular, make every effort to gain a good image, because with many Japanese enterprises image is often more important than the goods they produce.

Should the JV fail to establish an image of permanency it will be regarded as a short-timer, and Japan has no place for short-timers. Its employees' morale will drop and its new recruits, if it gets any, will be either third or fourth-class beginners, or dropouts from other Japanese or foreign companies. Everything about the JV will foretell its early demise, which will probably not be long in coming.

If, on the other hand, the JV becomes a permanent entity in the Japanese industrial society, it will enjoy the fruits of diligent, hardworking, and devoted employees, who will not be lacking when needed. It will soon be able to take it's place with pride among successful Japanese enterprises striving to lead the world in their field, and it will contribute much, not only in monetary terms, but also in stature, to its parent organizations, both in Japan and abroad, which will mean more business and more profit, and that is what JV's are all about.

The road to a successful JV is not an easy one. It takes long and patient planning and a lot of hard work and uphill fighting, but, if it is successful, it will have succeeded not only in bringing two companies closer together, but in a small way two peoples with all their respective prejudices and shortcomings; a noble achievement indeed!