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Keiretsu: Their Effect on Business and How American Government and Business Can Confront Them

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Keiretsu: Their Effect on Business and How American Government and Business Can Confront Them

I. INTRODUCTION

While recent reports indicate an increasing tolerance of foreign companies doing business in Japan,¹ substantial obstacles still exist.² One of the most difficult aspects of doing business in Japan is competing with the well-established system of keiretsu³ which permeates the Japanese business world. Simply defined, keiretsu are networks or families of corporations that have interlocking interests in one another.⁴ Keiretsu primarily affect foreign and local companies competing in the Japanese market, but they also have a secondary effect on U.S. companies competing with keiretsu-affiliated Japanese companies operating in the United States. For many "foreigners trying to do business in Japan, [keiretsu] have become the symbol, and source, of the country's most exclusionary practices."⁵

This comment examines the effects of keiretsu on business in Japan and America. It also explores approaches American government and business can take to confront keiretsu. Section II of this comment begins with a brief overview, summarizing the origins of keiretsu and defining its different types. Section

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¹ According to a report given to the American Chamber of Commerce in Japan (ACCJ), "[t]he environment for U.S. trade and investment in Japan has significantly improved in the last five to 10 years." Green Light Seen for Trade, JAPAN TIMES, June 12, 1991, available in Nikkei Database. Also, "[i]n an extensive study done in early 1991 by the ACCJ and the global management consulting firm A.T. Kearney International Inc., . . . some 55 percent of respondents said the climate for investment had improved over the last five years." Trade, Investment Climate Has Improved, Survey Finds, INT'L BUS. DAILY (BNA), Aug. 29, 1991, available in LEXIS, Nexis Library, BNAITD File [hereinafter Survey].

² Among the main obstacles listed were the high cost of doing business in Japan, the difficulty in finding qualified personnel, the multi-tiered distribution system, the interlocking business and ownership relationships known as keiretsu, and government ministry guidelines, policies, and regulations." Survey, supra note 1 (italics added).

³ Keiretsu is both singular and plural, and is pronounced kā're-tsoo.


III examines the benefits and costs of keiretsu. Section IV analyzes various strategies American government and business can employ to deal with keiretsu. Section V concludes that imitation of the keiretsu system, coupled with reforms in federal corporate law, may be the best choice for the United States.

II. BACKGROUND

A. Origins of Keiretsu

After World War II, keiretsu grew out of the dismantled zaibatsu, which were huge banking families that, during the nineteenth century, were "closed, monolithic superstructures tightly held together by a single holding company." The zaibatsu built themselves into huge industrial combines, controlling everything from mining to manufacturing. The zaibatsu were a concentrated source of power in Japan and "became the driving force of Japanese militarism" in the 1930s.

Because the Allied Powers saw the enormous power of the zaibatsu as "a hinderance to democracy," General MacArthur and the occupation forces attempted to dismantle them. However, in the early 1950s, after the American occupation forces left Japan and tacitly allowed the Japanese government to relax restrictions, many of the zaibatsu companies began to renew their former alliances, albeit this time in a more loosely affiliated and diversified form. In fact, "three of the big six horizontal keiretsu were formed in the 1950s out of the pieces of the . . . zaibatsu."

One of the reasons these companies regrouped was the Tokyo capital market's inability to raise capital in the early postwar years. According to Kermit Schoenholtz, a senior econ-
omist at the Tokyo branch of Salomon Brothers, “companies that wanted to expand” had to join groups to raise capital. By gathering around a bank, keiretsu companies were able to obtain investment capital at a lower rate in exchange for entering into the group relationship. With the expansion of the capital market in Japan, keiretsu have lost much of their initial appeal, “but Schoenholtz does not believe that [they] will disappear overnight just because the financial conditions have changed.” Indeed, as explained below, companies affiliated with a keiretsu are under intense pressure to remain loyal.

One of the obstacles the former zaibatsu companies had to overcome when regrouping into their current keiretsu was the prohibition against companies buying their own shares. To avoid this problem, companies engaged in “a form of corporate blood brotherhood called cross-shareholding.” Under this system, member companies own shares in other member companies. Currently, “[a]s much as 25% of some companies is held by other members of a keiretsu.” This interdependent ownership alliance, while within the laws established by the occupation forces, serves much the same function as the former zaibatsu. The keiretsu companies are tied together through their cross-holdings, and “[s]hareholders expect business, not dividends, to flow from their investment.”

B. Types of Keiretsu

Precisely defining keiretsu is difficult because the term encompasses a number of different types of corporate alliances. However, “keiretsu are characterized by the presence of a dominant firm which organizes and partially finances the other associated companies, ‘extensive intra-keiretsu stockholding,’ and frequent purchases of intermediate goods from other

14. Id.
15. Rapoport, supra note 12, at 85.
16. Id.
17. Id.
18. The first of the two Chinese characters used to represent the word keiretsu means system, lineage, faction, group, zone, corollary, connection. The second character means row, rank, tier, file, column, line, procession, queue. Together, they mean order, succession. ANDREW N. NELSON, THE MODERN READER’S JAPANESE-ENGLISH CHARACTER DICTIONARY 89, 521 (2d rev. ed. 1974). However, when used in a business setting, the word keiretsu does not have an English equivalent, so the Japanese word has been imported.
keiretsu members."19 Many of the current keiretsu are "based on either prewar [industrial] conglomerates (zaibatsu), financial ties ... or vertical integration."20 These keiretsu groups are not closed or tightly held. Rather, they are "a loosely knit, permeable set of industrial networks, connected through cross-cutting linkages."21

Keiretsu are divided into two types: horizontal and vertical.22 Horizontal keiretsu are usually organized around a bank and consist of a variety of companies that perform different functions. Mitsubishi is an example of a horizontal keiretsu.23 "Corporate membership in a [horizontal] keiretsu ... usually involves heavy reliance on the main keiretsu bank for debt financing, and extensive intra-keiretsu stockholdings."24 Vertical keiretsu, on the other hand, are "composed of a major industrial corporation and its suppliers in a particular industry."25 These vertical keiretsu are "held together by fairly predictable transaction patterns and based on implicit long-term contracts, financing, and equity ownership."26 The Toyota keiretsu is an example of a vertical keiretsu, dominating its family of parts manufacturers and suppliers.27

20. OKIMOTO, supra note 7, at 132-33.
21. Id. at 133.
22. In both types of keiretsu, member companies own some of the others' stock and "top executives of the group's main bank or trading company have seats on other members' boards." Rapoport, supra note 12, at 77. Many Americans would call this collusion, but to the Japanese, this system of business alliances and long-term relationships is the keiretsu system that marks Japan's special brand of capitalism and is the reason Japan has come to dominate international markets. Id. at 76. Keninchi Imai, an industrial-policy expert at Hitotsubashi University in Tokyo, provides a more detailed breakdown of these two main classes of keiretsu in Inside the Charmed Circle, supra note 5, at 54.
23. The Mitsubishi keiretsu has member companies in such diverse fields as financial services, computers and electronics, automobiles, food and beverages, construction, metals, real estate, oil and coal, rubber and glass, chemicals, fibers and textiles, pulp and paper, industrial equipment, cameras and optics, and shipping and transportation. See Rapoport, supra note 12, at 81.
25. Kinsley, supra note 6, at 4.
27. Toyota owns 19% of Koito Manufacturing, its headlight provider; 41.4% of Toyoda Gosay, its rubber manufacturer; 14% of Fubata International, a muffler manufacturer; and so on through its entire group of suppliers. Each of these companies also owns shares in Toyota. See MacNeil/Lehrer Newshour, supra note 9.
III. BENEFITS AND COSTS OF THE KEIRETSU SYSTEM

A. Benefits

While the United States continues to urge Japan to change the keiretsu system,28 the Japanese refuse to be apologetic about keiretsu and view them as a superior form of business structure worthy of emulation.29 Indeed, many advantages exist in the keiretsu system.

One of the most often cited advantages of the keiretsu system is that it allows member companies to plan on a long-term basis, rather than having to focus on short-term profits. This advantage is well illustrated by the relationship between Sumitomo Bank and Nippon Electric Corporation (NEC), both member companies in the Sumitomo keiretsu.

When NEC needs to raise investment capital, it will rely on direct external financing from Sumitomo Bank, which owns shares in NEC. Unlike individual stockholders, Sumitomo Bank, as a corporate stockholder, is “willing to accept low rates of return on investment (ROI) as long as the real value (as distinct from par value) of equity shares appreciates.”30 Consequently, because U.S. companies tend to rely on internal financing to raise capital, NEC is under less pressure than most U.S. companies to adopt strategies yielding high short-term profits. This decreased pressure results from Sumitomo Bank’s policy of putting less pressure on NEC to pay out large dividends if such dividends might lead to NEC’s default on the loan. This cross-holding of stock “by corporations willing to accept low ROI give[s] Japanese companies some degree of insulation from imperatives of equity markets,”31 allowing them to plow back a higher portion of retained earnings into research and development, marketing, and other investments that provide continuous growth.32

In addition, when the economy is sluggish, “Sumitomo
Bank is often willing to refinance old loans or extend new ones. This affords NEC the luxury of continuing growth strategies even during difficult economic times. As rebuffed corporate raider T. Boone Pickens wrote, this aspect of the keiretsu system "reinforces Japan's stable business environment, providing corporate managers with the time and capital to plan for the long term."

Of course, Sumitomo Bank also benefits from this practice. It requires NEC to fully disclose "information concerning company operations, cooperate when business is good, and, if necessary, accept some infringement of autonomy in allowing the bank the right to send its own people into key management positions." NEC, however, regards this as a small price to pay for the luxury of a continual source of financing.

An advantage of the keiretsu system that was much publicized during T. Boone Pickens's futile attempt to gain a seat on Koito's board of directors is that keiretsu member companies are much less vulnerable to hostile takeovers and leveraged buyouts. Two factors provide this protection. First, if a keiretsu fears that one of its member companies may be taken over, it can deliberately shield itself by raising "mutual shareholdings to fight off potential takeover attempts." Second, keiretsu member companies, the big shareholders, never sell their interests because their investments are "for business reasons and capital gains."

Another benefit of the keiretsu system is that it "encourages the exchange of information and technology." This is because keiretsu provide "a ready-made network for information gathering, sharing, and policy deliberations" which "cut[s] across industrial sectors."

Although foreign businesses often

33. OKIMOTO, supra note 7, at 137.
34. Kinsley, supra note 6, at 4.
35. OKIMOTO, supra note 7, at 137.
36. Koito is a supplier in the Toyota keiretsu. See supra note 27.
37. It is noteworthy that after Pickens sold his shares of Koito stock, Tetsuya Tsukatani, the former chairman of components maker Ichikoh, renewed his effort to smash the keiretsu system. Ichikoh is a supplier company in the Nissan keiretsu, and Tsukatani claims he was fired from his own company by a board of directors controlled by Nissan. See Anthony Rowley, Whistle Blower, FAR E. ECON. REV., May 23, 1991, at 65.
38. See Okimoto, supra note 24, at 48.
39. Smith, supra note 13, at 54.
40. Rapoport, supra note 12, at 77.
41. Rowley, supra note 29, at 44.
42. Okimoto, supra note 24, at 47.
complain that this sharing is a form of unfair collusion, the Japanese government has yet to address these complaints.

The keiretsu system also provides the Japanese government easy “access points” for government intervention, though such action is rarely needed. The leaders of the keiretsu companies often work closely with the Ministry of International Trade and Industry (MITI) and other government ministries. A comparison of the Chrysler and Mazda bailouts illustrates this point. The Chrysler bailout required heavy U.S. government intercession, but the Mazda bailout was “handled by the Sumitomo . . . group, especially Sumitomo Bank, and [Mazda’s] subcontractors and distributors.”

Finally, the keiretsu system assures the member companies both a constant supply source and a constant market. The remarks of a Japanese auto executive in America illustrate this supply source preference system: “First choice is a keiretsu company, second is a Japanese supplier, [and] third is a local [U.S.] company.” This policy means suppliers can always sell their goods to the manufacturers and manufacturers have a continual supply source. However, this attitude is also the main reason the United States government and businesses are calling for the dismantling of the keiretsu system.

B. Costs

Despite the benefits, keiretsu also have several disadvantages. Companies within the keiretsu face the costs of “lower profit margins for member firms, the dangers of oligopolistic collusion, and wasteful duplication.” More severe are the costs to the Japanese consumer who pays more for both domestic and imported goods. Still another cost is the trade friction created by the keiretsu’s exclusionary practices, often within the keiretsu’s distribution system.

Keiretsu involve many costs for the member companies. Keiretsu are organized to spread the costs of business among the member companies. Their profit margins can be lower than

43. OKIMOTO, supra note 7, at 149-52.
44. Rapoport, supra note 12, at 84. “Even if MITI wanted to be confrontational, it would be hard to confront an industry chock-full of ex-MITI officials. The system of amakudari, literally ‘descent from heaven,’ sends scores of MITI officers, retired at a vigorous 55, to Japanese industry each year.” Id.
45. OKIMOTO, supra note 7, at 139.
46. Rapoport, supra note 12, at 80 (italics added).
47. Okimoto, supra note 24, at 47.
they otherwise would be for a highly profitable company within the *keiretsu* because they must devote capital to other less profitable member companies.

Another problem, according to T. Boone Pickens, is that supplier companies often "become captives" of the *keiretsu*. For example, when the main company in the *keiretsu* decides to cut costs, it often forces its supplier companies to sell their goods at a lower profit, and sometimes at a loss. Because these supplier companies rely so heavily on the main company for orders, they have no choice but to comply.

As noted, opportunities for collusion are built into the system. This means that problems such as price fixing are common. This drawback is compounded by Japan's soft, and loosely enforced, antitrust laws.

*Keiretsu* also pose a problem of misallocation of resources. This happens when a member company has excess plant capacity as a result of each *keiretsu* 's desire to have a member company represented in all major industries. This leads to "pressures to overproduce during recessions and to export surplus production in order to climb out of recessions."

*Keiretsu* often cause increased costs to consumers. Imports cost more because *keiretsu* deny foreign firms access to their national distribution system. Accordingly, foreign producers have difficulty selling their goods in Japan. The American automobile industry is an excellent example of this problem. American car manufacturers who wish to sell cars in Japan encounter difficulty in finding a dealership willing to sell American cars. According to Tamiya Tezuka, a car dealer at Tokyo Nissan Auto Sales, "Japanese auto manufacturers and the dealers are very closely tied to each other in capital ownership,

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49. See *Okimoto*, *supra* note 7, at 140.
50. See Rapoport, *supra* note 12, at 76. "[T]he Japanese don't really believe in antitrust. Enforcement is lax. Everyday business practices ... ignore the gospel according to the Sherman and Clayton Acts." *Id.*
51. *Okimoto*, *supra* note 7, at 141.
52. According to Richard Johnson, president of General Motors, Japan, "[w]hen the Japanese companies went to the United States, the whole dealer organization was opened up to them." U.S., *Japan to Form New Forum to Boost U.S. Car Sales in Japan*, INT'L BUS. DAILY (BNA), July 24, 1991, available in LEXIS, Nexis Library, BNAITD File [hereinafter *Boost Car Sales*]. Where the Japanese had an advantage coming into the U.S. market, the Americans have a disadvantage trying to penetrate the Japanese market.
CONFRONTING KEIRETSU

and it's next to impossible to sell a car from a different company.”

Another reason for high consumer costs is that many cheaper imports never reach the Japanese market. Through their exclusionary buying practices, keiretsu keep less expensive foreign parts and goods out of Japan. This is also true of goods produced in Japan by newer companies that are not part of a keiretsu. Without a buyer, these companies soon wither and die.

The final disadvantage of keiretsu is the international trade friction they create. According to Charles Dallara, U.S. Assistant Treasury Secretary for International Affairs, “the amount of foreign investment in Japan is only 10 percent of the level of foreign investments in the U.S. and less than one fifth of the level in most other industrialized countries.” Predictably, this discrepancy creates friction with other countries and is largely due to the keiretsu system’s exclusionary nature.

IV. POSSIBLE APPROACHES

A. Government Intervention

The U.S. government can adopt two different strategies in regard to Japan’s keiretsu system: attack it or imitate it. Either strategy will likely irritate the Japanese, if not tactfully done, and neither strategy guarantees success. The following, however, are several possible alternatives the U.S. government might pursue within these two strategies.

1. Attack on the keiretsu system

The U.S. government could attack the keiretsu system in at least four ways: through antitrust laws, retail sales regulations, taxes, and corporate rules. Each of these approaches involves pressuring the Japanese government to adopt new laws or to enforce existing laws.

First, antitrust laws could dismantle the keiretsu system. Japan’s current antitrust laws were largely enacted by the occupation forces after the war. The purpose of these laws was to dismantle the zaibatsu, or huge industrial holding com-

53. Id.
54. See MacNeil/Lehrer Newshour, supra note 9.
55. Loosen Structures, supra note 28.
56. See Rapoport, supra note 12, at 76.
panies, which fueled the imperialistic war machine. Initially, these laws were successful. However, when the occupation forces left Japan, enforcement of the antitrust laws relaxed and the zaibatsu companies once again formed business affiliations in the more loosely structured keiretsu.57 To this day, the antitrust laws remain on the books, but are generally unenforced58 because "the Japanese don't really believe in antitrust."59 However, if the United States and European governments band together and demand that Japan enforce its antitrust laws, the keiretsu system as it now operates would need to reform.60 With the enforcement of the current laws alone, keiretsu companies would be forced to deal more openly and become more loosely affiliated. This is one of the approaches the United States took during the 1991 Structural Impediment Initiative (SII) talks.61

A second way for the U.S. government to use antitrust laws to attack the keiretsu system would be to extend U.S. antitrust laws "to allow prosecution of U.S.-based subsidiaries of Japanese companies that engage in anti-competitive trade practices in their home [U.S.] markets."682 Thus, without having to pressure the Japanese government, the United States could force change on the keiretsu system. Consider, for example, the Tenneco Automotive incident.

Tenneco, an Illinois company, supplied exhaust systems and shock absorbers to Mazda's U.S.-based manufacturing plants. When Tokico Manufacturing, a member of the same keiretsu as Mazda, set up in Kentucky, Mazda's orders for the Tenneco-made shocks suddenly stopped.63 In such a case, the federal government could prosecute Mazda for antitrust vio-

57. See Inside the Charmed Circle, supra note 5, at 54. According to Michael Gerlach, a professor of business administration at the University of California at Berkeley, "telling [the Japanese] to dismantle the keiretsu is like telling Americans to rip up their credit cards. It is fundamental to the way business has been done in Japan." Rapoport, supra note 12, at 85 (italics added). This statement would have been even more true in early postwar Japan.

58. See Linda Sieg, Foreigners Have Doubts About Japan's Antitrust Stance, REUTER BUS. REP., July 16, 1991, available in LEXIS, Nexis Library, BUSRPT File. "The FTC has been called a 'toothless tiger,' unable to emerge from the shadow of the powerful Ministry of International Trade and Industry whose mission has been to nurture, not restrain, industry." Id.

59. Rapoport, supra note 12, at 76.

60. See Rowley, supra note 29, at 44.

61. See Loosei Structures, supra note 28.

62. Rapoport, supra note 12, at 84.

63. Id. at 80.
lations in the United States, thus punishing the Japanese company. Such a policy would put pressure on *keiretsu* companies to deal fairly and openly within the United States. It might also indirectly pressure the Japanese government to effect changes from within Japan.64

Another means the United States could use to attack the *keiretsu* system is to pressure the Japanese government to establish stricter retail regulations. Currently, *keiretsu* manufacturers have so much control over retail outlets that they are able to set any retail price at which their goods must be sold.65 Often the manufacturer prints the price on the package which is "often inflated by 30%."66 Manufacturers are thus able to sell at inflated profits by forcing the retailer to sell at a certain price or offering phony discounts without cutting their own margins. Abolition of this resale-price fixing would hurt *keiretsu* manufacturers by cutting into their profits.

In retail sales the United States could also press for the termination of "sale-or-return" arrangements that commonly exist between Japanese manufacturers and retailers. These arrangements provide that if goods cannot be sold at a certain price the retailer must return them to the manufacturer.67 In other words, these arrangements prohibit retailers from using true clearance sales to move dead stock. This keeps prices artificially high and profits healthy for *keiretsu* companies.

A third means the United States could use to attack the *keiretsu* system would be to insist on corporate tax reforms in Japan. Under the existing system, *keiretsu* companies are "allowed to write off the exorbitant sums they spend on promoting group-wide harmony."68 Managers in Japanese companies spend ¥5 trillion ($35 billion) annually on entertainment.69 Elimination of tax breaks for corporate entertainment would do much to break up the power of the *keiretsu* groups. This, however, is probably an unrealistic solution because "it is difficult to imagine America's corporate leaders advocating a crackdown

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64. The federal government is currently investigating at least six such cases in the United States. See id. at 84.
65. See *Cheaper Shopping in Japan*, ECONOMIST, Jan. 28, 1989, at 15. Matsushita has 27,000 wholesale and retail outlets, and Toshiba has 14,000. Id.
66. Id.
67. Id. "In clothing, for instance, 30% of the goods in shops go back to the manufacturer unsold." Id.
68. *Inside the Charmed Circle*, supra note 5, at 54.
69. Id.
on executive wining-and-dining, even for the Japanese.\textsuperscript{70} American companies enjoy this tax write-off luxury as much as the Japanese.

The fourth possible method of attack available to the U.S. government is to press the Japanese government to enact strict corporate laws. Such laws could include a requirement that \textit{keiretsu} companies "list shares in their annual accounts,"\textsuperscript{71} maintain a mandatory outside director on the board of directors, "strengthen shareholder[] rights, and facilitate mergers and acquisitions."\textsuperscript{72}

Robert Zielinski, a financial analyst at Jardine Fleming Securities, argues that the \textit{keiretsu} "system could in theory be diluted by introducing some changes to the rules under which banks and other holders of \textit{keiretsu} shares are required to list shares in their annual accounts."\textsuperscript{73} The theory behind such a rule is that by exposing the extensiveness of the \textit{keiretsu} alliances, the system would suffer. However, the \textit{keiretsu} system has become so entrenched that this alone would probably not be enough to dismantle or change the system.\textsuperscript{74}

At the May 1991 SII talks in Tokyo, the United States urged Japan to install outside directors on the boards of Japanese corporations to "strengthen shareholders' rights, and [to] facilitate mergers and acquisitions."\textsuperscript{75} Outside directors often sit on the boards of American companies and are "deemed to prevent collusive deals among companies with interlocked shareholders."\textsuperscript{76} An increase in shareholder rights would ideally loosen the corporate \textit{keiretsu} cross-shareholder's stranglehold on the corporation, allowing the company more freedom in the market. Lastly, laws facilitating mergers and acquisitions would allow investors to buy companies that may be potentially more profitable outside the \textit{keiretsu}.

However, if the United States pushes for such changes in Japan, the Japanese will surely require concessions from the

\textsuperscript{70} Id.
\textsuperscript{71} Smith, supra note 13, at 54. Listing is already required, but strengthening of the requirement is necessary.
\textsuperscript{72} Loosen Structures, supra note 28.
\textsuperscript{73} Smith, supra note 13, at 54.
\textsuperscript{74} Id. Zielinski believes "the durable \textit{keiretsu} system has shown signs of strengthening over time, at least if the internal 'cohesion factor' is measured in terms of the percentages of interlocking shareholdings of the various group members." Id.
\textsuperscript{75} Loosen Structures, supra note 28.
\textsuperscript{76} Id.
Americans. At the SII talks, the Japanese pressured America to “reduce its federal budget, enhance private savings and 'press for an international investment climate that would facilitate U.S. efforts to maintain its traditional open and nondiscriminatory investment policy.'” The U.S. government must, therefore, decide if the keiretsu system is a structure it should attempt to change or rather one it should attempt to imitate.

2. Imitation of the keiretsu system

Lester Thurow, Dean of the Sloan School of Management at the Massachusetts Institute of Technology, is a proponent of the keiretsu system. He outlines several steps the U.S. government should take to imitate the keiretsu system and build American competitiveness. Unless the government takes such steps, Thurow argues, American companies will not be able to compete with their Japanese counterparts.

Thurow first asserts the government should “[l]et groups of companies own substantial shares in one another and put executives on one another's boards.” Additionally, he contends the government should “let financial institutions own controlling shares of nonfinancial public companies.” Currently, the largest shareholders of many American corporations are financial institutions such as mutual funds, pension funds, and insurance companies. Unlike those in Japan, these financial institutions “usually do not put their executives on boards of directors, since this would give them inside information not available to small shareholders. America's largest owners main-

77. Id.
78. Lester Thurow, Let's Learn from the Japanese, FORTUNE, Nov. 18, 1991, at 183 [hereinafter Thurow, Let's Learn]. For a more detailed discussion, see LESTER THUROW, HEAD TO HEAD: THE COMING ECONOMIC BATTLES AMONG EUROPE, JAPAN, AND AMERICA 280-90 (1992) [hereinafter THUROW, HEAD TO HEAD].
79. THUROW, HEAD TO HEAD, supra note 78, at 290. “In today's economic world economy, where American firms must match up against the business groups of . . . Japan, American firms need to be able to form the same strategic alliances, the same self-help societies, and the same joint strategies for conquering world markets.” Id.
80. Thurow, Let's Learn, supra note 78, at 183.
81. Id.
82. THUROW, HEAD TO HEAD, supra note 78, at 282. “In the aggregate, financial institutions such as pension funds, foundations, or mutual funds own 60 to 70 percent of most publicly listed companies.” Id.
tain an arm's-length relationship with the firms they collectively own.\textsuperscript{83}

According to Thurow, this practice of arm's-length relations between companies prohibits large shareholders from being "active builders who seek to strengthen a company's long-run competitive position."\textsuperscript{84} Instead, these financial institutions become short-term speculators trying to succeed in the takeover wars. If "finance and industry... become so entwined that their destinies cannot be separated,"\textsuperscript{85} short-term speculation would cease and corporations could focus on long-term results rather than on quarterly dividends.

Thurow argues that the current antitrust laws, passed in Congress's attempt to find "a scapegoat for the Great Depression... should be removed."\textsuperscript{86} This would allow the leaders of financial institutions to sit on boards of directors, in effect binding them to the corporation for the long haul. Financial institutions "should be encouraged to get into financial situations from which they cannot extract themselves, except by making the corporations in which they have invested successful."\textsuperscript{87}

Thurow's second suggestion is to pass laws requiring that "those who own a dominant position in any company—say 20 percent or more—should be forced to give the public one day's advance notice of their intention to sell any of the shares."\textsuperscript{88} These laws would prevent dominant shareholders with representation on boards of directors from abusing inside information. If a dominant shareholder attempts to jump ship, the day's notice requirement would give smaller, uninformed shareholders ample time to sell their shares, driving the price

\textsuperscript{83} Thurow, \textit{Let's Learn}, supra note 78, at 183.

\textsuperscript{84} \textit{Thurow, HEAD TO HEAD}, supra note 78, at 282.

\textsuperscript{85} \textit{Id.} at 287.

\textsuperscript{86} Thurow, \textit{Let's Learn}, supra note 78, at 184. "[O]ne of the institutions that allowed America to build its economic supremacy in the late 19th and early 20th centuries [was] the alliance of companies interlocked through financial institutions." \textit{Id.} at 183. An example of this was the House of Morgan, centered around the merchant banker J. P. Morgan, with significant investments in a diverse group of industrial companies. Because such alliances were seen as the cause of the Depression, the government passed antitrust laws to break them up. According to Thurow, many "[h]istorians now know that factors much more fundamental than Morgan's practice caused the Depression, but the rules prohibiting business groups have persisted." \textit{Id.} at 184.

\textsuperscript{87} \textit{Thurow, HEAD TO HEAD}, supra note 78, at 287.

\textsuperscript{88} \textit{Id.} at 289.
down for the dominant shareholder. Conversely, if a dominant shareholder wanted to accumulate more shares, the notice would allow investors not privy to the same information to buy at the current price.

Thurow's third suggestion is to reinforce the distinction between traders and investors by making "voting rights increase with the length of time shares are held, with full rights attained after . . . five years." This would encourage investors, especially large institutional investors, to invest with an eye to the long term. While this would still allow the sharp-shooting stock trader to grow rich by buying and selling shares, it would deny him "owner" status with a right to vote and make decisions.

Last, Thurow recommends "assign[ing] voting rights to lenders who make long-term loans to a company." This would largely erase the distinction between debt and equity, allowing institutions that provide long-term loans to companies active strategic direction in those companies. As lender-directors, the banks' roles would be those of informed and active lenders, rather than of the "absentee landlord" positions they currently occupy.

According to Thurow, these four changes in U.S. corporate law would create an American industrial environment capable of competing in the global market by putting "real capitalists back in the driver's seat of the American corporation. Then box them in so that they have no choice but to improve their firms and, hence the nation's productivity and competitiveness if they want to be personally successful." Rather than force the rest of the world—especially Japan, whose history and culture is so different from the United States—to follow our rules, America can succeed by banding together and learning to play the Japanese game like the Japanese. Thus, America may be better off by imitating the keiretsu system rather than attacking it.

B. Business Solutions

Until lawmakers change domestic laws to weaken the

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89. Id.
90. Thurow, Let's Learn, supra note 78, at 183.
91. THUROW, HEAD TO HEAD, supra note 78, at 289.
92. Thurow, Let's Learn, supra note 78, at 183.
93. THUROW, HEAD TO HEAD, supra note 78, at 290.
94. Id.
keiretsu ties of Japanese companies within the United States, American companies need to compete by either imitating the keiretsu system or forming alliances with Japanese companies already in established keiretsu. Companies entering the Japanese market have found at least two noteworthy means to beat the keiretsu system: operating specialized stores and retailing through their own networks. These two techniques have proved successful for several companies operating in Japan.

Over the last five years, specialized clothing stores in Japan, while lowering prices, have managed to double their market share. This is partly due to revisions in Japan’s Large Scale Retail Store Law of 1974, which allow for “large-scale” stores to open with fewer restrictions than before. Specialized clothing stores in particular have succeeded by moving more clothes at lower costs than competing keiretsu retail distributors. These specialized stores do this by cutting handling costs, especially because unsold goods are not returned to the wholesaler. By selling only a single line of goods, focusing on the weekend customer, and hiring more part-time employees than traditional keiretsu controlled retail stores, specialized stores have found a profitable niche in the Japanese market. American companies wishing to succeed in Japan may find this a viable alternative to competing within the keiretsu dominated system.

American companies can also compete in Japan by creating their own distribution networks. Amway and Tupperware have done this successfully in Japan much like they have in the United States. Both of these companies distribute and sell products largely through a home sales network. This works especially well in Japan where many women still have difficulty working outside the home. These women provide an excellent work force, distribution network, and customer base. “Eastman Kodak, which has sales of more than $1 billion a year in Japan, is putting together its own mini-keiretsu. Kodak has acquired a number of its distributors and has taken small

95. Charles Smith, Wholesale Killers, FAR E. ECON. REV., Jan. 17, 1991, at 45, 45. “So-called ‘roadside’ stores in city suburbs, which buy directly from manufacturers, now account for 10% of the $3.6 trillion (US$26.5 billion) men’s clothing market.” Id.

96. See Charles Smith, Reforms in Store, FAR E. ECON. REV., Jan. 17, 1991, at 44, 44. “Large stores” are defined as having more than 500 square meters of floor space. Id.

97. See Smith, supra note 95, at 45.
stakes in some 50 suppliers and customers. Although this may not be a feasible way for all companies to enter the Japanese market, it is one way to compete successfully in the keiretsu dominated distribution system.

With the increasing number of Japanese companies setting up shop in America, many companies with no interest in entering the foreign arena are finding it necessary to compete with the keiretsu system. MIT's Charles Ferguson bluntly states: "When an opponent or a competitor is using a particularly strong and distasteful tactic, you may have to use it too."

Examples of American companies joining together in keiretsu-fashion to become more competitive are the recent IBM joint ventures involving Apple Computers (once a key rival), Seimens, Lang Labs, Sears, and Diebold. Together, these companies are more capable of competing in the international market. In fact, Yoshi Tsurumi, a professor at Baruch College in Tokyo, asserts that such alliances are long overdue and that "American companies will be doomed unless they really just start forming their own international as well as domestic alliances." For Americans like Lynn Williams, former U.S. Trade Negotiator who feels the Japanese "have to play along with the rest of us," this is not a very palatable alternative.

Although probably more difficult, another alternative is for American companies to try to become part of the Japanese

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98. Rapoport, supra note 12, at 85. Albert Sieg, former head of Kodak Japan said, "To the Japanese, the keiretsu is a very comfortable way of business." Id.
99. A study by the University of Michigan suggests that as much as "90% of the parts in Japanese cars built in America come either direct from Japan or from Japanese manufacturers which have set up shop in the United States." Inside the Charmed Circle, supra note 5, at 54. Even Honda, the most aggressive about using locally procured parts, only uses about one-third American-made parts. Boost Car Sales, supra note 52.
100. MacNeil/Lehrer NewsHour, supra note 9.
101. Id.
102. Seimens is a German firm and the joint product is in the field of semiconductors. Id.
103. The Lang Labs joint venture involves imaging. Id.
104. The Sears venture involves personal computer software. Id.
105. The Diebold venture is for automated teller machines. Id.
106. Id.
107. Id.
108. Id. Williams insists, "Anyone who says that a Keiretsu system is good is looking at it from the standpoint of a taker, somebody who's benefiting from it. Those who are outside the system do not benefit from it at all and can compete with it only in their Keiretsu system." Id. (italics added).
keiretsu web. This, however, has proven difficult as Japanese companies prefer to keep business to themselves. Even when inclined to let foreigners into their alliances, the Japanese are more apt to choose European companies over American partners.\textsuperscript{109}

V. CONCLUSION

Keiretsu present a serious challenge to American business. Because of their many benefits, the Japanese are not likely to abandon keiretsu unless the U.S. government applies serious pressure. However, this may not be in America’s best interest. American government and business must develop an alternative approach. Imitation of the keiretsu system, coupled with reforms in federal corporate law, may be the only workable choice for the United States.

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\textsuperscript{109} See Inside the Charmed Circle, supra note 5, at 54.