Portrait of Tomorrow's Trading Firms

— Summary of the final report
from a special research project of the same title
promoted by Japan Foreign Trade Council, Inc. —

Foreword

November, 1998

Today, the world is in the midst of momentous change. Japan, too, is in the process of ambitious structural reform for adaptation to the emerging climate in the international community. Reform breeds a new round of creation that can open up hopeful prospects for the world in the 21st century. In light of the currency and economic crises in Asia and the deceleration of the U.S. economy, it appears that the global economy is entering a phase of temporary adjustment. Nevertheless, historic developments such as the steady progress toward the unification of EU currencies suggest that the world market will reach an unprecedented degree of consolidation and magnitude with the arrival of the new century. This may be interpreted as excellent surety for the future that was finally obtained by humankind at the close of the 20th century, only after the bitter taste of the ordeals of the Cold War. At present, the Japanese economy is being confronted with its most critical test of the postwar period owing to a severe domestic demand drop in areas such as housing and personal consumption as well as to financial instability and a credit crunch. Precisely because "the rising sun also sets," Japan must push ahead with structural reform even if accompanied by some pain, so that "it may again rise" while remaining at harmony with the rest of the international community. I am convinced that the Japanese economy will rebound from the depths of the current recession and head toward recovery, and that the 21st century has a bright future in store for Japan's trading firms as well as its economy. Japan's presence in the context of the global economy is by no means small. While it is true that there can be no revival of the Japanese economy without the further advancement of the global economy, it is also true that there can be neither growth in Asia nor global economic advancement without this revival. As such, Japan's recovery and re-ascendance may be regarded as holding the key to advancement in the world as a whole in the 21st century.

The 21st century promises to be an age of megacompetition in which reform calls forth counter-reform, and creation, counter-creation. Ongoing advances in information and communication technology will result in an increasingly sophisticated coverage of all parts of the globe by networks. Regardless of their location on the face of the earth, all principals will be able to participate in markets through these networks and collaborate with each other in the generation of new business. The 21st century will be an age of cooperation as well as competition. Each time they have faced crisis situations, Japan's trading firms have thus far quickly responded to the trends in the business environment and undertaken programs of self-reform that made them even stronger. With its focus on reform and creation, the 21st century therefore should

present trading firms with rich prospects.

To exploit these prospects, however, Japan's trading firms will have to embark on another major program of self-reform. In the interest of prompt decision-making, for example, they will have to shift to flat, flexible organizations that are more resilient to change. They will also have to equip themselves with highly professional talent, identify fields offering good profits, and proceed to develop effective business in them. By arming themselves with strong, highly strategic powers as regards overall activities, planning, and information, tomorrow's trading firms will sweep away the boundaries between the Japanese and world markets, take full advantage of information networks to forge partnerships with able counterparts inside and outside Japan, and engage in a dynamic genesis of new business aimed at a worldwide market. And by so doing, they can discharge their role of producing more wealth for people, communities, and countries throughout the world.

Entitled "Portrait of Tomorrow's Trading Firms," this publication is a summarized English translation of an original Japanese manuscript compiling the findings of a special research project presided over by Professor Iwao Nakatani of Hitotsubashi University on the occasion of the 50th anniversary of the founding of Japan Foreign Trade Council, Inc.. We would be glad to receive any expressions of wishes, expectations, or criticisms concerning trading firms, not only from persons working for such firms or dealing with them as business partners, but also from all other readers inside or outside Japan, with the intention of taking full consideration of them in the future management of our firms and the activities of the Council.

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Chairman,
Japan Foreign Trade Council, Inc.

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Chapter I
Japan's postwar economic development and the role of trading firms

1. Trading firms in general

Known as "shosha," Japan's trading firms are wholesaling companies whose transactions center around trade. They include all-around firms dealing in various fields, firms dealing exclusively in a certain field, and firms affiliated with major manufacturers. According to the "Kigyo Katsudo Kihon Chosa Hokokusho" (Report of the Basic Survey of Corporate Activity) released by the Ministry of International Trade and Industry, they number around 2,000.

(1) Sogo-Shosha : Integrated (all-around) trading firms

There is no hard-and-fast definition of integrated trading firms.

Ordinarily, the term is applied to 17 firms that are members of the PR Committee of Japan Foreign Trade Council, Inc., a private non-profit organization. Nine of these firms are considered to have a "major" standing. Viewed from the standpoint of corporate affiliations, there are sometimes said to be six major integrated trading firms, i.e., three deriving from the prewar conglomerates (Mitsui & Co., Ltd., Mitsubishi Corporation, and Sumitomo Corporation) and three affiliated with banks (ITOCHU Corporation—called as C. Itoh & Co. till 1992—, Marubeni Corporation, and Nissho Iwai Corporation, affiliated with Dai-ichi Kangyo Bank, Fuji Bank, and Sanwa Bank, respectively). All-around trading firms share the following five characteristics.

First, they have enormous sales. The combined sales of the roughly 2,000 Japanese trading firms reach 165 trillion yen. Of this total, the nine integrated majors account for about 85 trillion yen, or over 50 percent. The combined sales of the nine therefore also amount to about 17 percent of Japan's GDP (see Figure 1).

Second, integrated trading firms handle a wide variety of goods and services. The biggest ones reportedly each sell from 20,000 to 30,000 items, these ranging in scope from materials

TABLE 1. The Performance Scale of Sogo-Shosha (MARCH 1997)

	Sales (trillion yen)	Ordinary Income (billion yen)	Capital Stock (billion yen)	Numbers of Employee	Numbers of Consolidated and Associated Company
①ITOCHU Corporation	14.2	51.7	174.7	6,999	1,007
②Mitsubishi Corporation	11.9	71.3	126.6	8,794	567
③Marubeni Corporation	13.5	15.9	194.0	6,386	662
④Mitsui & Co.,Ltd.	13.3	64.1	289.9	7,783	894
⑤Sumitomo Corporation	12.7	107.7	169.4	5,931	653
⑥Nissho Iwai Corporation	7.8	22.3	102.9	4,330	516
⑦Kanematsu Corporation	2.9	3.6	41.0	2,347	229
⑧Tomen Corporation	4.7	16.9	49.8	2,795	479
⑨Nichimen Corporation	3.5	17.5	52.2	2,216	272
Total	84.5	371.0	1,100.5	47,581	5,279
Average	9.4	41.2	122.3	5,287	587

DATA: EXECUTIVE BOARD OF DIRECTORS LIST.
MARKETABLE SECURITIES REPORTS.

and supplies in various fields (including textiles, machinery and information equipment, metals, energy resources, chemicals, foodstuffs, lumber, general commodities, and construction) to consumer goods, producer goods, and services. The integrated firms truly handle everything from mineral water to satellite communications.

Third, they share a diversity of types of transactions. Sales fall into the four broad categories of domestic, export, import, and third-country transactions, but the actual dealing takes more varied and complex forms.

Fourth, they are all equipped with a variety of capabilities for discharge of a variety of functions. Besides ordinary commercial transactions, these include project investment and formation, financing, information, distribution, and risk assumption. Furthermore, they have a synergistic power that comes from exercise of these capabilities in combination.

Fifth, integrated trading firms have global networks. Along with the overseas expansion of their business, they have planted locations in other countries and organically interlinked them. These networks have been at the source of their powers of information gathering and their synergistic strength. In sum, they each have established business locations of some type and interwoven them into a network covering the globe.

(2) Profile of trading firm business in each division

Japanese trading firms are engaged in a genuinely diverse business. This section profiles this business in terms of division (i.e., business field).

*** Machinery**

The main items handled in this division are shipping, industrial machinery, construction machinery, aircraft, automobiles, and plants of various kinds, including petrochemical, electric power, steel, cement, and sea water desalination.

In their shipping business, trading firms export cargo ships, container ships, oil tankers, tankers for liquefied petroleum gas (LPG) and liquefied natural gas (LNG), and other types of vessels. They also export construction machinery to China and other Asian countries while importing machinery used in the paper and pulp industry and foodstuff industry, as well as construction machinery such as giant cranes, from Europe and North America. The latter are also the sources of import of precision equipment, medical apparatus, and machine tools.

In the aircraft business, trading firms act as agents for foreign manufacturers and import passenger planes, small aircraft, helicopters, and other craft per se as well as spare parts for the same. They also purchase such craft themselves for development of a global business in leasing to customers around the world.

In the automotive field, activities are by no means confined to the import and export of vehicles and components; they extend to participation in projects for siting of sales offices and production plants by Japanese manufacturers in other Asian countries, Europe, and Latin America and the preparation of locations for sales of imported models within Japan. The demand for automobiles is relatively stable in the developed-country markets but is steadily expanding in Asia as well as Latin America and Eastern Europe. To meet such demand, manufacturers are attempting to develop uniform worldwide models while promoting the siting of production and sales locations in the optimal places across the globe. To assist these efforts, trading firms are deploying carefully tailored regional strategies. They are committing their financial and human resources in collaborative investment in the area of Asia, Eastern Europe, and Latin America; acting as dealers in North America and Western Europe; and helping to cultivate markets in other regions.

In the field of plants, activities center around the formation of projects based on international consortiums. Trading firms are also engaged in a multifaceted business including buying out the products turned out by the plants upon their completion (such as petrochemicals, petroleum products, cement, and steel goods) and exporting to other markets. The global demand for plants exhibited an expansion driven by developing countries in Asia and other regions beginning in the late 1980s. The next ten years as well hold the prospect of burgeoning demand associated with infrastructural conditioning in China and other Asian countries. Trading firms are already deeply involved in machinery and plant business related to independent power producers (IPPs) in other Asian countries, but it should become increasingly important for them to have a package capability for all phases from project organization to the actual operation. In addition, the forging of alliances with optimal partners across national and industrial borders is indispensable for dispersion of risk in infrastructural projects, which are acquiring longer terms and larger scales. In these and other ways, business is offering more occasions for demonstration of the organizing capabilities of trading firms.

*** Information and multimedia**

In this field, trading firms sell communications and electronic equipments, information-related electric products for the home, semi-conductors, and computer software, while also developing new business and enterprises involved with information and communications. Furthermore, they are putting resources into the areas such as the information infrastructure, entertainment contents, mainly through participation in satellite and cable network business. It might be added that they are engaged in communications business overseas, chiefly in other Asian markets.

The multimedia field has promising prospects for evolution into a leading industry in the 21st century. Thanks to the fast-paced trends of deregulation, technological advancement, and international corporate alliance and reorganization, it is becoming the field of greatest activity, even on the global scale. Although U.S. firms pioneered it, the Japanese firms began to gain ground upon the deregulation of the domestic telecommunications market in 1985, and their business domain has steadily broadened in the 1990s owing to the rapid spread of cordless telephones and personal handy-phone systems (PHSs), cable TV deregulation, and the initiation of multichannel digital broadcasting applying communication satellites. Trading firms already have from 20 to 30 years' worth of experience and know-how in computer-related business including sales of hardware and software and provision of information processing services.

In the field of information and communications, they are building on this foundation in making investment participation and functioning as agents for the new common carriers competing with the recently privatized Nippon Telegraph and Telephone while organizing alliances with Western counterparts. And in that of satellite business, international communications, and cable TV, they have played a leading role in the creation of new business through activities beginning with infrastructural investment and continuing with operation and establishment of firms. The 21st century should witness the emergence of a huge multimedia market due mainly to the fusion of broadcasting and communications and to the diffusion of Internet. Trading firms will presumably have to make even more aggressive investments in this business and exercise their powers in all areas, from infrastructure to contents, to the hilt.

*** Metals**

In the field of metals, the trading firm assortments includes steel-making materials (crude carbon and iron ore), steel products (steel for construction, shipbuilding and plants, and automobiles), and non-ferrous metals (such as aluminum, copper, zinc, nickel, tin, and other base metals, as well as precious metals such as gold, silver, and platinum).

The nine major trading firms are involved in about 75 percent of Japan's total import of coking coal and about 80 percent of that of iron ore. They import mainly from Australia, Canada, the United States, South Africa, and Russia for the former, and Australia, Brazil, and India for the latter. Their involvement spans the phases of mine development, mining, financing, assurance of demand, conditioning of the infrastructure (of roads, harbors, etc.), and transportation. As for steel products, besides engaging in import and export, they have established sales and processing firms in the United States and other countries in order to provide goods adapted to the needs in the market. For the future, trading firms are likely to build efficient end-to-end systems in this field extending from upstream areas such as quality resource development to downstream ones such as manufacture of steel products, coil center operations and other processing, and construction of sales networks. In addition, they could freely combine materials suppliers, manufacturers, and contractors for closer accommodation of market requirements. In these and other ways, they will be able to open up new markets and generate new business, and on a global scale. To this end, it will be important for them to strengthen and refine their powers in all sorts of aspects, including information gathering, business development, trading, marketing, and business creation.

The main non-ferrous metals handled by trading firms are copper and aluminum.

In this segment, the firms promote a wide range of activities, including participation in projects for mine development and overseas refining; import of base copper metal, copper ore, and aluminum ingots; and sale of copper wire and pipe, electric cable, electronic components, aluminum building materials, aluminum cans, and other aluminum products. They are also engaged in import of precious metals, options (futures) transactions for the same, and sale of jewelry. In this field, trading firms have made the most of their global information networks; rich knowledge of products; financial might; and capabilities for new business planning and investment, risk management, trading, and sales in order to secure a stable supply of materials, vend products, cultivate demand, and adjust demand and supply. They have played a particularly critical role in the segment of non-ferrous metals, for prices which fluctuate greatly with the conditions in the market; specifically, they have hedged risks by dealing through LME and other measures taken in commodity exchanges. This kind of function is likely to assume increasing importance.

*** Energy**

Trading firm activities in this field basically fall into two categories: assurance of resources and distribution. They include exploitation of overseas deposits of crude oil and natural gas, import and domestic sale of crude oil and petroleum products (i.e., gasoline, naphtha, kerosene, diesel oil, heavy oil, asphalt, and LPG), management of filling stations, operation of oil terminals, operation of tankers, domestic sale and export of fuel for ships, import and handling of fuel for nuclear power stations, and third-country transactions for crude oil and petroleum products.

Japan's oil industry is being affected by changes including the liberalization of the domestic market, drop in gasoline prices resulting from the progress of deregulation, and the squeeze on the profits from "motouri" oil companies to the firms acting as sole agents for sales of petroleum products in Japan. This is making it harder for trading firms to continue relying on brokerage in this business. To cope with such a situation , they are working to strengthen their capabilities through expanded project investment for which they themselves assume the risk. More specifically, they are undertaking a rigorous rationalization of sales and distribution including possession of oil and gas themselves in the upstream sector, improvement of logistics for transportation of energy resources after they have been mined, and development of large Western-style service stations in Japan. The global demand for energy is anticipated to show further expansion driven by the Asian region. This should make the trading firm activities in supply of energy resources to overseas markets even more vital.

* **Chemicals**

In this division, the chief categories of products handled by trading firms are organic chemicals, inorganic chemicals, and synthetic resins. Activities encompass capital participation in overseas ethylene centers, import of petrochemicals and alcohol for industrial use, export of raw synthetic fiber, triangular transactions for western petrochemical products, and production of polyvinyl chloride (PVC) and polyethylene terephthalate (PET) resin in China and other Asian countries. Trading firms are also moving downstream into business directly linked to the consumer. Examples are development and sale in areas such as containers for ready-made lunches sold in convenience stores, vinyl bags for use as supermarket check-out counters styrofoam containers, video tape, animated cartoon and movie software, and even Christmas trees (based on an OEM tie-up with a Canadian firm). There are large regional gaps in respect of chemical supply and demand, and trading firms discharge a major function by helping the two ends meet. They have brought various capabilities to bear in order to link suppliers and customers. While continuing to emphasize the domestic market and Asia, their strategy for the future will probably turn on the streamlining of distribution, project investment, and reinforcement of local sales capabilities on a global scale in order to provide goods and services tailored to the needs of customers and consumers in each market.

* **Life industries**

The major product segments in this field are foodstuffs (and particularly feed such as corn, wheat, and soybeans), food products (seafood, vegetables, sugar, coffee, cocoa, oils and fats, livestock products, fruit, canned goods, noodles, seasonings, and alcoholic beverages), and materials and supplies (e.g., lumber, paper pulp, cement, glass, tires, ceramics, and sports gear). In the area of foods, trading firms play a multifaceted part. They import not only foodstuffs such as grains and raw sugar but also semi-processed goods such as juice and final products such as canned foods, wine, and beer.

In addition, they export Japanese-made beer, invest in business in brewing and sale of beer in China, manufacture sugar and other products in Japan under their own brand name, and handle the processed foods of domestic manufacturers. In certain segments, they have built schemes for global integration joining sites of production and sites of consumption. In the grain business, for example, they own silos in the United States and Australia to serve as the collection and storage depots. And to receive shipments in Japan, they also own large grain centers which, in turn, ship small lots to customers.

The global supply of food is forecast to tighten in the future. A particularly big increase in consumption is anticipated in China and other parts of Asia due to population growth and rising income levels. Trading firms will have to harness their expertise in trade, transportation, credit, information, risk-taking, stable supply, marketing, and other aspects in order to address food problems from a perspective that is not confined to Japan but extends to the rest of the world as well.

In the area of lumber, trading firms import and sell pulp wood, plywood, and construction woods of the southern territories called luan, the North Americans and the Russians in varieties. In that of paper pulp, they are pursuing projects overseas together with Japanese paper manufacturers. They expanded their business to imports of logs and sawn lumber in response to the increase in demand for lumber in Japan beginning in the 1960s. They have also participated in investment in forestry development and forestry product companies, and rationalization of lumber transport and distribution. Besides this business in ordinary sawn lumber, they are also involved in the development, import, and sale of plywood, chipboard, fiberboard, glued laminated boards, and various other construction materials. Outside Japan, they are actively taking part in afforestation projects to preserve forest resources, projects combining afforestation with business in paper pulp business using lumber from the trees, the development of glued laminated boards using waste lumber from rubber trees and other types of trees, and other business mitigating environmental problems. Activities of this type will undoubtedly assume increasing importance over the coming years. In the area of life/lifestyle materials and supplies, trading firms handle a broad spectrum of items including everything from the footwear, golf clubs, bowling gear, and other products of the top manufacturers of sports and recreational goods to substances such as cement, rubber/tires, glass, and furniture and other products for home interiors. In this field, too, they are expanding their domain and refining their capabilities through investment in overseas projects and alliances with foreign counterparts. Examples are joint cultivation of the market with overseas suppliers of shoes and a tie-up with a leading U.S. glass manufacturer for offshore production, import, and domestic sales of plate glass.

*** Textiles**

The assortment of textiles handled by trading firms extends from materials for textile production, such as silk, hemp, wool, cotton, and synthetic fibers to dyed woven fabric and items of apparel including men's wear, women's wear, underwear, gloves, socks, sportswear, casual wear, and fashion wear, and further to various other goods such as carpets, rope, sheets for construction work, and nets. In the area of fashion, they import and sell articles bearing the big-name brands of the West, and may even conclude licensing agreements to produce apparel themselves. They are also producing items such as shirts and pajamas in other Asian countries for import back to Japan.

Japan's textile industry underwent sweeping structural change in the wake of the 1985 Plaza Agreement. The sharp appreciation of the yen meant a plunge in export from Japan. While production within Japan has contracted, transplantation of the same to China and Southeast Asian countries has rapidly gathered momentum. Amid these changes, trading firms are not only deepening their involvement in production and distribution but also building up their abilities to come up with new projects by drawing on their information resources. They are also preparing global networks organically integrating production, distribution, and sales. The idea is to give play to their capabilities in the global arena by siting production and sales at the optimal spots on the globe instead of bringing the entire volume of textiles produced offshore back to Japan for sale. Business in local markets and triangular transactions should become increasingly important. Southeast Asia and China are making the transition from sites of production to sites of huge consumption, and it will surely become more and more important to develop business there in apparel (including famous brand-name merchandise) and other textile items of both the industrial and consumer types (for automobiles, construction, housing, etc.).

*** Construction and real estate**

Trading firms have a highly diverse development of business in this field. In Japan, they have hands in the construction and sale of condominiums, preparation of residential land, sale of detached housing, sale of imported housing, construction of office buildings and golf courses, resort development, hotel business, and franchise business for small and medium realtors. In China and other Asian countries, they are developing housing, office buildings, and large industrial parks. In the area of housing construction in Japan, the future holds the prospect of rising requirements as regards size and quality, response to the increase in single-member and aged households, and regional redevelopment spearheaded by the rehabilitation of urban condominiums. Trading firms will have a leading role to play in proposal of pleasant in-town housing with a global angle by, for example, designing model space for comfortable urban living with an European touch and promoting the construction and sale of imported housing units. Redevelopment projects represent opportunities for raising the quality of urban housing, and also give trading firms chances to show their skills in such areas as coordination of interests, consolidation of small and medium condominium complexes, and the offer of new ideas in residential urban space.

* **Financing, insurance, and distribution**

Trading firms are involved in financial business and venture capital funds, mainly in Western markets, and have also begun to handle both life and liability insurance in an agency capacity. Their activities in the area of physical distribution center around dispatch of ships and warehousing.

The financial business of trading firms is underpinned by their financing capabilities. Over the coming years, greater importance should be attached to financial business tailored to Asia and other regions, effective supply of funding for global growth industries (i.e., venture capital), participation in project financing (especially for infrastructural conditioning in Asia), procurement of funds for the entire group (including consolidated subsidiaries), and enhanced management of financial risk (through re-establishment of divisions as separate companies and transformation of head office units into pure holding companies). In conjunction with the decontrol of foreign exchange transactions, financial liberalization, and other components of the "big bang" of financial reform in Japan, trading firms are being looked to as new principals in financing. And with the approach of the computer network society, they will presumably also step up activities related to Electric Data Interchange as well as electric commerce transactions.

In the area of distribution and logistics, trading firms are likely launch efforts on fronts such as schemes of global integration linking sites of production and consumption around the world, building of systems for production and sales at optimal sites, and preparation of distribution centers and networks directed to China and other parts of Asia, which are making the transition into enormous consumer markets. Within Japan, they will have to meet the needs of the emerging distribution reform keynoted by developments such as steep price discounting, participation by Western retailers, and advances in multimedia technology. To do so, they may be expected to develop distribution and retailing business through investment in or alliances concerning, elements such as discount centers, category killers, power centers, drug stores, television shopping, and electronic commerce through Internet. In short, trading firms will probably explore ways of seamlessly linking all of their activities, from the upstream to the downstream sectors, by fully demonstrating their global synergy.

2. History of Japanese trading firms in the postwar period

Consideration of a few economic indicators shows that Japan today is one of the world's foremost economic powers. For example, in 1995, Japan's gross domestic product (GDP) per capita of population came to some 41,000 dollars, far above the corresponding figure of 26,000 dollars in the United States. Similarly, in 1996, Japan accounted for about 10 percent of the amount of global trade, with export worth 450 billion dollars and import worth 380 billion dollars. In the same year, its foreign currency reserves totaled an impressive 217 billion dollars. Nevertheless, a look back reveals that, just a half-century or so ago, the Japanese economy was on a diminutive scale which might never be imagined from its current size.

It was in 1955 that Japan emerged from the economic turmoil after its defeat in the Second World War and restored its economy to the prewar levels. In the same year, an economic white paper published by the Japanese government declared that the "immediate postwar period" had finally ended, but the scale of the Japanese economy was less than 1 percent as large as it is today. In terms of the aforementioned indicators, statistics showed figures of only 269 dollars for GDP per capita of population, 2 billion dollars for export, 2.5 billion dollars for import, and 700 million dollars for foreign currency reserves. The recovery and advancement of the Japanese economy over the last 50 years could not be discussed without considering the relationship with trade. For a Japan that is nearly devoid of natural resources, it would have been impossible to buy either the production technology or the external resources needed for economic growth without the foreign currency earnings from export of the products of its processing industries.

Japan's trading firms may be said to have progressed along with its trade and economy.

(1) From immediately after the war to the 1950s

Shortly after the end of the war, Japan announced official policy placing trade at the backbone of the national economy. Private sector trade resumed, albeit under limitations, in August of 1947, the second year after Japan's surrender. The exchange rate was fixed at 360 yen to the dollar in April 1949, and the government subsequently took various measures to promote export. The creation of the Ministry of International Trade and Industry in May of the same year was followed by the establishment of a series of export-supporting institutions, beginning with the Export Bank of Japan in 1950 (this was re-inaugurated as the Export-Import Bank of Japan in 1951), and continuing with the Bank of Tokyo and Japan External Trade Organization

(JETRO) in 1958 as well as export associations in each major product field. In the same period, the government installed provisions for tax deductions on export income, preferential financing for export, export insurance, and other systemic support for export.

By the same token, the days of control by the general headquarters of the occupation forces were also a time of great trial for trading firms. As a result of a GHQ memorandum issued to the Japanese government on 3 July 1947, the Japanese government ordered the dissolution of the Mitsui & Co. and Mitsubishi Shoji Kaisha, Ltd. (old name of Mitsubishi Corporation) effective 5 July. This was a harsh measure; the authorities would be satisfied neither with mere severance of their ties with the "zaibatsu" (financial cliques) that had spawned them nor with their division into several companies. Mitsui and Mitsubishi were consequently disbanded, but numerous smaller trading firms were later founded by their former employees. It might be added that Daiken Sangyo , the predecessor of ITOCHU Corporation and Marubeni Corporation, was covered by the GHQ instruction for dissolution and divided into the four companies ITOCHU, Marubeni, Kureha Spinning, and Amagasaki Seiteisho in 1949.

Japan's economic recovery was driven mainly by textiles and steel. While the all-around commercial firms formerly affiliated with the Mitsui and Mitsubishi "zaibatsu" families and headquartered in Tokyo were being stripped by the dissolution activity, those hailing from the Kansai region (greater Osaka area) began to come to the fore. In the textile field, great inroads were made by the firms Toyo Menka Kaisha., Ltd., Japan Cotton and General Trading Co., Ltd. (Nichimen), the Gosho Co., Ltd., ITOCHU Corporation, and Marubeni Corporation, which were collectively known as the "Five Kansai Cotton Dealers." And in the steel field, among the major players were the Nissho Co., Ltd. (which was descended from Suzuki Shoten and was the designated trading firm of Fuji Iron & Steel) as well as Ataka Sangyo and Iwai & Co., Ltd. (both of which handled the output of Yawata Iron & Steel).

The Korean War broke out in June 1950, and the related supply requirement of the U.S. military generated the Japanese economy to boom. However, this effect did not last long; hostilities were concluded in the following year, and many trading firms with fundamentally frail constitutions struggled in the succeeding collapse on the commodities market and economic slump. Nevertheless, events had reaffirmed the role of trading firms in spearheading the expansion of Japanese export, and the fourth cabinet of Prime Minister Shigeru Yoshida, which was instated in 1952, took steps to assist and reinforce them. Aid for the Kansai regional trading firms in the textile field that had been hurt by the plunge of prices for the three big commodities in the wake of the Korean War (i.e., rubber, leather, and oils and fats) was followed by the creation of a reserve fund for cancellation of export contracts, special depreciation system for the assets of overseas offices and other preferential tax measures, and an amendment of legislation governing export transactions (enacted as the Export-Import Transaction Law in 1953) for the purpose of preventing excessive competition. As a result, trading firms again stood in the vanguard of moves into external markets by other Japanese firms and played an aggressive role in the process.

In spite of the burgeoning demand, import initially was in effect under strict government control. This control operated through the system of foreign currency allocations imposed because of the shortage of the same. Manufacturers were given quotas under this system, and therefore held the initiative in import; trading firms merely performed import processing in accordance with their intentions and as their agents. This situation, too, was remedied when provisions were made for foreign currency holdings by trading firms in 1956.

Another hallmark of this period was trading firm consolidation. Upon the easing of the conditions of the aforementioned dissolution order in 1950, there arose new firms bringing together numerous smaller ones whose consolidation had been approved by the holding company liquidation committee. The revision also made it permissible to use the old “zaibatsu” names and trademarks. This led to the rebirth of Mitsubishi Shoji Kaisha, Ltd. in July 1954 and reconstitution of Mitsui & Co. in February 1959. There was also a string of mergers that paired Nichimen Co., Ltd. with Maruei, ITOCHU with Taiyo Bussan ,Toyo Menka with Kanegafuchi Shoji, Marubeni with Takashimaya-Iida, and Nissho with Hakuyo Trade. In 1952, upon a change of name by Nippon Kensetsu Sangyo, Sumitomo Corporation became the last of the leading all-around trading firms to make a fresh start after the war. The current of consolidation bolstered the foundation of trading firms while enlarging the scope of products they handled, and so raised their business to a higher level. The history of trading firms in the postwar period is sometimes said to be a history of reorganization, and this is evidenced by additional mergers, such as that of Kanematsu and Gosho to form Kanematsu-Gosho (present name: Kanematsu Corporation) in 1967 and that of Nissho and Iwai & Co. to form Nissho Iwai in 1968, when another merger formed Nippon Steel Corporation. Including ITOCHU’s absorption of Ataka Sangyo, the wave of consolidation activity lasted for more than 20 years.

(2) The 1960s

From the late 1950s to the early 1970s, Japan achieved strong economic growth at a rate averaging about 10 percent annually. During this period, its export increased at a pace far outstripping that of the growth of world trade. The share of the amount of global export occupied by Japanese export rose from 2.1 percent in 1955 to 6.2 percent in 1970. This surge in export from Japan was supported by the sizable increases in investment for production facilities by private firms as economic growth went into high gear. The investment led to massive production of quality goods at lower cost, a major improvement in the competitiveness of Japanese products in the international market, and a dramatic increase in capacity for export. Another important development in this period was the rapid rise of heavy and chemical industries in Japan’s economic structure, with great change in the export makeup.

Whereas textiles and other light industrial products accounted for the majority of Japan's export in 1955, the share occupied by the output of heavy and chemical industries topped 70 percent in 1970. Moreover, the corresponding 1970 share for household appliances, automobiles, and other such machine equipment taken separately was 46 percent.

Experts in the cultivation of external markets

In this period of high-order growth, trading firms played an important role, first and foremost in relation to import of production facilities and introduction of technology. Given the enormous appetite for facility investment in Japan's manufacturing industry, bringing the latest machinery and technology into Japan was the key priority. Trading firms actively addressed these needs by acquiring exclusive rights of distribution in Japan for the products of leading overseas manufacturers. The information-gathering capabilities of their overseas locations held the key to this end. They consequently set about beefing up their networks of locations around the world. The big firms came to have overseas networks consisting of about 100 locations each. Trading firms also augmented their corps of technical experts and worked to elevate their service capabilities, eventually acquiring an end-to-end proficiency in all related works, from import, financing, and installation of the latest machine facilities to negotiation and contracting for introduction of technology.

Armed with high technical and production resources in this way, Japan's manufacturing industry turned out a steady stream of new products. Disposal of these products generated a mounting need for development of overseas markets for them. Many manufacturers wanted to export their latest products but were projecting only limited sales initially and were not international competitive in aspects such as sales costs. In such cases, it was often more economical to have trading firms act as intermediaries, in light of their ability for hard-hitting sales making the most of their economy of large scale and far-flung overseas network. The international information-gathering and sales might of trading firms was a particularly vital advantage in the field of material-type products such as steel, chemicals, and textiles. Since the days of soaring growth to the present, therefore, export of such products has expanded on the basis of cooperation between manufacturers and trading firms. In export of automobiles and other types of mechanical equipment as well, trading firms worked with manufacturers in setting up overseas sales subsidiaries and making careful arrangements for marketing and after-sales service. This exercise of the capabilities of trading firms as experts in cultivating overseas markets was a major reason that Japan's balance of international payments went into the black within a relatively short time after the war.

Theory of trading firm decline

In the mid 1960s, as Japan achieved strong economic growth underpinned by trading firms, speculation about their prospective decline arose and created quite a stir. The main points of this theory were as follows.

1. With the continuing high-level economic growth, industrial capital will assume gigantic proportions, and manufacturers will increasingly force out wholesalers and come to control distribution themselves. Trading firms are nothing more than commission merchants and will gradually lose their place.
2. Once manufacturers build their own networks for sales in overseas markets, it will not be worth while to make use of those of trading firms.
3. To handle the products of heavy industries requires permanent sales channels and post-sales service networks as well as technical knowledge; the job can no longer be entrusted to trading firms.
4. The involvement of trading firms in all sorts of fields is complicating their distribution schemes, increasing their personnel expenses and interest charges, and causing difficulties in management and control. These phenomena are reducing profit margins; in this sense, trading firms are cutting their own throats.
5. Along with the rise of new consumer goods industries, trading firms are losing their past grip on distribution and will devolve into mere commission merchants.

Subsequent events proved this theory wrong. Trading firms greatly enhanced their performance by diversifying their functions and wielding a comprehensive capability attuned to the demands of galloping growth. From fiscal 1965 to fiscal 1974, the sales of the nine major ones increased by a remarkable 24 percent annually on average, far above the corresponding rate of 17 percent for the country's nominal GNP growth. Be that as it may, some of the theory's assertions drew attention to fundamental issues which trading firms were unable to resolve completely in the succeeding years.

Dawn of the age of mass consumption

The 1960s also heralded the arrival of the age of mass consumption by the Japanese public. A 1960 white paper on the national life called for a renovation of styles of living, and stage for the consumption boom was set around the same time by an increase in the number of white-collar households and influx of affluent home-life patterns from the United States. In Japan, as in the United States, the boom was spearheaded by demand for electrical products for home use. With the onset of the "consumer society," observers predicted great gains by supermarkets, as had occurred in the United States, and a number of the big distribution concerns, including department stores and railway companies, jumped into the business, one after the other. Trading firms also joined in the fray with the intention of getting footholds in the distribution industry. However, they lacked experience in running retail stores, and their presence consequently took various forms. These included capital participation in existing enterprises (by Mitsui & Co., Marubeni Corporation, Toyo Menka Kaisha., Ltd., and Nichimen

Co., Ltd.), establishment of a new enterprise in partnership with a Japanese retailer (by ITOCHU Corporation), and partnership with U.S. supermarket capital (by Sumitomo Corporation). As things turned out, supermarkets affiliated with trading firms virtually disappeared with the passage of time, but they enabled these firms to acquire a lot of experience and know-how in this field. Two that are still in business today are the Sumitomo-affiliated Summit and Sunny, which is affiliated with ITOCHU (Iwataya, a long-standing department store in the Kyushu region has a 60-percent interest; ITOCHU's share is 40 percent).

(3) The 1970s

In the 1970s, a stream of developments sent shock waves through the Japanese economy. U.S. president Nixon's 1971 decision to stop the convertibility of the dollar to gold led to the collapse of the financial order resting on the Bretton Woods Agreement and transition to floating exchange rate systems for developed-country currencies. In the autumn of 1973, the First Oil Crisis broke out when production restraints imposed by the Organization of Arab Petroleum Exporting Countries during the Fourth Mideast War pushed crude oil prices to 22.65 dollars a barrel, a roughly four-fold increase. In Iran, the Pahlavi regime was toppled by the Islamic Revolution of 1978, and an Islamic republic was instituted in April,1979. And in 1981, the Second Oil Crisis boosted crude oil prices to 34 dollars a barrel.

Criticism of trading firms

In this period, the big trading firms were subjected to a barrage of criticism from society at large that lasted roughly from late 1971 to early 1974. The criticism started with charges to the effect that speculators working for the big trading firms and banks (referred to as the "demon-children of Tokyo") had made a killing by selling dollars in huge amounts. These charges were taken up by the media and opposition parties, which put great pressure on the concerns in question. The backdrop for the flap was the growing uncertainty about the course of the dollar. It was in August 1971 that Nixon halted the dollar's convertibility to gold (an event known as the "Nixon Shock" in Japan), forcing Japan and other developed countries to revalue their currencies as they soared against the dollar. The Bank of Japan intervened in the market and made purchases to support the dollar, reportedly spending about 4 billion dollars doing so in the ten days after Nixon's announcement. In spite of this intervention, it was not able to keep the rate at 360 yen to the dollar. Subsequently, financial ministers from ten developed countries met at the Smithsonian Museum in Washington D.C. and reached an agreement on multilateral adjustment of par values. In accordance with this agreement, the rate for the yen was revised upward from 360 to 308 yen to the dollar. However, this was not enough to stop the dollar-based appreciation. The dollar fell against other major currencies again in 1973, and Japan and other developed countries decided to switch to a floating rate system in March of the same year.

In fact, trading firms had put great resources into export of large plants, and consequently suffered immense foreign exchange losses due to the decline in their long-term trade credits. In their financial statements for fiscal 1971 (ending on 31 March 1972), the top ten trading firms posted a combined exchange loss of more than 30 billion yen. The charges about big profits on the yen's revaluation were actually off the mark.

Another chorus of criticism arose shortly thereafter and lasted into early 1973. This time, trading firms were accused of igniting the swift rise in the cost of living by land speculation, commodity hoarding, and holding off from selling. The voices of the press and opposition parties were joined by those of consumer groups, certain members of the ruling party, and even administrative authorities (such as the Ministry of International Trade and Industry and the Fair Trade Commission). At the time, the country was generating excess liquidity in enormous amounts in the atmosphere of the strong yen and weak dollar, the surplus in the current balance, and very easy money. The situation was compounded by the wave of speculation in domestic real estate best exemplified by the land-buying spree that was triggered by the grandiose plan for "remodeling the archipelago" after the inauguration of Kakuei Tanaka as prime minister in July 1972. However, trading firms were not the only ones involved in the spree; numerous realtors, tourist businesses, railways, and other companies as well as individuals were caught up in the land-speculation fever. Indeed, a contemporary commentator quipped that the country seemed to be inhabited by 100 million realty dealers.

Around the same time, prices for primary products jumped worldwide, and Japan was compelled to pay much more for basic imported commodities such as lumber, wool, and soybeans. Trading firms were soon suspected of buying up such commodities and refraining from selling them. A fact-finding investigation conducted by MITI in response concluded that, although there was no definite proof, trading firms were open to suspicion of having hoarded, or rushed their purchases of items including wool, yarn, cotton thread, and raw silk thread.

Matters deteriorated in the autumn of 1973, when the First Oil Crisis struck and threw Japan into a frenzied price spiral. In April 1974, the head of the six leading trading firms were called before the National Diet to answer criticism of the activities of their firms during intensive discussion of what was to be done about the soaring price of goods. Among other things, the executives were pointed out by their critics that they did not have a sufficient appreciation of the influence of their firms, which was now big enough to sway the national economy; that the behavior of their companies was not entirely proper; and that they had not done enough to further understanding of their business among the general public. These claims prompted trading firms to set up public relations departments and independent organizational units to monitor fulfillment of their corporate obligations to society. They also voluntarily drew up codes of behavior in accordance with the standards of all-around trading firm behavior laid down by Japan Foreign Trade Council, Inc., in May 1973, and pledged themselves to observance of the same. The Fair Trade Commission launched studies of the actual activities of trading firms in January 1974 and January 1975, and determined restrictions on the raising of funds domestically by big trading firms and the formation of corporate affiliations based on ownership of stock. The specific means were the restriction on large-scale financing by banks imposed in late December 1974 (which prohibited ordinary banks from making loans in excess of 20 percent of their owned capital to any single borrower, and set a period of five years for correction of any loans in excess of this ceiling), and the limitation of the total amount of stock that could be held by business enterprises along with the effectuation of the amended antitrust law in 1977.

Trading firm ventures in large overseas projects

Beginning in the second half of the 1960s, when Japan was enjoying sustained high-order economic growth, the country's demand for energy and other overseas mineral resources ballooned, and trading firms bolstered their overseas investment related to resources. In the 1970s, the economy's vulnerability to shortages of natural resources was dramatically exposed by the two oil crises, and trading firms learned an important lesson from disruption of their overseas resource-related projects.

① The Ataka Sangyo affair

It was in this period that Ataka Sangyo reached the end of its line in the crude oil business. The troubles sprang from a August 1972 agreement by Ataka America, the U.S. affiliate, to provide loans of 15 million dollars to fund investment as part of a product for construction of a refinery (which was to swing into operation in December 1973) by the Canadian firm Newfoundland Refining Company (NRC). Ataka America signed an agency contract for supply of crude oil in return for contracting by NRC for long-term use of three large tankers. However, NRC's position deteriorated when crude oil prices quadrupled in the First Oil Crisis, which struck in the autumn of 1973. In accordance with the agency contract, Ataka America supplied NRC with a total of 520 million barrels of crude oil over the roughly two-year period from the autumn of 1

973 to late 1975, but NRC's situation did not improve and payments for this supply were consequently delayed. The arrears dealt a great blow, first to Ataka America, and then to its parent Ataka Sangyo. Toward the end of 1975, a plan for reconstruction of the firm was put together, mainly by Sumitomo Bank, its main bank. Ultimately, it was decided to rescue Ataka by amalgamation with ITOCHU Corporation. For trading firms taking up challenges and braving risks, the affair underscored the importance of quick action to hold damage to the minimum and douse fires while they are still small, as well as of risk management to make this possible.

② The IJPC problem

The petrochemical project promoted by Mitsui & Co. for the use of gas concomitant with petroleum served to bring home the seriousness of country risks to trading firms. The story begins in 1973 with the establishment of Iran-Japan Petrochemical (IJPC) through equal outlays by the Iran Chemical Development Company (ICDC) on the Japanese side and the state-run National Petrochemical on the Iranian side. The IJPC set about building a comprehensive complex at a total cost of 190 billion yen, with completion scheduled for March 1980. The complex was to have an annual turnover of 240 billion yen and employ 3,000, and was sited at Bandar Shahpur (the present-day Bandar Khomeyni). However, the Islamic Revolution of February 1979 replaced the Shah with the Ayatollah Khomeyni, and work on the complex was suspended. After funding from the Japanese government and transformation of the ICDC into a national project, construction resumed in March 1980, but was again set back by the outbreak of the Iran-Iraq War in September 1980. Although the complex was on the verge of completion, all Japanese personnel had to be pulled out of the site in October of the same year due to the new hostilities. The war finally came to an end in August 1988, but the complex had been left exposed to the fighting over the roughly eight intervening years. After the war, in October of the same year, a Japanese team visited the site to inspect it, and concluded that the complex could not be completed because of the heavy damage from shelling. Whereas the Mitsui side was resolved to abandon the project altogether, the Iranian side sought a continuation, and negotiations between the two failed to make progress. A resolution finally came on 8 October 1989, when Mr. Ejiri, then the president of Mitsui & Co., personally went to Iran and reached an agreement with the Iranian side on the IJPC's liquidation.

With the dissolution of the IJPC, Mitsui received overseas investment insurance payments from the Japanese government, but nevertheless incurred a tremendous loss. The entire affair deeply impressed trading firms with the magnitude of risks associated with long-term overseas projects.

③ Brunei LNG

By the same token, some overseas projects scored resounding successes.

One example is the development project for liquefied natural gas (LNG) in Brunei, promoted by Mitsubishi Shoji Kaisha, Ltd. Mitsubishi had been acting as an agent for import of LNG from Alaska for about five years (the first shipment was made in November 1969), and was strongly convinced of the promising future of the LNG business. In December 1969, it decided to join hands with Shell and Brunei in the establishment of Brunei LNG as a joint-venture company owning liquefaction plants. The plans envisioned purchase of raw natural gas from Brunei Shell Petroleum (Shell's Brunei subsidiary), liquefaction for production of LNG, and import of the product by Japan. In 1972, a contract was signed for supply of 5.14 million tons of LNG a year for a period of 20 years to the customers back in Japan, which were Tokyo Electric Power, Tokyo Gas, and Osaka Gas. The tanker carrying the first load docked at Senboku port in Osaka in December 1972. In the wake of the First Oil Crisis in 1973, LNG prices also jumped, and Mitsubishi Corporation was consequently able to reap a substantial profit from the venture on a long-term basis. Because it had invested in the production end of energy resources, the company stood to realize a high gain like that enjoyed by oil-producing countries.

(4) The 1980s

In the early 1980s, the developed-country economies of the West down shifted to only moderate growth under the lingering effects of the twin oil crises of the previous decade. The average annual growth rates of the members of the Organization for Economic Cooperation and Development (OECD) over the years 1980–1985 was a meager 2.4 percent. Japan, too, remained in an economic slump during the first half of the 1980s as it adjusted to the structural changes in the global economy, which were symbolized by efforts to conserve energy and resources after the oil crises. On the political front, the Reagan administration aspired to a "strong America" backed by military might, but economically, a "weak America" was at the same time clearly in evidence. The chief sign was the swelling of the "twin deficits" in trade and national finances.

As this situation persisted, the dollar was judged to be overvalued, and the value of the yen was adjusted greatly upward as a result of the Plaza Agreement signed by the financial ministers of five developed countries (G5) in September 1985 for cooperative intervention to correct the strength of the dollar (the agreement was so named because the meeting was held at the Plaza Hotel in New York). The exchange rate to the dollar, which had been in the neighborhood of 240 yen for the preceding three years (in terms of the yearly average), reached 165 yen in 1986, 145 yen in 1987, and 128 yen in 1988. The impact of the strong yen hurt business in Japan, and the official interest rate was gradually lowered beginning in January 1986. The rate had sunk to 2.5 percent by late February 1987, and stayed there until the end of May 1989. The economy bottomed out in November 1986 and then went into the so-called "bubble" phase.

The winter of trading firms

Amid the aforementioned structural changes in the global economy, trading firms, like the Japanese economy, entered a phase that was characterized as their "winter season." A work entitled "Shosha–Fuyu no Jidai" (Trading Firms–A Winter Period) published by Nikkei Shinbun Newspaper in 1983 cited the following as problems of the firms.

1) A decline in fundamental earning power, owing to factors such as the slumping market for commodities including textiles and lumber, and the stagnation of domestic transactions

for steel and crude oil

2) Tardy adaptation to the macroscopic re-conversion from traditional heavy industries to new industries and products with more pronounced elements of software and technology, etc. (After the oil crises, Japan made rigorous efforts to reduce levels of consumption of energy and resources, and this accelerated the shift in the industrial structure from heavy and chemical industries to technology- and knowledge-intensive industries. In the process, automobiles and home electrical products became the leading items of export.)
3) Slowness to enter advanced “high-tech” fields that will be the sources of growth in the next generation

Talk about the winter of the Japanese economy and trading firms disappeared as the country emerged from the bottom recorded in November 1986 and basked in a wave of prosperity deriving mainly from the domestic demand. However, some fundamental changes had taken place in the trading firm industry. The most striking was the substantial shake-up in major firm rankings in terms of sales; although it ranked third in fiscal 1985, ITOCHU Corporation took over the No. 1 spot in fiscal 1987.

New management strategy of trading firms

In the environment of the sharp appreciation of the yen and drop in crude oil prices after the 1985 Plaza Agreement, sales proceeds plummeted at trading firms where the energy sector carried great weight. In the autumn of 1986, for example, it became clear that Mitsubishi Corporation was going to lose its grip on the top sales rank in the industry, which it had held for the last 20 years in a row. In November 1986, the company unveiled its new “K Plan,” which was born of a judgment in the top layer of management that it was time for the company to reorient itself for higher levels of profit and retreat from sales competition aimed at maintaining shares of the market even at the sacrifice of profits. The K Plan was to effect a profit rebound by the combination of more careful selection of business domains attuned to the tone of the times and increase in the value-added level of activities as a trading firm. In accordance with the plan, the company commenced to reallocating resources, reforming the organizational system, and establishing a results-based scheme of evaluation. The K Plan signaled the birth of a new kind of trading firm management strategy, one accompanied by a long-term vision for radical reform of the conventional structure of management that would enable firms to cope properly with changes in the business into the 21st century and to evolve in the right direction for the future. It was at the same time a response to the problems of trading firms pointed out in the “A Winter” publication. The trend was not confined to Mitsubishi; the other major trading firms also came out with their own long-term visions in the same period. ITOCHU Corporation , for example, announced a vision in 1985 under the banner “all-around international firm,” and commenced a program of reform for realization of this vision in 1986. Mitsui & Co. released its basic long-term strategy in 1986 and strove for transformation into a provider of composite high-value-added services, a global marketer, and a decentralized network enterprise. Marubeni prepared its long-term vision in 1988 with the watchwords "taking a hard look at the 21st century and targeting creation of value," and launched a new medium-term management program in line with the vision. And Sumitomo Corporation drew on its slogan of "global mind and global reach" in formulating a long-term program (entitled "Toward Growth as a Total Business Enterprise") in 1988, and set in motion a corresponding action plan.

Development of financial business

For trading firms, financing had been an incidental capability for expansion of their main business transactions. Beginning in the second half of the 1980s, however, it was built up as a business in its own capacity by means such as domestic issuance of commercial papers and operation of large-scale compensatory fixed-term deposits, chiefly by the major trading firms, which were expanding their equity financing activities. Particularly notable was the operation of securities through special money-in-trust programs and (non-designated) fund trusts. Whereas the mode of operation was specified in the case of the former, it was left to the trust bank in question in the case of the latter. At its peak, the combined balance of both at the five major trading firms other than Mitsui & Co. came to almost 3 trillion yen (this was at the end of March 1990). Among some of these firms, the peak one-year profit from them hit 30 billion yen and accounted for about one-third of the entire current profit. These special money-in-trust programs and fund trusts crumbled when Japan's economic "bubble factor" burst shortly thereafter. Around 1992, trading firms began a phased amortization of the resultant latent losses. As of 31 March 1997, the combined balance of the same five firms had been reduced to 150 billion yen. The problem of the special money-in-trust and trust funds is therefore nearing complete resolution.

Trading firms are continuing to make strategic approaches to other types of financial business. The areas concerned include dealing in foreign exchange, the development and sale of commodity funds, project financing, venture investment aimed at capital gain, and leasing. Trading firm involvement in the leasing business dates from the mid 1960s, and has recently broadened to large segments such as aircraft and company cars.

Advance into the information-communications industry

The year 1985 marked the start of liberalization of the domestic telecommunications market (i.e., the first phase of reform in the information-communications industry). The liberalization opened the door to entry into the field by enterprises from other industries. Like many others, trading firms took this opportunity to enter the industry, chiefly in connection with infrastructural projects. In February 1985, ITOCHU Corporation and Mitsui & Co. joined with the U.S. company, Hughes Communications to found Japan Communications Satellite Co.

(JC-SAT). This event was closely followed in March of the same year by the establishment of Space Communications Corp. (SCC) by the Mitsubishi Group. These two enterprises represented the initial launch of satellite communications business in Japan. In the international communications sector, Kokusai Denshin Denwa Co. (KDD) acquired competition with the founding of International Telecom Japan (ITJ; a joint venture of the five firms Mitsubishi, Mitsui, Marubeni, Sumitomo, and Nissho Iwai) in July 1986 and International Digital Communications (IDC; a joint venture of ITOCHU Corporation, the British firm Cable and Wireless, and Toyota Motor) in March of the same year.

(5) The 1990s

In the 1990s, the world witnessed the end of the Cold War and beginning of the transition to a market economy by the former members of the Eastern bloc. At the same time, developing-country economies started to boom, especially in Asia, which came to the fore as a global growth center. The world economy entered a new age of megacompetition symbolized by the key words “globalization,” “information,” and “borderless.”

In Japan, the prosperity of the late 1980s began to be referred to as “the bubble days.” Apprehensions about inflation led to a gradual hike in the official rate beginning in May 1989, and the country entered a tight-money phase. This has had a serious dampening effect on the tone of the domestic economy. Meanwhile, stock and land prices both fell way back from their peak levels, which were recorded in late 1989 and 1991, respectively. This assets deflation has since persisted, and the adverse fallout from the bubble period is becoming even more serious. The government has attempted to encourage business by financial deregulation and ambitious packages of stimulative measures, but these have not ushered in a solid recovery. On the contrary, the impasse appears to be deepening; the government has clearly been slow to react to the worsening of public finances and need for globalization of Japan’s economic system. Many trading firms have been compelled to dispose of bad debt in huge sums from the special money-in- trust programs, fund trusts, and real estate investment after the bubble burst, and this has squeezed their profits. At the same time, however, trading firms are coming to grips with management reform to lay the foundation for a new round of advancement while adapting to changes in the business environment both inside and outside Japan.

Response to deregulation

Deregulation got under way in the early 1980s with the deliberations of the Provisional Commission for Administrative Reform headed by Toshio Doko (then Honorary Chairman of the Japan Federation of Economic Organizations, i.e., Keidanren), and has slowly but steadily made progress. Japan’s fall into a syndrome of negligible economic growth in the 1990s sharpened perceptions of deregulation as a must for economic revitalization. In 1993, the

Keizai Kaikaku Kenkyukai (a group instituted for deliberation on economic reform by the prime minister and headed by Gaishi Hiraiwa, a succeeding Keidanren chairman) recommended the removal of economic regulations as a general rule and a running review of social regulations, in keeping with its conviction that Japan, as a developed country, ought to bring itself into harmony with systemic standards in the rest of the world. The group's conclusions added impetus to the movement for deregulation.

Trading firms reacted to the wave of deregulation, and, first and foremost, their aforementioned entry into the information-communications business deserves special mention. In succession, they moved into a wide variety of other fields as well. In the foodstuffs field, trading firms made inroads into distribution and sales routes for rice upon the enactment of new foodstuffs legislation in 1994, and commenced business in import of rice upon the partial opening of the domestic rice market in 1995. In the energy field, they embarked on import of petroleum products following the abolition of the provisional measures restricting trade of certain products, in March 1996. And in the housing field, they began to engage in the business of imported housing.

Deregulation made especially steady progress in the information-communications and broadcasting fields. The start of commercial services in Internet connection and personal handyphone systems (PHS) in 1993 was followed by the explosive spread of PHS and cordless telephones in 1994 as suppliers cleared out their communications terminal devices. Restrictions on cable TV business were relaxed over the years 1993–1995 (by provisions for multiple system operators, a hike in the ceiling of foreign interest, and other measures), and digital broadcasting commenced in 1996. In the United States, where developments in these areas are farther along, the 1996 amendment of telecommunications law made it possible for service suppliers in the sectors of long-distance communications, local communications, and CATV to enter each other's markets. In Japan as well, related legislation was amended in June 1997 with a view to giving the country an information-communications market that was as open and free as that in the United States.

The amendment brought about a revision of controls on participation (i.e., removal of stipulations regarding surplus facilities), lifting of restrictions on foreign capital, free interconnection in the public-line/private-line/public-line pattern, and elimination of the need for official approval of carrier rates. Ensuing decisions resulted in rule-making for connection to the network of Nippon Telegraph & Telephone (NTT), the reorganization of NTT, and permission for carriers in the international sector (e.g., KDD) and those in the domestic sector (e.g., NTT) to move into each other's territory. This second round of reform in the information-communications field has had a strong impact on trading firms. A number of them have already begun remolding their business in international communications, gotten involved in CATV or telephone services, or started providing digital broadcasting services via communications satellites. Investment and business development by trading firms in this field are poised for a big push.

In the course of deregulation, the main competition for trading firms is starting to come from the established enterprises in the concerned field in stead of from other trading firms. More and more, trading firms are finding it necessary to recruit or train specialists with a level of expertise that is on a par with or higher than that possessed by the original entrants.

Cultivation of the Asian and Chinese markets

In the 1990s, focus in trading firm approaches to external markets has shifted to other Asian countries and China. Beginning in the second half of the 1980s, trading firms greatly upped their investment in business abroad, but mainly in the United States. There, their primary object has been investment in the manufacturing sector, the software and service sector, and other sectors promising a high return from business within that country. In China and other Asian countries, by contrast, trade and manufacturing sector investment have been the twin backbones of their business due to the strong ties of interdependence in the Asian Pacific, inclusive of Japan. Growth has remained high, especially in East Asia, and a gigantic consumer market is surfacing in the region as overall income levels rise. This suggests more investment by trading firms for business in production, distribution, and sales in local markets. The region also has a burgeoning demand for power plants and other infrastructural elements, and large-scale projects for infrastructural conditioning are growing into big pillars of the Asian business of trading firms.

In China, 1997 saw the successful completion of two momentous events in the form of the reversion of Hong Kong and the 15th National Party Congress. The new leadership corps that emerged from the Congress reconfirmed the commitment to the country's continued modernization in accordance with the line of reform and liberalization. Efforts to curb inflation have been effective, and the Chinese economy could very well continue to grow at high rates on the order of 7 or 8 percent until at least 2010. As such, opportunities for business by trading firms there are anticipated to broaden. Trading firm business in China dates from the establishment of "friendship firms" in 1972, when Sino-Japanese relations were normalized, and therefore already has a history of more than 25 years. By 1996, all nine of the major trading firms had obtained approval for founding "Touzi Xing Gongsi" (the Chinese term for domestic affiliates of foreign capital that take the form of holding companies). Trading firms are not only bolstering their trade with China but also setting about investment expansion in business rooted in the domestic market, in sectors such as manufacturing, distribution, retailing, and real estate.

Management reform for globalization

In accordance with the scenarios set forth by the long-term visions which they articulated in succession in the latter part of the 1980s, the major trading firms are coming to solid grips with the task of structural reform of their management. They share the agenda items of giving the company a constitution that will ensure profits even in the low-growth age, building a management system adapted to the hyperinformation society and globalization, and refining their capabilities and functions. To these ends, they have drafted medium-range plans and taken strategic steps, such as executing restructuring programs and doing the groundwork for further action. The core components of these action plans are priority allocation of resources to fields of strategic emphasis, stress on increased profit and consolidated accounts of all businesses, project investment, decentralization of management authority toward the goal of more self-supporting accounting schemes in each market, and total in-house outfitting for the information age.

On the issue of decentralized management, trading firms instituted provisions for in-house capital allocation beginning in the mid 1990s, and have also been exploring the establishment of in-house companies as a means of making the management of business divisions more autonomous. And on the information front, they have been augmenting internal infrastructures by installing an average of one personal computer for each employee and promoting extensive use of Internet and other computer networks. The chief aims in this connection are support for more effective application of information technology in sales activities, greater efficiency in the business process, and wider sharing of information.

Thanks to this management reform, the profit structure of trading firms is gradually improving. However, a look at the current status indicates that the improvement has not reached the level of fundamental change in the high-cost, low-profit disposition of trading firms. It can also be noted that the speed of change in the surrounding environment is accelerating, and that today's gigantic trading firms will have to undertake further management reform also in order to recover their former flexibility and keep up with the faster pace.

The 21st century is now less than three years away. At this historic juncture, trading firms are in the process of reviewing their long-term visions and drafting their final medium-term plans of the century. Japan's trading firms are in many respects unique and without parallel worldwide, and perhaps what they most have to do today in order to achieve more advancement in the new century is to paint a vivid portrait of where they are headed for tomorrow, one that is solidly underpinned by reflection about where they have been thus far.

Chapter II
Portrait of Tomorrow's Trading Firms

1. Changes in the business environment and the mission of trading firms in the 21st century

(1) Five key currents in the global economy and implications for Japan.

In the 21st century, the global economy may be anticipated to enter the age of full-fledged megacompetition marked by unprecedented levels of dynamism and vitality, as symbolized by the trends of globalization, diversification, information intensification, and networking. In the process, the following five key currents should gather momentum.

In the first place, the progressive liberalization of trade and investment, and deregulation in various areas, may be expected to spur the free movement of goods, capital, and labor.

This should result in the increasing integration of the global economy and formation of a huge global market. For business, it would mean the emergence of opportunities with scales beyond those thus far. Also expected is increasing access to the service industry for closer proximity to the consumer. In addition, the siting of production, distribution, and sales activities in optimal locations around the world through direct investment should takes its place alongside horizontally-oriented international divisions of labor as a vital business strategy.

The second key current is the spread of global standardization as regards the specifications and methods of technology and systems around versions with the status of de facto standards.

This supply-side perspective on global standards will presumably become extremely important for management of companies acting on the global stage, seeing that economies around the world should become increasingly unified in the 21st century. As evidenced by the many cases of success achieved by venture firms in the United States, even petty operations that are still in their infancy can become No. 1 in the immense global market by being the first to develop technologies and concepts that grow, or could grow, into global standards. Fast-growing firms with a core competence that stands out even in this new landscape are likely to evolve into the global firms of the 21st century.

The third current is the arrival of the "network society" in which all points on the earth are linked by computer.

A consensus is forming worldwide around the emergence of such a socioeconomic arrangement along with the trends of digitization, infrastructural conditioning, and expanding personal use in the field of information and communications equipment. This is anticipated to quicken the flow of capital and information around the world.

The rapid advances in digital communications technology should also revolutionize ways of doing business. One prospect in this connection is the creation of an electronic commerce transaction market that is global and borderless. As a result, the new technology will make it possible for companies from different industries, newly formed enterprises, groups, and even individuals to participate in markets and play against the established entrants. These various economic agents could also become interconnected and fashion a complex mass of business alliances in what might be called a "global business network community."

The fourth current is the rise of emerging markets.

Amid the dynamic changes in the global economy, the emerging markets led by China and other parts of Asia outside Japan are expected to continue playing the main role in world economic growth, given their diversity and high growth rates. These markets began to come into the limelight due to the global industrial shift from developed to developing countries. Their importance into the next century will rest not only on the burgeoning demand associated with infrastructural improvement but also on the gradual actualization of their enormous consumer markets. In China, policy emphasizes development of the central and western regions, and there is a good possibility of a simultaneous expansion of industrial siting and consumer markets around Chongqing and other cities in the middle and upstream portions of the Changjiang basin in the course of comprehensive development programs there.

As for the fifth current, the coming years hold the risk of a worsening of problems related to the supply of resources, energy, and food as well as global environmental problems.

The need for improvement of factors inhibiting growth in aspects such as energy, food, and the environment is liable to come increasingly to the fore as an issue of worldwide concern in order to assure the sustainability of economic growth. Similarly, economic aid for Africa and the Middle East, for example, will undoubtedly continue to be a major priority.

In Asia, the energy problem will probably become more serious as global environmental problems deepen. In light of this outlook, it will be even more vital to pursue international cooperation related to technical, human, and financial resources in the fields of resource development, infrastructural conditioning, energy conservation, fuel conversion, and environmental measures. Similarly, the combination of population growth and a rise in calorie intake along with income levels points to an expanded demand. As such, an increase in the self-sufficiency of the food supply is a top priority in Asian countries. In this atmosphere, international collaboration related to agricultural technology and infrastructural improvement should assume increasing importance.

Major restructuring of the Japanese economy by the "big bang"

In light of these changes under way in the global economy, Japan cannot afford to postpone the job of restructuring its economy. Japan's population is steadily aging, and its economy is moving deeper into the mature stages of the life cycle. There is a danger that the country will be left behind in the changes taking place in the global economy. For this reason as well, there is an urgent need for not only the structural reform being promoted by the government but also cooperation between government and business sectors to open up the Japanese economy. Deregulation and reform of administrative and financial arrangements are bound to inflict some pain, and there are deep-seated fears that the calls in this direction will not be translated into action. However, it is now all too obvious that structural reform is the only way to break the current economic impasse, and a national consensus seems to be jelling around the idea.

Japan therefore could very well experience socioeconomic structural reform of surprisingly large proportions within the short space of time remaining before the start of the 21st century, much as the wall that had divided East and West Germany crumbled in a moment. Because Japan has been highly regulated thus far, the extent of change wrought by economic liberalization should be much bigger than in other developed countries. This, coupled with the scale of the Japanese market, which contains roughly 130 million affluent consumers, suggests that Japan has a good chance of standing head and shoulders above other countries in respect of the wealth of business prospects it offers. More specifically, the systemic harmonization with other countries, removal and relaxation of economic restrictions, and rigorous market-opening measures can be counted on to stimulate competition in accordance with a freer market process, and this would correct the prevailing high-cost disposition. Furthermore, developments such as higher mobility in the domestic labor market and greater activity by venture businesses can be anticipated to give birth to new industries in fields such as multimedia, business support, lifestyle and culture, distribution and logistics, the environment, medicine and welfare.

Dramatic structural changes are also on the horizon for Japanese companies.

The “big bang” of financial sector reform will weaken the past scheme of public-private collaboration, which has been likened to a convoy providing official protection for private financial institutions, and leave the money market to be operated more in line with clear rules and a transparent market mechanism. This will make foreign firms possible able to get Japanese financial institutions under their umbrellas. Japan as well can expect to see the growth of purely institutional investors aiming exclusively for capital gain (like Mutual Fund) and quickening the global operation of assets. The future also holds the prospect of change in the Japanese-style setup of corporate governance based on “main bank” systems, with considerable consequences for the Japanese style of corporate management. Additionally, with the progress of globalization, internal systemic arrangements as regards supervision, law, and accounting will have to be valid in the eyes of the international community and so brought into conformance with global standards.

(2) The mission of trading firms

This scenario for the 21st century raises the question of the value and role to be played by trading firms in the new age. The earmarks of the 21st-century business climate are likely to be rich diversity and sharp change. Owing to the nature of their business, trading firms must seize upon this diversity and change as opportunities. For trading firms, the forecast of more upheaval in the 21st century should also mean a brighter tomorrow and larger sphere of activity. Viewed from this perspective, the mission of trading firms in the next century can be summarized in the following three points.

The first is responsibility for the world’s enrichment.

As economic globalization proceeds, trading firms will have to show more initiative in taking up the challenge of business activities on a worldwide scale. In the field of resource development, for example, they must build global systems for stable supply of natural resources from the countries of production to those of consumption around the world. It will also be their job to create and promote efficient business in production, domestic sales, and export in each country. In this way, the proper role of trading firms would lie in execution of various business activities that generate wealth in numerous countries and markets in a manner attuned to the characteristics of each, considering that they are located in the another part of the world from Japan.

The second is being in the vanguard of business proposal ahead of others and its execution.

Trading firms have forged bonds of trust with customers by proposing all sorts of business and offering support for their successful pursuit. They have also taken risks themselves and tackled big projects in cooperation with many other companies while also promoting numerous venture-type businesses. This kind of challenging spirit should be a prime reason for their continued subsistence in the 21st century.

The third is the discharge of their responsibility as corporations, which naturally must be reaffirmed.

Corporations have a responsibility to make efficient use of their capital, human, and other types of resources to earn a reasonable profit. In addition, they are obligated to distribute this profit fairly among shareholders, employees, and all other stakeholders in their activities. As trading firm activities move further toward high-risk, high-return domains, big failures could very well prove fatal. Firms must bolster their systems of internal control and capabilities of risk management for project (business) investment. In the age of megacompetition characterized by full and free movement of capital around the world, capital will tend to gravitate toward companies with more efficient operation of capital. Similarly, trading firms will have to have good ratings in order to raise funds on favorable terms and on a stable basis. For this reason as well, it will be extremely important for trading firms to fulfill their corporate responsibilities in all areas, including fuller disclosure of information.

2. Tomorrow's trading firms — vision and management concept

(1) Vision of tomorrow's trading firms

Where will the real value of trading firms lie in the changes in the business environment anticipated in the 21st century? The answer is in discharge of their role as global business integrators and creators, i.e., enterprises that assist the construction and operation of organic business systems consolidating all activities, from development and production to distribution and sales, and on a global stage. If they are so disposed, tomorrow's trading firms will be able to develop their business both on a global scale and in a multidirectional manner. They will harness formidable powers of information assimilation to unearth and propose new types of business and organize projects around the same. In implementing projects, they will bring to bear diverse capabilities and exercise synergistic strength. The overall picture is one of powerful, high-profit firms with superb abilities to develop new business and induce synergistic effects.

Global business investors

The trading firms of the 21st century will not be mere middle-men; they will put investment in other businesses at the core of their activities, and so also function as global investors. The combination of various investments and the linkage between businesses through the trading business, which may be regarded as their mature main line, will create an overall synergy and support their status as business integrators. Furthermore, they will engender new business through venture investments.

Increased adaptability

To enhance their ability for adaptation to change, tomorrow's trading firms may be expected to make dynamic adjustments of the business portfolio through ongoing scrap-and-build programs. At the same time, they will concentrate their resources in several fields of particular strength and work to make their core competence even stronger. In fields where they are less competitive or less confident, they should turn more to outsourcing and expand ties of global alliance and partnership with other firms. As such, they will place greater value on intercorporate networks.

Increased diversification (no longer simply trading firms)

By bolstering their activities in fields of special expertise and strength, trading firms of the future are anticipated to become increasingly diverse. Each will have to discern its field of core competence and allocate management resources to it on a priority basis. As a result of this process, some trading firms could come to resemble high-tech enterprises, while others could end up specializing in project engineering or financing business. In this sense, the future evolution of trading firms will be a diversification away from the conventional trading firm business in various directions. Quite possibly, the lumping of all into a category called trading firms will become a thing of the past.

Venues of self-fulfillment

To date, trading firms have been driven by their staff members(employees) more than by any other single factor. The importance of human resources will presumably rise if the trading firms of the future are to discharge their role of devising and erecting highly creative business systems. In Japan, as in other countries, the business network society of the 21st century should bring increased mobility in the labor market. Personnel with highly specialized skills and other knowledge workers will be able to move from one employer to another with comparative ease. If they want to recruit and keep first-rate personnel in these conditions, trading firms will have to become venues offering self-fulfillment to employees animated by a challenging spirit. And to do so, they will have to make flexible and stimulating arrangements as regards organization and employment systems.

(2) Five concepts for tomorrow's trading firms

In accordance with this underlying vision, tomorrow's trading firms should embody the following five concepts.

The first is the need of refined ability to adapt to changes in the business environment.

The network society will herald the arrival of a new global age characterized by rich diversity and massive exchange of information worldwide by means of computers. It appears certain to accelerate the speed of changes in the business environment, and companies will have to react to such changes with greater flexibility and quickness. Trading firms are therefore anticipated to incorporate network-type organizations oriented toward swift scrap-and-build activities.

The thrust is a move away from mammoth pyramids held together by rigid hierarchies and toward looser umbrella-like aggregates bringing together several small and medium firms, each enjoying a higher degree of autonomy and specializing in certain fields. To keep abreast of globalization, it will be vital for trading firms to adopt management systems that are open and in line with global standards.

They will have to procure all management resources—human, material, and financial—from a worldwide market, and open up routes for sales of goods and services to customers across the globe. In short, they must be global firms in fact as well as name.

In the new age, it will be even more necessary for trading firms to achieve high levels of return. To this end, they will have to be managed more with an accent on earning power, i.e., ability to extract the largest possible capital value as judged with reference to benchmarks such as return on equity (ROE) and return on assets (ROA).

The second concept is separation of management strategy and the operation.

In the 21st century, trading firms may emerge to play an even more important role, and in a wider sphere of activity, amid the new currents in the Japanese and global economy. However, even if their possibilities are boundless, commercial firms will not be able to take full advantage of them without high levels of corporate strength and management capability. More specifically, they will need capabilities above and beyond the conventional management setup in areas such as diversification into a variety of fields and regions, expansion of the business scale and scope by forging the portfolio parts into a synergistic chain, and elevation of the role of management through increased commitment to investment in other businesses. The most crucial will be capabilities for preparation of long-term strategy for the entire group and shrewd execution of the same. This suggests a need to maintain a separation between management strategy, which would be positioned as a means of management build-up for execution of the groupwide, long-term strategy, and the day-to-day operation. In concrete terms, steps must be taken to keep the corporate brass making decisions on larger strategies and tactics at the head office separate from the top layer of management in each business division. One major option here is the establishment of pure holding companies.

The third concept is speed-oriented, strategy-minded management.

In the dynamic, vibrant activity of the 21st century, power to plot effective strategy for the entire corporate group will be a key drive for demonstration of synergy. Japanese companies in general have been regarded as having excellent capabilities for executing strategy but lesser ones for devising it. In this view, they tend to be good at managing the operation based on the cycle of planning, execution, and review of results with feedback of the findings in the new plans (known for short as "plan-do-see"), but poor at managing strategic visions. In extreme cases, decisions on strategy may be left to the past experience or hunches of the brass. Trading firms are no exception here. In this connection, it can be noted that there are three key elements in the process leading from the generation of ideas for strategy to the determination of policies.

The first is good concepts. Management must erect frameworks of thought geared for attainment of objectives. More creative concepts can give birth to more effective strategies. The second is good value judgments. Management must be able to judge not only whether prospective actions will benefit the company but also whether they are consistent with its own values. A clear set of standards of value judgment is always required. The third element is a genuine commitment to the strategy by all concerned. Japanese companies usually produce a unanimous consensus on courses of action through careful parleying "spadework" among all concerned, but the vital point here is the degree of motivation and enthusiasm felt about the strategy as opposed to formal allegiance. Besides deriving from attractive concepts and being grounded in a proper sense of values, strategies therefore must also possess a persuasiveness that is backed by in-depth analysis and lucid logic. Tomorrow's trading firms must have built-in powers of strategy formulation that meet these requirements. They also must strengthen the head office structure to support superior strategy-making from a global perspective while rearranging the divisional setups for full exercise of ability for speedy execution of the strategy. As such, it will become increasingly important for them to groom the head office executive corps and its strategic staff as management professionals who wield sophisticated expertise, and from at an early date. Although the virtues of Japanese-style management should be retained, this end will demand a fairly extensive adoption of the Western style.

The fourth concept is the best mix of decentralized and centralized authority.

Tomorrow's trading firms will have to achieve this best mix in order to install the group as a whole with a high cohesion around the head office and help it to execute growth strategy.

Viewed from the standpoint of global management, they must also achieve the optimal balance between localization and globalization. While deepening their commitment to the host economies and building their expertise in the local market, they will have to exercise their overall power from a global perspective. This would create a situation in which trading firms eliminate distinctions of nationality in hiring, make varied arrangements for employment crossing boundaries of country and race, and develop a global group of subsidiaries rooted in the market of their establishment.

It will consequently be important for commercial firms not only to delegate more authority to subsidiaries but also to increase the group-level cohesiveness. In order to establish such unity toward the head office in coexistence of decentralization and centralization, it will be also important to share information through sophisticated networks and a management philosophy based on universal values.

The fifth concept is the role as global business creators.

The 21st century should bring a dramatic increase in business investment by trading firms. The capability corresponding to this investment may be termed “global business creation.” Its substance is the creation of business and development of markets on a global scale. Core capabilities to date will become further specialized, reinforced, and exercised in conjunction with each other.

Also expected is a steep increase in opportunities for commitment to high-risk, high-return projects of a complex nature that could not be handled by a single business division and would tie up management resources into the long term. More than ever before, the ability to unearth quality projects with a high financial efficiency, examine prospective business, and manage risks will dictate the fate of the company. In addition, trading firm business should increasingly spread into the service sector.

In the interest of refining expertise and boosting efficiency, trading firms therefore should consider network-type organizations providing for linkage of the respective core capabilities with product divisions even while increasing the autonomy of the function divisions. And they will need personnel equipped not only with expertise in their individual field but also an entrepreneurial ability for creative concept generation to act as the agents of global business creation.

3. Basic strategy for development into tomorrow's trading firms

The following is an account of the basic strategy for evolution into trading firms embodying the aforementioned vision and concepts in six aspects.

(1) Business strategy: pursuit of strategic comprehensiveness

Business strategy creating high costs

In their business activities in the past, trading firms have changed to meet the demands of the times. As a result, they have acquired various capabilities as well as maintained and expanded activities in a wide range of domains, including everything from mineral water to satellite communications. In this sense, their business strategy thus far has been characterized by a kind of indiscriminate, sweeping comprehensiveness.

During the phase of rapid economic growth, this wholesale diversification held great benefit, in that even firms late to enter a given field could build up their business in it and post a certain amount of sales and profit, if low. With the onset of the phase of low growth and fierce international competition, however, greater emphasis must be placed on efficiency and profitability, and this has magnified the negative aspects of the line of expansion on all fronts following the lead of other entrants.

Such being the case, today's trading firms must take measures for expansion of high-return business by focusing investment on domains with a strong growth potential. They also must set up a cost-based scheme that will permit reasonable profit a major pillar of management strategy, and execute programs of investment restructuring and cost review to this end.

The contraction of business fronts that have become extended is bound to be accompanied by a lot of pain. In reality, it is difficult to compress overhead expenses, and cost-cutting policies usually do not make as much headway as was hoped. It can also be noted that, since the bursting of Japan's economic bubble, trading firms have applied latent profit from their store of corporate stock and other property accumulated over many years for the disposal of bad assets and operating losses, and no longer have much margin as far as their owned assets are concerned.

Another big factor behind the high-cost disposition of trading is the maintenance of a worldwide network of locations to support their powers of information gathering. Part of the problem here is the nature of management objectives in firms that let this dispersion and fixation of resources pass as a matter of course. Trading firms have extricated themselves from the corrosive sales competition of the past, but their objectives undeniably still stress the scale of sales. The belief that this scale is a barometer of information collecting capabilities and total power, remains strong. High sales figures may even be equated with status as a “major” trading firm. In the future, however, the disadvantages of this outlook will outweigh the advantages. As long as they stay massive affairs according precedence to sheer size and indiscriminately involved in all areas, trading firms will not be able to move swiftly, and will be capable of only passively coping with the rapidly unfolding changes. Unless they resolutely revise their business strategy, trading firms will probably be unable to take full advantage of the virtually limitless opportunities anticipated in the 21st century.

Accelerating manufacturer movement away from trading firms

Since the second half of the 1980s, many Japanese companies have established locations in other countries aggressively. In the process, they have also promoted an expansion of independent sales channels inside and outside Japan, offshore production, retail industry develop-import schemes, and transactions through direct foreign trade. With the coming of the age of megacompetition and even hotter cost competition, Japanese companies will not be able to survive without a rigorous curtailment of production and distribution costs. In this situation, they have begun to take a hard look at whether or not continued dealings through trading firms are really worth the cost.

One of the factors behind the calls for putting even more resources into project investment is the need to address this bypassing trend. Trading firms therefore have to demonstrate their capabilities in fields that are hard for other types of companies to tackle. This will require aggressive investment in information-communications field in Japan, and manufacturing/processing, local sales/distribution, and infrastructural conditioning in other countries.

New economic currents: boundless opportunities

The new currents in the Japanese and global economy point to a bigger role and wider sphere of action for trading firms. The four noted below are likely to gather momentum and do much to shape the arena of action for trading firms in the 21st century.

First, industrial restructuring on a global scale should cause a rise in the share occupied by the service sector in developed-country industry and by the manufacturing sector in developing-country industry. Meanwhile, the global economy should become more integrated through expanded trade and investment.

Second, the newly industrializing countries should provide not only a burgeoning demand in connection with infrastructural conditioning but also enormous consumer markets.

Third, the combination of advances in information-communications technology and deregulation is opening up all sorts of possibilities for new business, and the formation of strategic alliances with counterparts around the world should become a common tactic.

And fourth, increasing importance will undoubtedly be placed on approaches to securing the supply of energy and foods, resolving global environmental problems, and meeting other requirements for sustained economic growth.

Required conversion for strategic comprehensiveness

As described above, trading firms have a host of agenda items for the 21st century. This raises the question of how and in what direction they will allocate their finite resources in developing business. One of the keys to success will presumably be the forceful promotion of strategy targeting fields of particular strength. This will require a bold revision of the strategy of sweeping, all-points diversification in favor of a lean, strategic comprehensiveness with a modulated allocation of resources. The main means to this end will be active resort to outsourcing, decisive yet selective investment in fields conducive to exercise of the group-level synergy, and vigorous scrap-and-build programs.

(2) Capabilities: upgrading of business creation capabilities, and exercise of information and synergistic capabilities

Core capabilities to be reinforced

Trading firms have a wide variety of functional capabilities. The core ones fall in the categories of distribution, financing, information, risk-taking, and organizing. Trading firms have undertaken resource development, technology development, product manufacture, delivery, and other economic activities by mustering and combining these capabilities. These core capabilities must be inherited by tomorrow's trading firms. As for functioning as a mere intermediary, however, their mission will probably come to a gradual end. The business of tomorrow's trading firms should exhibit a shift in emphasis from transactions to (business) project investment. In the process, firms will have to graduate from low-risk, low-return business and become more committed to the high-risk, high-return variety.

As such, they will have to upgrade their capabilities for business creation. These will consist of more specialized capabilities of business generation/construction and risk management. To possess and exercise powers of business generation/construction, they will need to utilize the sophisticated know-how and skills of teams of experts, including investment consultants, certified public accountants, lawyers, and information gatherers and analyzers. To do so, they could not only resort to outsourcing but also reinforce programs for human resource development through internal training and more extensive mid-career hiring.

Rising importance of risk management

The 21st century should see higher speeds of change in aspects including technological obsolescence and price reduction, and markets of hot competition offering greater opportunity but also greater risk. In this climate, capabilities of risk management will be of crucial importance; indeed, the company's very survival could hinge on them. For example, rapid progress is anticipated in know-how for hedging the risks of derivative commodities, and trading firms will have to become better able to utilize the new techniques. It should also become more difficult for a single firm to make commitments that would tie up a lot of capital for a long period.

In the future, trading firms will essentially have to confine project investment for which they would be held accountable to their fields of special competence. In the case of project investment in new fields requiring induction of an overall synergy, decisions would have to be preceded by in-depth feasibility studies. And even if the project is found to be feasible, firms should avoid making a big outlay all at once and take steps to see that responsibility is assumed mainly by a partner with more of the necessary expertise in the field in question.

Trading firms also must strengthen their capabilities for management and supervision of project investment, subsidiaries, and affiliates. Internally, they will have to concentrate on group-level management with reference to consolidated statements; externally, they will bear a main-bank-type responsibility for governance of the group members. And in their capacity as parents of subsidiaries and affiliates, they will need schemes for smooth disengagement as well as efficient execution of corporate governance.

Trading firm capabilities for management of risks associated with projects in which they are participants will also be called into question, and must be bolstered. There are especially high risks attached to infrastructural projects drawing on private-sector resources and vitality in other Asian countries, which generally apply build-operate-transfer (BOT) or build-own-operate (BOO) schemes.

In approaches to new business, trading firms must accept that many venture investment projects will wind up in failure, and consequently carry out risk management with the idea of realizing reasonable return overall, as in adjusting the portfolio mix in securities investment.

Mounting importance of financial and distribution capabilities

Greater importance should be put on capabilities of financing accompanied by screening. With the onset of the "big bang" of financial reform and population aging in Japan, trading firms will have to reap earnings from personal financial assets totaling some 1,200 trillion yen. In addition, with the further opening of the Japanese market and globalization of economic activities, it should become more vital to raise quality funds right from the capital market. In the wake of liberalization of foreign exchange law, the role of trading firms in foreign-exchange transactions should widen. Trading firms will also have a larger role to play in promotion of venture investment, M&A tactics, and projects pairing public and private entities. For all of these reasons, they must reinforce their investment and financial capabilities.

Distribution capabilities will presumably also become more important.

In the global business network society of the 21st century, the virtual cyber transactions (Electric Commerce) market will make it possible for consumers to shop globally with just a simple commitment. This will result in more globalized distribution activities and a sharp increase in transaction diversity and the number of petty transactions. Trading firms will have to build distribution systems that can cope with these trends.

In this way, trading firms will have to make their respective capabilities more specialized while improving them qualitatively for closer correspondence with the demands of the times. This effort will at the same time give them a keener appreciation of the need to strengthen powers of information and synergy that underpin their other capabilities.

Information capabilities as mobile power for business creation

One of the key strengths of trading firms is their capabilities for information collection and processing. These are at the foundation of all of the other capabilities, and their reinforcement consequently can bolster the others. Information capabilities rest on the solid base of customer relationships built by means of the business presence and commercial rights established by trading firms, whose activities span a range of industries and regions. Such relationships were built, and are being maintained and improved, at a considerable expenditure of time, manpower, and money. The information capabilities of trading firms are not merely a matter of information; they also serve as mobile power for business creation. Information capabilities support their trade and project investment, and facilitate the exercise of the various other capabilities.

In the network society to come, trading firms must upgrade their ability to provide quality information that leads to business creation and has a high tactical value. At the same time, they must lower the costs and raise the efficiency of information provision by utilizing intranets and other sophisticated, computerized systems for information processing and communication.

On the information front, the crux is the ability to interpret data and translate the contents into concrete business. To heighten this ability, trading firms must deepen the specialized knowledge and issue-awareness of each and every employee as well as strengthen their commercial rights through more extensive localization. To induce a full demonstration of the group-level synergy, they should erect global information network systems harnessing digital technology for information-sharing around the world.

Combined strength as the synergy of capabilities

The overall or combined strength of trading firms may be equated with the group-level synergy. Fused with the unique information capabilities and business experience and know-how that come from the wide scope of their activities in terms of both industrial categories and regions, the diverse assortment of trading firm functions is manifested as a synergistic energy covering all aspects, including project organization, discovery and launch of new business, development of resources and products, and market matching.

In the 21st century, the broadening of the sphere of trading firm activity will presumably be accompanied by an increase in opportunities for commitment to high-risk, high-return projects of a complex nature that could not be handled by a single division. For this reason, trading firms will have to heighten the specialized character and autonomy of each business division while distancing the head office unit from the operation and making it into a synergistic nerve center for direction and control of such composite projects.

Even with their overall strength, however, trading firms will not be able to take advantage of big chances if they stay on without pulling out of business that has no future or in a state of collapse, just by saying it is difficult to do so. They must realize higher profit through pursuit of a strategic comprehensiveness and acquire an overall strength residing in a lean but muscular disposition.

(3) Human resources: pursuit of self-fulfillment by a professional team with management-minded perspectives

Human resources: the most precious of all trading firm resources

For trading firms, human resources are the most precious management resource. A look at trading firm offices does not turn up much in the way of facilities or equipment other than furniture, telephones, computers, and fax machines. The story is the same in the sales division. Trading firms are staffed entirely with white-collar workers. Business activities are proposed and put together on the basis of the knowledge, experience, and information-analyzing capabilities of the individual employees. Today's trading firm personnel (shosha-man) therefore may be regarded as first-rate generalists with a great deal of versatility. This quality enables intragroup transfer of human resources across divisional boundaries for adaptation to the demand of the times and changes in the economic structure. In this sense, the flexible structure that is a hallmark of trading firms has been supported by talented generalists. This versatility also made possible a mobilization of labor within the group.

In the business network society of the 21st century, however, trading firms will have to acquire specialized expertise on a par with or above that of professionals in the industry in question if they are to take a leading role in the global networks. The implication here is that trading firm personnel must, in effect, become professionals in their respective fields.

A game without formal rules

To carve out new business domains, shosha-man (trading firm personnel) will have to possess powers of creative management thought and act as entrepreneurs who make their own business rules. With the onset of the age of megacompetition, business environments will change due to the removal of market barriers and entry by numerous newcomers. The existing business rules resting on official regulations and commercial conventions may be of benefit to firms with vested interests, but adherence to them will be disadvantageous to new entrants. Even thus far, newcomers have turned the business environment in a direction more to their liking by introducing the new rules of low-cost management, discounting, and speed, and this trend is likely to gather momentum. Business does not have any formal rules, and matching wits will be a big part of the coming competition.

Shift in emphasis from ability to results

Trading firms must change their outlook on the personnel system in order to recruit and develop human resources suited to the new age. In short, they must shift their emphasis in schemes of hiring, remuneration, and promotion from ability to results, and erect a system enabling objective evaluation of the special competence of each individual employee.

In the first place, trading firms must recruit creative professionals. And in the second, they must prepare an in-house climate conducive to holding on to and making the most of this talent. It will also be necessary for trading firms to contain supporters who ensure that uniquely creative individuals are not left off of teams and are allowed to exercise their abilities in coordination with the other members. The cooperative relationship between specialists and generalists as the conventional type of trading firm employee must be built into the corporate culture.

To this end, firms must consider replacing the current system of hiring only new university graduates as regular employees with one in which such employees account for only about half of the total, the other half consisting of professionals hired in mid-career. It will also be necessary to organize project teams that are as small as possible and bring together specialists and generalists. Teams will be better able to give full play to the rich, creative expertise of their members if they are compact, autonomous units free of outside interference, are given sufficient authority for the job, and have frameworks enabling members to keep close tabs on each other's actions. As for the system of rating and remuneration, the arrangements for the specialists should emphasize results (pay for performance) over ability. This would create a need for a two-track personnel system, one track for specialists and the other for generalists.

In addition, in-house personnel transfer should show more consideration for individual aspirations. Firms must study options such as the institution of flexible personnel systems grounded in free competition and comprising something akin to an in-house labor market in which each employee would be able to find a position coinciding with his or her pursuit of self-fulfillment as an employee.

(4) Organization: flexible network organization for adaptation to rapid change

Highly flexible organizations

As described above, one of the hallmarks of trading firms has been a flexible framework made possible by the versatility of their human resources. This has been a key strength that could not be matched by other types of companies. However, the limits are appearing to adaptation even with this framework; as the speed of change in the industrial and economic structure accelerates, trading firm response appears to be more passive and tardy. This implies a need to build new flexible organizations so that firms will be able to initiate change themselves. The effort will proceed through organizational reform from the following standpoints.

First, trading firm organizations must offer a high degree of freedom and achieve coexistence of the specialized and generalized components. This is necessary for full exercise of the expertise of professionals and induction of a companywide synergy. The aim is a setup that allows both devotion to the core competence on the part of the divisions, each of which is highly specialized, and the production of a total synergy through interlinkage among them. It demands organizational structures that not only increase the autonomy of each division but also facilitate the maintenance of collaborative ties among different divisions even while fueling a friendly rivalry.

An example is provided here by the U.S. firm Hewlett Packard. HP's roughly 150 business divisions function as independent business units vying with each other in product development efforts in their respective fields. Those which have outlived their usefulness or completed their mission are scrapped. The company eliminates from 10 to 15 divisions on the average each year, and the resulting surplus resources are reallocated to other divisions.

Viewed in companywide terms, HP has both specialized and generalized capabilities, and its organization has the kind of structure enabling flexible accommodation of changes in business paradigms.

Second, trading firm organizations must make it easier to revamp the business in order to improve return on investment (ROI) by eliminating divisions which have lost their strategic value or payability and by concentrating the input of management resources into those of strategic importance. It would be hard to retreat from the typical Japanese precedence on preserving employment in trading firm management. Aggressive scrap-and-build tactics would require measures to cushion the blow and prevent damage in the event of such a retreat.

The management strategy of the U.S. company General Electric incorporates provisions for mutual liquidation and swapping or sale of weak units. It calls this approach to restructuring a "win, win, win strategy." In 1987, GE swapped its home electric appliance division, which was not internationally competitive, for the medical system division of the French company

Thomson, inclusive of the staff. The swap boosted the competitiveness of the divisions on each side, and therefore benefited both. At the same time, the affected employees on each side were also winners, in that the swap gave them jobs with a company ranking at the top worldwide in the field in question.

GE's ability for timely disposal of companies and divisions through M&A moves, in packages including staff, derives more from the management environment of the United States than from the shape of the corporate organization. At the least, it can be said that organization in terms of business divisions, as in American companies, favors such resolute tactics. By contrast, Japanese companies would find it hard to deploy M&A tactics under the current type of divisional system. Japanese employees tend to have a deeper sense of belonging to the firm employing them, and elements such as in-house unions are fixtures of Japanese-style management. To compensate for this kind of environment, Japanese companies would have to make adjustments in their organizational setup.

Third, trading firms must have superior powers of both strategic thought and strategic action, as well as organizations that are geared from prompt decision-making and execution by the company. U.S. companies are typically said to be managed "from the top down" with great powers of strategic conception. And in recent years, they succeeded in building up their powers for execution of strategy, which were generally regarded as weak, by making extensive use of sophisticated information technology to pull down the information barriers between the head-office brass and the business divisions. This is also a factor in the increased strength of U.S. firms in the tough competition in the global market, where the speed of corporate action can determine the fate of the business.

Japanese companies, on the other hand, have typically been regarded as being excellent at executing strategy but not so adept at devising it. This style of management is also a weakness of Japanese trading firms. While retaining the good features of the Japanese style, trading firms therefore should bring their management closer to the U.S. style with a view to acquiring superb strategic powers of both thought and action with a global outlook, and to remodeling the organization for a great improvement in the speed of decision-making and action. For instance, trading firms must heighten the autonomy of their business divisions by delegating more authority to them, and also reinforce the head office unit in the interest of prompt decisions at the top on large-scale projects with a high strategic value.

Fourth, trading firms must bolster provisions for risk management and other forms of corporate governance. In a recent Moody's report, it was noted that risk management at trading firms is not functioning adequately, in spite of all the talk about its importance for so many years. The report also asserts that the frailty of risk management at these firms is caused chiefly by the feebleness of control of risks, and of corporate governance associated with project investment and in the portfolio aspect. There is a strong connection here with the fact that trading firms take the form of business holding companies. In essence, they accord top priority to the profit of their various business divisions. As a result, in both dividend policy and transaction policy, the logic and interests of the parent business divisions are given precedence over the interests of subsidiaries and affiliates.

For their part, the business divisions tend to have strong preconceptions about the business of firms under their umbrella and to have difficulty maintaining a strictly objective stance as investors. Furthermore, the business division control over these firms has not been all that it should because the parent divisions must look after numerous such firms while also tending to their own operation.

If trading firms become more deeply committed to project investment, it will be even more vital for them to undertake organizational reform for correction of these deficiencies

Network organization based on pure holding companies

One type of organization that could meet these requirements is a network organization based on pure holding companies. In Japan, an amendment of antitrust law has removed the 50-year ban on establishment of such entities. There is no general rule prohibiting pure holding companies in developed countries of the West, and the amendment is expected to give Japanese firms the same range of management options as Western counterparts enjoy. Trading firms ought to consider taking the form of pure holding companies with a view to organizational reform from the aforementioned four standpoints, as follows.

In the first place, the combination of specialized and generalized competence could be achieved by transforming the head office, which would be in charge of companywide strategy, into a pure holding company, and the business divisions carrying out the actual operation, into independent companies. The question in this case is the degree of easiness of information acquisition, i.e., whether or not the head office unit as a pure holding company would be able to share information held by the business divisions after they have been set up as separate companies. The head office unit would probably have less knowledge about the business per se than a holding company of the business type. By the same token, management of project investment from the portfolio aspect could be expected to reach higher levels of sophistication because supervision of the activities of subsidiaries would be the chief work of the head office unit. Any information difficulties could presumably be overcome through extra measures for information exchange and sharing between the head office unit and the business companies. These could take the form of regular video conferences for executives and expanded information networks.

As for the second reform item (improved investment efficiency), transformation of the head office unit into a pure holding company would make it easier, even in a Japanese-style management culture, to carry out an extensive reorganization of business divisions through merger and acquisition tactics, which are difficult to execute under the current divisional system.

More importantly, strategic product investment in new fields having little connection with existing ones could be made under the jurisdiction of the head office unit in separation from the existing business divisions, and this would facilitate moves for higher efficiency in long-term business investment. Venture-type investment of a high-risk, high-return disposition and strategic project investment with a long gestation period could be seated in an ad-hoc business development company directly responsible to the head office unit.

The third reform item of reinforcing powers of both strategic thought and strategic action could be accomplished by separating strategy from the operation. Naturally, this can be done even with holding companies of the business type if the right systemic arrangements are made. In fact, trading firms are already introducing the company system in an attempt to separate strategy and the operation. However, a pure holding company scheme would be much different, in that the head office unit and business divisions would clearly be separate entities with mutually distinct roles in this regard. The clear definition of roles through this scheme would probably make it easier for shosha-man (trading firm personnel) to execute strategy.

Finally, instatement of a pure holding company scheme could serve to reinforce governance of subsidiaries and affiliated companies. This scheme would draw a sharp line between the business companies, each headed by executives with an entrepreneurial outlook who are enthusiastic supporters of business development, and the head office unit, which must take an objective look at things from the portfolio aspect (i.e., investment efficiency) and devise strategy with an investor-like attitude. As a pure holding company, the head office unit would not be directly involved in the business and therefore would be freer of preconceptions and wishful thinking about it. This, in turn, will make it able to view the business and financial affairs of subsidiaries more objectively than a business holding company.

Current organization of trading firms and the company system

Today's trading firms can be regarded as characterized by three major pairs of features: 1) function-type divisions in charge of management and administration, and sales divisions in charge of the operation; 2) a network of overseas locations including independent affiliates and a network of domestic locations; and 3) a group of overseas business companies and a group of domestic business companies. Overall, trading firms apply a divisional system that is centered around the sales divisions, and take the form of business holding companies that own independent overseas affiliates and other business firms inside and outside Japan.

The strategy of adopting a pure holding company system would have to proceed from the current divisional system as the starting point. To bridge the gap between the two, the in-house "company system" could be instituted as an intermediate stage. The following is an account of this option, which has already been taken by some leading trading firms.

The company system could be regarded as a form of internal branch companies. In the case of trading firms, the sales divisions and other business units generating profit are given positions akin to independent companies in the in-house organization.

One of the distinguishing features of this approach is that these profit-making units are apportioned internal capital as if they were independent companies. Based on this capital, these units each have their own balance sheets.

As such, these quasi-companies can use these financial resources to make their own investments. This type of organization therefore holds advantages for trading firms which intend to give more weight to investment activities for the future. Furthermore, because the quasi-companies have their own balance sheets, they can also accumulate internal reserves. This amounts to an in-house system of surplus funds, and the recognition of such internal reserves for these units provides the incentive for development of project investment with a higher degree of autonomy.

A second characteristic is that the in-house companies, like truly independent ones, are accountable for net (after-tax) profit. Under the current divisional system, by contrast, the responsibility of the sales divisions essentially extends only up to the level of operating profit as a management target. Moreover, the quasi-companies can be evaluated in terms of not only their own accounts but also net profit as appearing in consolidated statements inclusive of the net profit and loss of business enterprises under their umbrella. Whereas the sales division responsibility for the performance of the numerous enterprises under their control goes no further than dividend income under the divisional system, it therefore can be extended to the very net profit of the same under the company system.

As a third characteristic, it can be observed that the in-house companies are evaluated by the head office unit with reference to ROE and ROA. The absolute amount of net profit is, of course, a major management concern, but the operating efficiency of the internal capital apportioned by the head office unit becomes a key indicator. In other words, the head office unit can direct more capital to those companies judged to yield a higher profit on the same investment.

The in-house company system therefore would put a substantial limit on the conventional approach under the divisional system, whereby sales divisions continue to make vigorous investments and participate in markets yielding only low profits for the purpose of building bridgeheads and expanding the company share from a long-term perspective. Leading investment of a strategic nature therefore would probably have to be made by the head office unit, based on its own judgments and with its own capital. The in-house company system places the apportionment of internal capital at the pivotal point, and this makes possible transition to an organization with management features that cannot be delivered by the divisional system. Nevertheless, it is a scheme of only pseudo-companies fabricated by the internal system and administrative accounting procedures. Its effectiveness will vary depending on the degree to which these virtual companies seem real in the minds of employees. By contrast, the pure holding company system would offer the same benefits as that of in-house companies but entail the formation of real branch enterprises. For this reason, it would demand a more serious renewal of consciousness among executives as well as the rank-and-file.

Vision of the organization of tomorrow's trading firms

The foregoing raises the question of the nature of the organization at trading firms opting for the pure holding company system. By way of response to it, this section presents a vision of tomorrow's trading firms with a focus on the organization.

The head office unit that becomes a pure holding company would be as slim as possible and possess formidable capabilities of strategic thought so that it could function as the seat of groupwide control from a lofty position and perspective. It would have five major capabilities/functions, as follows.

First, it would administer the existing business divisions that are detached and set up as branches in the portfolio aspect. Thanks to the separation between the management and business ends, the business divisions would be free to concentrate on achieving higher levels of investment efficiency in their business, while the head office unit could engage exclusively in administration and concentrate on supervision of the business divisions from a neutral position. The head office unit would also be the seat of governance over all affiliated business divisions, like a main bank.

Second, the head office unit would be in charge of investment for development of new business that is not an extension of the existing business. In this connection, it would probe strategic prospects involving venture capital, M&A, and alliance. It would therefore fulfill the role of venture capital.

Third, the head office unit would be in charge of and administer the function (i.e., function-type) divisions. Besides the vertical business divisions organized in terms of product fields and known as sales divisions, trading firms have horizontal divisions organized in terms of function and known as secondary sales divisions. Examples are the financial and distribution divisions. There is a strong possibility of reorganization of the personnel, information, legal, and other such function divisions into business divisions. In such an event, these divisions, like the existing business divisions, would be set up as separate companies, placed under the umbrella of the head office unit, and geared for improved efficiency.

Fourth, the head office unit would be in charge of and administer both the foreign and domestic locations. It would be responsible for matrix management encompassing the product divisions, function divisions, and regional networks of locations. However, because these three components would be comprised of independent companies, transactions among them would be left to the free market process. For example, whether a product division is to utilize the services of a function division or outsource them from another company altogether would be a matter for the company in question to decide, based on the service substance and cost. Similarly, the services and space of the regional locations would not be utilized if it is more economical to contract with external agents and to lease office space. Direct matrix management of the regional locations by the head office unit would therefore be extremely limited; emphasis would be placed on portfolio management of regional headquarters from the standpoint of a pure holding company.

Fifth, the head office unit would prepare long-term plans for the entire group and make decisions on strategic projects. It would also have skills of coordination across business and regional boundaries for exercise of synergy. In the interest of swift decision-making, large-scale projects involving several divisions would have to be planned and decided at the top (as opposed to through consensus built “from the bottom up”), and this would be another key role of the head office unit.

The business divisions as business units

The existing business divisions organized in terms of product field would be turned into business holding companies devoted exclusively to execution of strategy. They would be business units of the optimal size, capable of exercising creativity and autonomy.

Besides its own internal departments, each business division would have subsidiaries and affiliates. Each would pursue business centering the two hubs of trade and investment. As a result, each would heighten its ability for execution of strategy and deepen its customer orientation in its field of special competence. Although the optimal size as a business unit would vary with the division, the organizations should be as small as possible to facilitate exercise of creativity. Business units far outnumbering today’s business divisions therefore could be linked in a network under the umbrella of the head office unit as pure holding company.

To elevate trading firm capabilities and increase mobility, the reorganization of divisions into separate companies should not be confined to the product divisions, but include the horizontal divisions in charge of financing, information, distribution, development, etc. Unlike the product divisions, which would engage mainly in trade, the companies born of the function divisions would act mainly as seats of investment in all kinds of business in the field in question. It consequently would be better for them to take the form of pure holding companies rather than business holding companies. The company in charge of financing, for example, could have insurance companies, non-banks, and other sorts of financial institutions under its affiliation, and itself engage mainly in formulation and execution of strategy in the financial field and supervision of the affiliated enterprises. The company in charge of development, on the other hand, would make venture investments of strategic importance as planned by the head office unit. In each case, the companies would form a second tier of pure holding companies under the head office unit.

Streamlined overseas networks

As for regional strategy, tomorrow's trading firms would construct networks with cores in the United States, Europe, Asia outside Japan, and Japan. The head office unit would function as the central hub, making strategic decisions from a global perspective. In each core market, a regional headquarters would be established for control of the locations there and apply a system of self-supporting accounts. The regional headquarters would also form a twin tier of pure holding companies together with the head office unit. The head office unit would probably be located in Japan, but this may not be necessary for discharging its duties. Even if it is located in Japan, a separate regional headquarters would also be established there to safeguard the head office function of strategic conception from a global standpoint. The Japanese headquarters would be in charge of the network of locations in Japan.

The network of overseas locations has supported the international information capabilities and synergy of trading firms, which may have a great geographical expansiveness, by ensuring that they have a business presence in markets around the world. The offices in developing countries have been maintained throughout the years in spite of considerable political and economic turmoil, and so have earned the trust of the populace there. This network must be termed a key asset of trading firms that was painstakingly constructed by them over a long period. At the same time, however, it cannot be denied that the need for patronization of trading firms in overseas business is fading along with the globalization of activities by Japanese firms in general.

In addition, the rise of Internet and other global information networks is making it easy to obtain international information at reasonable cost. Under these circumstances, the maintenance of a worldwide network of overseas locations staffed mainly by Japanese employees is becoming a chief cause of high commercial firm costs.

The global strategy of tomorrow's trading firms will lie in induction of overall synergistic effects by deepening the commitment to local markets and building up expertise as regional specialists. At the same time, however, it will be difficult to achieve this equally over the world , along the lines of the global coverage to date.

Trading firms will have to make thorough reviews of the network of overseas locations with attention to cost performance, and conduct programs of selection and rationalization based on the results.

Such programs would amount to restructuring through an extensive, ongoing consolidation of locations. They would leave only those locations which have self-supporting financing capabilities and profitability, and a sound base of independent management, and are part of the groupwide synergy; for the others, a switch would be made to the employment of local staff or outsourcing. The point is to streamline the overseas network and make it a leaner one consisting of selected overseas locations that were reinforced.

Divisional system as an option for synergy

There could be some disagreement about the viability of the network organization in which the head office unit takes the form of a pure holding company as described above. This is because, if they set the business divisions up as separate companies and become pure holding companies, trading firms could lose the advantages enjoyed under the divisional system.

One concern is that the pure holding company system would work against the sharing of information among subsidiaries and between subsidiaries and the parent, make the management responsibilities of the parent unclear, and detract from the synergistic effects obtained under the divisional system. The problem here is how to achieve the “best mix” of decentralization and centralization of authority. It is consequently thought that many trading firms will limit the detachment and incorporation to those divisions which have a highly autonomous management and staunchly independent disposition, free of head office expectations for anything above dividends; the other divisions would retain the form of business holding companies attached to the head office. To compensate for the drawbacks in this area, it will be vital to ensure a full sharing of information in the pure holding company system, and this will call for sophisticated information networks, which will also be needed to induce synergy. This could be accomplished by building global information network systems that link the holding company (head office unit) with the regional headquarters and their respective groups of satellite subsidiaries by intranet.

Another concern is inability to transfer internal profit and loss between divisions. Transactions known as “combination deals” have been one of the manifestations of trading firm synergy. They may be exemplified by deals combining an oil transaction with a shipping transaction. The oil is received at a rather high price, but the ship export yields an immense profit. This profit is distributed between the division in charge of oil transactions, which would otherwise produce loss, and that in charge of ship export. Because both are in-house entities, the transfer can be carried out quite easily. This would not be the case if they are separate companies. A pure holding company system involving detachment of business divisions and their re-inauguration as completely independent, self-contained companies could therefore work against the quest for synergy, especially in the case of trading firms which intend to keep intermediary transactions as the major pillar of their business. This is a potential stumbling block and merits in-depth investigation and discussion.

(5) Management philosophy: a truly global company and a good corporate citizen of the world

Management philosophy for becoming a truly global company

To become genuinely global companies, trading firms must embrace a management philosophy that is grounded in universal values, i.e., values that are held internationally. Tomorrow's trading firms will present a diversity of forms of employment transcending distinctions of nationality and ethnicity, and have a mass of local subsidiaries devoted to the market in which they are sited. In their network organizations that have both local and global dimensions, the management philosophy will rank alongside information sharing as a vital force holding the group together.

Management philosophy is also needed to maximize the corporate profit. It must motivate each and every employee to make a complete commitment of his or her energies to the company in search of self-fulfillment. By uniting the corporate and individual objectives, it raises morale throughout the company.

The management philosophy also serves as a means of imparting the corporate identity to all employees as the agents of the diverse development of business on a global stage. If they are instilled with the philosophy's values, they will refrain from acts which violate those values, whatever their assignment and wherever they are. If trading firms may be likened to ships attempting to navigate the global seas, the management philosophy would be a polar star. It presents an unchanging set of values that will push employees ever on in their work. Firms which construct such a philosophy and see that its values permeate the operation will be in a position to win trust as truly global companies that are also good corporate citizens of the world.

Company-wide permeation of the philosophy

For trading firms intending a global expansion, it is therefore important to devise a management philosophy, but it is even more important to put it into practice. Firms must make sufficient expenditures for regular checks to make sure that all employees perfectly understand the philosophy and are applying it in their activities company-wide. One company that has been given high marks for its construction of a philosophy under the banner "Our Credo," as well as its efforts to see that its roughly 90,000 employees around the world faithfully practice the same, is the U.S. firm Johnson & Johnson.

The Credo is set down in writing, up-to-date, and simple language. The terms and expressions have been revised several times. Every few years, executives from companies that are members of the group, which has affiliates worldwide, get together for modification of details and expressions and for discussion on practice of the philosophy in management. Once every two years, the company conducts a questionnaire survey with its employees around the world to confirm that things are actually being managed in line with the philosophy. In short, J&J is spending a lot of time and money to keep its image as a trustworthy and clean company intact.

(6) Leadership at the top: structural reform and professional management

Expertise as management professionals

With its boundless stage of borderless business activity, the 21st century will present trading firms with chances for great leaps, but these chances will always be accompanied by risks, and so colored by uncertainty. Radical changes unfolding in the competitive conditions and rules which Japanese companies have taken for granted to date will increase the possibilities of entry from different industries and the birth of new enterprises in the field in question. At the same time, trading firms will be locked in fierce rivalry with a wide variety of other players under the new competitive circumstances. Entrants without the power to defend themselves will not be able to survive. This is why trading firms must set about structural reform without delay.

Given this requirement, forceful leadership at the top is assuming increasing importance.

To increase the professional caliber of management, trading firms should at least provide in-house training for executives with a specialized competence at an early date. In those intending to evolve from mere trading firms into high-profit global players of a larger scope, it could very well be necessary to recruit first-rate management talent from outside the company. The company brass will also require a higher level of expertise as management professionals, including excellent powers of strategic thought and a good sense of balance in respects such as the distribution of profits among stakeholders. Thus far, management at Japanese companies has undeniably put employees before shareholders in the distribution of profit, and trading firms are no exception. To grow into truly global companies, trading firms will have to show more consideration for the shareholder piece of profits.

Incentives for attaching increased importance to shareholders

As the global capital market becomes increasingly borderless, trading firms will presumably have to be managed with more attention to their shareholders. This is to say that they must be more geared to get the maximum value from their capital if they are to raise funds on favorable terms. And in the handling of profit, the market will undoubtedly no long tolerate the Japanese-style practice of curtailing shareholder dividends and expanding the latent corporate holdings. Precedence should instead be accorded to purchase and amortization of the company stock and restoration to shareholders in the form of dividends. In the age of megacompetition and the free flow of capital around the world, companies will in effect be vying with each other to attract shareholders, and capital will gravitate toward those stressing efficiency in its operation. As such, incentives must be provided for management that is more shareholder-minded. One prospective means to this end is the institution of a stock option scheme.

4. Six recommendations

Assimilating the contents of the preceding sections, this section presents six recommendations for structural reform and transformation into tomorrow's trading firms. The 21st-century trading firms emerging from this reform should be fully prepared to discharge their role as standard-bearers for the formation of new markets for the global economy; agents of the globalization of, and shift to the service sector in, the Japanese economy; and fine global corporate citizens helping to usher in the hyper-information society of the new age.

Recommendation 1: Shift from omnibus strategic comprehensiveness in the basic outlook on allocation of resources

Conventional trading firm strategy has covered everything from mineral water to satellite communications, and without much selectivity. Trading firms must replace this kind of omnibus comprehensiveness with a leaner, more strategically-minded version exhibiting greater selectivity in the allocation of resources. The switch can be made by active resort to outsourcing, resolute priority investment in fields conducive to production of synergistic effects for the entire group, and incessant restructuring. This will amount to a vigorous scrap-and-build program whereby firms actively commit resources to new businesses and high-return fields while also actively eliminating non-performing divisions. Trading firms are hardly incapable of restructuring even today, but the speed of the same will be of the essence. They therefore must make provisions enabling abandonment of business at an early stage without much pain and smooth withdrawal without detracting from job security.

Recommendation 2: Refinement of powers of global business creation as the core capability

In the 21st century, the focus in trading firm business may be expected to move to global business project investment, and this should lead to a considerable increase in high-risk, high-return business. Trading firms therefore will need sophisticated capabilities of business creation, which may be viewed as packages of skills in risk management and in business generation and construction. As the term indicates, these capabilities will make it possible to create business and develop markets on a global scale. At the same time, firms must reinforce their existing core capabilities and exercise them in combination. It will also be vital to replace "scale" with "value" as the orientation of management objectives. Firms will have to give greater priority to the production of new economic value by developing new businesses and markets, and to the provision of high-quality services, goods, and software by upgrading their capabilities and expertise. In such efforts, they should aspire to become empowered not merely for adaptation to change but for anticipating the times and igniting trend-setting change themselves.

Recommendation 3: Development of human resources (the most precious type of trading firm resource) for a corps of highly professional entrepreneurs blazing new business frontiers

To lead the way in the 21st century, each and every trading firm employee will have to possess a superlative level of professional expertise and powers of management-type thought to open up new business domains with an entrepreneurial spirit.

This is to say that trading firms will need personnel systems attuned to their combination of generality and specialty. To afford venues for self-fulfillment within the company, they should have flexible arrangements that will give all employees chances in fair competition with each other, without abandoning the principle of employee accountability.

Recommendation 4: Ultimate organizational reform for flexible, speedy, and steady creation of business by a network organization

Trading firms must carry out a far-reaching reform of their current corporate organization. The ultimate goal would be the network organization. This would effect a separation between management strategy and the operation, and allow the head office unit to present strategy for the entire group plotted from a lofty standpoint and perspective. Beneath the head office unit would be a network of highly independent business divisions devoted to execution of the strategy. The keys to this transformation are a higher level of specialization in the business divisions and comprehensive capabilities of orchestration and control over complex projects by the head office unit. In the interest of specialization and efficiency, it would probably also be necessary to make the divisions in charge of horizontal functions such as financing, information activities, development, and investment into more independent entities, like the product divisions.

As for the organization of overseas locations, trading firms must strive for a network-oriented scheme revolving around regional headquarters in markets such as Asia, Europe, and the United States, and including the respective locations under them, each with their own group of subsidiaries. The overseas locations must become more firmly anchored in the market in question and also raise their degree of professional expertise about it. Trading firms also must resort to means such as laying the foundation for autonomous management, appointing more local staff, and outsourcing in order to make overseas networks into lean systems composed of locations that have been specially selected and reinforced.

Recommendation 5: Management philosophy befitting truly global firms that are good corporate citizens of the world

Because they are genuinely global companies, trading firms must draw up a management philosophy that is grounded in universal values held the world over. Those which are able to permeate their entire organization with the values of their philosophy and see that it is put into practice will be viewed as truly global firms that are good corporate citizens of the world and merit trust.

Recommendation 6: Formidable leadership at the top for structural reform, and development of more expert management professionals

The 21st century will offer trading firms chances for great leaps, but always accompanied by risks. In this sense, it will be an age of uncertainty as well as opportunity. The competitive conditions and rules which Japanese companies have taken as a matter of course thus far are in the process of fundamental change. At this juncture, trading firms must undertake programs of structural reform without delay, and this will demand more formidable leadership by their brass. It may be added that the top layer of management will have to acquire a higher level of professional expertise in managing, including excellent powers of strategic thought and ability to strike a proper balance in all areas, include allocation of profit among stakeholders.