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SAVING FAMILY BUSINESS SUPPLIERS OF KEIRETSUS

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Abstract

The Institutionalized business culture of a country exerts a strong influence on the executive and strategic directions of a multinational corporation (MNC). On the other hand, the MEs (medium sized enterprises) are also responsible towards the growth of a MNC, especially in the national business market and generally in the international platform. We study the tensions arising due to the inevitable globalization of the MEs. The impact of globalization is felt within the traditional institutionalized business culture of MEs (in Asia) and as a result, on the national business system. Particularly, this study examines the current situation of Japanese family businesses, which are small and medium sized suppliers to keiretsus, the large Japanese enterprises. The post-second world war success of the Japanese economic system is analyzed followed by its current collaboration with suppliers, which are tied to specific large Keiretsu enterprises as a sole supporter. We show how the lack of adaptation with the fast changing demands of globalization is causing the failure of keiretsu enterprises, like Toshiba, Canon etc. and thereby, affecting the fate of their suppliers.

In comparison, we specifically look into the case of Germany, which was also decimated after the Second World War and subsequently bounced back with a very successful economic system. In particular, we argue that the German Mittelstand can serve as an example of leading innovation and global niche market dominance, in contrast to the MEs tied to local enterprises. Through this comparative study approach between the German Mittelstand and Japanese Keiretsus, we suggest what the Japanese policy makers may have to engage in globalization and resolving issues of succession that plague family enterprises.

Keywords: Japan, Mittelstand, Keiretsus, Globalization, Policy, Family Enterprise, MEs.

1. Keiretsu and The Rise of Japanese Conglomerates

Before the Second World War, the four major family-owned business houses, termed as Zaibatsu – namely, Mitsubishi, Sumitomo, Yasuda and Mitsui, dominated the Japanese economy. In order to curb the monopoly, which was perceived as anti-democratic, Zaibatsus were specifically targeted for dissolution during the American occupation of Japan during 1945-1952. The dissolution of Zaibatsu was also marked by the subsequent rise of Keiretsu, where the shared stockholding took dominance over family held conglomerate. The set of businesses within a Keiretsu forms a complex layer of business relationships and shareholdings, not unlike a large family-held business.

The Japanese government policy (Industrial Targeting Policy) was designed to build internationally competitive industries, from nothing but only ashes after the war. The goal was to increase exports from Japan to survive, under which policy conventional SMEs required to be totally re-modelled or to be reformed into more "modern" management organization. This entailed management principles derived largely out of American management practices, such as, booking, accounting and enforcing technological development to management structure. This policy was included an implicit growth of Keiretsu-targeted industries or companies who accordingly started to behave like the parent of these small SME suppliers (Keiretsus). Traditionally, the SMEs were called "Do-ZokuKigyo" (literally translated to companies, which are interrelated by the same human blood chain) and were looked down as the typical symbol of backwardness of the Japanese Capitalism. Hence, simultaneously with the aforementioned policy reformations; "SME Cooperative Act" was enacted in 1949; towing the lines of economic democracy and anti-monopoly; and gradually resulted into formation of the tightly knitted Keiretsu Pyramid Industrial Structure. The post-war economic resurgence of Japan is largely credited to the rise of Keiretsus, in particular the big six, Fuyo, Sanwa, Sumitomo, Mitsubishi, Mitsui, and Mizuho Financial Group.

The horizontal diversification of the shareholding in the Keiretsus was primarily resulting from the dissolution of Zaibatsus and also in order to push back any efforts of a hostile takeover by a foreign entity. The alliance is further strengthened by vertical supply-chain management and creating dependence among the companies within a Keiretsu. Moreover, each Keiretsu is centered on a bank, which guards any potential takeover bid, safeguards against economic crisis and also holds equity in the Keiretsus. The concept of Keiretsu is fairly unique in Japan. Parallels of this are found in some cases internationally, such as large consortium in airlines and media industries.

With the bulwark of Keiretsus against any potential foreign takeover, Japanese economy flourished with a mixed economic model. From 1965 to 1980, even with trade liberalization and associated apprehension about foreign capital influx, Japanese economy recorded a staggering growth of GDP from $91 billion to $1.065 trillion.

2. MEs Tied With Keiretsu

Traditionally, Japanese SMEs largely operated as suppliers for large enterprises as part of the keiretsu system of integrated supply chain groups. With some exceptions, SMEs tend to be domestically oriented and export indirectly via the value chains of large multinational enterprises and general trading houses. It was realized soon in the wake of global financial crisis that, these arrangements are increasingly suboptimal. As the country's population continues to shrink at an alarming pace, Japanese SMEs urgently need to seek opportunities in faster growing regional markets to diversify demand and remain viable. Despite being the backbone of the Japanese economy, accounting for 99.7% of all Japanese enterprises and 70% work force, only about 10 per cent of Japan's medium-sized enterprises engage in direct export as compared to 15 per cent and 32 per cent from the US and EU, respectively. The problems plaguing Japanese SMEs are shrinking domestic markets, labour shortages, aging facilities, and a widening productivity gap compared with larger enterprises.

3. Impact of Globalization on Japan

Rising competition in a "flat world" means that Keiretsus are up against stronger international opponents, which calls for disruptive business strategies. In 2015, Toyota launched a new Corolla in Japan this year that shocked its tight-knit Japanese supplier network: a cutting-edge crash prevention system made by Continental, a German parts maker. Until then, Toyota relied on Denso, a major parts maker and key member of its traditional supplier network that provided such equipment only in high-end Toyotas. The decision to go outside its traditional network highlights a growing concern within Japan's car industry: parts suppliers, once considered the foundation of the country's car export prowess, are losing their edge, especially in next-generation software technologies for safety and autonomous driving. "Competition in the global automotive industry is becoming fiercer," Toyota president Akio Toyoda said earlier this year. "This is the time when Toyota must change its formation."

This strategy of Toyota is lauded by some analysts and identified Toyota as the "new, improved Keiretsu" (Aoki & Lennerfors, 2013). This set the stage for further breaking of the closely guarded Keiretsu network. For example, KKR bought Nissan-backed supplier Calsonic Kensei in 2016 (CNBC, 2016).

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Effects of globalization would also mean storming the recessions that regularly hit global financial markets starting in 2008. Note that the asset price bubble already weakened the Japanese economy in 1990 and kept it locked in recession for decades. In such periods, the unfailing loyalty of Keiretsu, and protecting it without questioning, in fact dragged the economy behind. A case for example is the Olympus scandal Tabuchi, (2011), which allowed the executives to deploy an all-familiar scheme of booking the losses, in effect, performing a large-scale accounting fraud.

The impact of globalization on Keiretsu was worsened by the fact that there were better equipped and determined niche market players that left no stone unturned to increase their presence in Japanese market. Continental, the auto-parts supplier, is a prominent example. However, it is not only the German automakers or EU that is proactive in breaking the Keiretsu practices. In 1989, the United States faced a mounting trade deficit, most of which was owed to

Japan, and complex nontariff barriers to U.S. products entering Japanese markets. The Bush Administration, in an effort to open Japanese markets and reduce the trade deficit, launched the United States-Japan Structural Impediments Initiative (SII). These efforts in overcoming the Japanese import barriers, presumably due to the Keiretsu practices, continued well into the formation of Trans-Pacific Partnership (TPP) agreement in 2016.

4. Japan and Germany: A Comparative Look

Japan and Germany shared similar cultural perspective and rapid rise of their economy in the post-war reconstruction period. However, they adopted different strategies, leading to clearly different results.

Japanese culture that once paid rich tribute to professional craftsmanship and merchant-ship had been quite hurt and left out without respect because of the government strategies like the said that is the truth about Japanese SMEs and FBs. Whereas, in Germany, unique formation of SMEs aggregation in the name of "Mittelstand" has been the historical and cultural result where respect to craftsmanship, and hence pride by those who worked for SMEs had long been nurtured and is now socially shared and maintained.

As for the policies, it differed significantly as well. For Japan, MITI targeted first at light manufacturing industries and later heavy manufacturing ones to make them export-competitive, in which strategy, manufacturing SMEs were woven into the pyramid industrial structure, where the SMES aspire to be the best reliable "dependent" partner, to comprised subcontractor groups to support its patron company. On the other hand, for the SMEs in Germany, they were honoured as independent and self-driven exporter [5], apart from supporting the local large corporations. As a result, from a study in 2012, it is found that while 2.8% of Japanese SMEs are participating in export, the figure is 19.2% for Germany.

5. German Mittelstands and Post-War Globalization

Though the two nations formed an alliance in the war and faced similar immediate aftermath, Germany took a different path towards its economic revival. One of the answers to Germany's success lies in its Mittelstand companies, their global competitiveness and their export orientation. "Mittelstand" in German means medium-sized companies, but invariably it refers to their SMEs that are family owned, or family-like corporate culture. They make up approximately 68% of Germany's exports and are the "backbone" of its economy.

These Mittelstand companies have established themselves as global leaders in many niches and have strong export markets. Examples include lesser-known brands Flexi in dog leashes, 3B Scientific in teaching equipment for science and medicine, Klett in textbook publishing and well-known brands like Playmobil in toys, Staedtler Mars in writing equipment, Sennheiser in audio equipment, and Miele in white goods.

In 2012, when Spain's youth unemployment rate was more than 50% with 1.5 million university students and only 270,000 trade school students, its Education Minister signed an

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agreement to bring Germany's “dual system” of vocational training, which combines classroom instruction with work experience, to its youth. Similarly, the Confederation of British Industry wanted Britain “to have its own version of the German Mittelstand”. Even when President Trump’s recent meeting in Washington with Chancellor Merkel did not go well, he still found common ground with praise for the Mittelstand and workforce training for the 21st century.

6. Mittelstand Stands Out

We identify six main characteristics of the Mittelstand that have made Germany a world export leader, and the trademark “Made in Germany” a symbol for German engineering, quality and reliability.

Family Business-oriented: Largely, these firms are not listed in financial markets, long-term oriented, financially conservative, invest in building skills in their employees, do not use a hire-and-fire strategy and community driven. The smaller ones tend to keep their production facilities in the locale in which they started in Germany, preferring to set up sales and service centres globally. Only recently have some started to raise capital through issuing bonds; otherwise, it has been investments through retained earnings and bank debt.

Global Niche Dominance: Technology and product engineering has become a part of the German national identity with performance, reliability, safety, durability and design bolstering acceptance in the global niche markets. Mittelstand often cater to small market segments but do so worldwide (termed “two-pillar strategy”). They avoid industries requiring high levels of capital asset expenditures and competition against large public corporations. They are solution providers rather that of just Products and services.

Geographical position: Germany occupies a geographically strategic position between Asia and the Americas that enables shorter travel times and communication advantages while uniquely positioned in Europe, bordering nine other European Countries. Germany gained hugely from the unification process and customs union.

Strong Educational Ties: Mittelstand supports the pillars of education, basic research and technology transfer and these supports are implemented via an organized approach – Fach Hochschule (FH) and Technische Hochschule (TH) produce strong vocational training graduates (equal in status with Universities); technology transfer is enabled by organizations like Fraunhofer; and basic science is promoted by centers like Max Planck.

Technological Leadership and strength in innovation: The foundation for these firms’ market success is innovative products and services of high quality with unique selling features that often define the state of the art in their respective markets. A key reason for staying cost competitive is the Mittelstand companies’ continuous investment in introducing advanced production methods. Along with that is their ever-increasing investment in R&D, working with a number of academic research institutions on the improvement or invention of new products and services.

Government Support: Government has played an important role in SME success. Kurzarbiet (or part-time working scheme) is a government work subsidy mechanism by which employees get about 80% of their pay while working just half time, especially in times of economic downturn orrecession. The German tiered banking system has as its third pillar, small cooperative banks that are owned by their members, operate on a mutual guarantee basis and subject to a regional principle, and are the principal source of Mittelstand funding. German Chambers of Commerce Abroad (AHKs), to whom all German enterprises are obliged to belong, focus on foreign trade promotion and support Mittelstand companies in their search for global markets. The AHKs are present in 130 locations in 90 different countries and have quasi-governmental mandates in areas such as organizing vocational training; providing information on taxes, marketing, innovation, and business law; offering advice on topics from incubating a business to energy efficiency.

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7. What Japan Can learn?

Analysis shows that SMEs, which generate healthy returns from their investments in overseas business development, share a series of common approaches. These include effective cost-benefit forecasting for hiring, training the necessary human resources including non-Japanese staff, formulating a strategic vision and business plan as well as taking a flexible, step-by-step approach as they build their overseas operations. There is concern that overseas business development will lead to fewer local employment opportunities. However, analysis shows SMEs, which invest overseas tend to increase their domestic employees.

Many of Japanese big companies, which were once seen as almost unbeatable, started losing competitive powers, not necessarily because of the Keiretsu System being weakened, but more due to the complacency in their technological and production superiority. This scenario did not last for long. Quick imitation and competition came from Taiwan, Korea and China. Therefore, large Japanese companies are considering dissolution of their Keiretsu supply chain and searching for solution for regaining competitiveness, either by finding suppliers out of Japan with cheaper labour cost or to build really high technology barrier in niche product areas. This is a welcome change, which draws a clear parallel to the strategy adopted by the SMEs in Germany.

Overall, we can summarize the following lessons that could be important for Japanese SMEs. First, to understand and explore global niche market by making the SMEs more export-driven. Second, to actively promote internationalization and adoption of the business of culture beyond national boundaries. Third, to form strategic alliance with clear competitive edge; and finally, forsaking loyalty over performance.

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