Understand the reasoning and rational of the keiretsu families essay sample

With that understanding, one can better understand the reasoning and rational of the “ Keiretsu” families. Keiretsu families are groups of businesses organized together as strategic alliances, and make up the backbone of Japanese industrial organization. An American corporation is forced to maximize profits to satisfy stockholders. Japanese corporations, by joining a keiretsu, can be spared this pressure of chasing short sighted profits because fully 78% of stock is owned by members of the keiretsu.

Rather than profits, the keiretsu members want certain preferential treatment as customers and suppliers of the corporation. In order to understand how the ‘ keiretsu’ works, and how it gives Japan a near insurmountable strategic advantage in empire building (strategic conquest of markets), I will discuss the role of the keiretsu in each stage of industry, and show its impact given that role. Initial Investment. In order for a business to make a capital investment, it requires financial capital. This is true in all market based economies, and Japan is no exception. One corporate member of a given Keiretsu group (such as the Toyota Motor Keiretsu) has a financial institution.

This financial institution provides loans to members of the keiretsu at below market price (below the interest paid by those that rely on market funds). One might wonder how the financial institution is able to profit by providing below market interest loans. This is done by increasing the supply of loanable funds. When a Japanese citizen wishes to purchase a home, the banks require a very large portion of the purchase price to be paid for as a down payment (sometimes as high as 35-50 percent, according to Head to Head by Lester Thurow).

In order to save enough money for this down payment, Japanese workers are forced to save a large portion of the salaries. The Marginal Propensity to Save (MPS) in Japan is between 11% and 15% (MPS in the US is in the single digits). This provides a large pool of loanable funds to Japanese banks, which they can then lend to keiretsu members at below market price (a ‘ preferential treatment’ to members as customers). The impact of this involvement by the keiretsu in the investment stage is clear.

By providing ‘ seed money’ and investment capital to industry at below the market interest rate, Japanese business has a strategic advantage before the investment is even made. The lower the interest the Japanese business is forced to pay, the lower the risk, and the more the Japanese investors are free to invest in the business venture. In addition, the law of demand states that the lower the price, the higher the quantity demanded. By lowering the price of investing, the Japanese conceivably increase the quantity of investment. Supplies.

When the Japanese business begins producing, supplies are sold to the keiretsu member at below market price. One might ask how this is possible, would the Japanese supplier then be losing money and be forced out of business. However, the keiretsu supplier then marks up the price of the supplies sold to consumers in the captive market. To illustrate this part of the process, I will use the controversial issue of auto parts. The Toyota motor company is able to purchase auto parts from members of the Toyota Keiretsu at below market prices.

To recoup the losses, the auto parts supplier sells the parts in auto parts stores in Japan at above market price (gouging the consumer). One might then wonder why foreign businesses don't undercut the Japanese prices and sell to consumers. To protect against this, the Japanese government requires that the consumption tax be levied against products imported. In addition, Japanese corporations and their keiretsu groups work closely with government to protect their special interests (just as it is done here in the US).

The only way to get around this is to invest directly in Japan, however, as we will see later in this paper, the keiretsu groups have also protected themselves against that. The supplies used by factories and manufacturers to produce their products represent a significant amount of the costs of production. By providing Japanese manufacturers with supplies at below market price, the keiretsu greatly reduces the costs of production, and enables the Japanese producers to undercut foreign producers and gain market share. Distributing the Finished Product.

In addition to gaining cost reduction by using shipping and receiving companies that are members of the keiretsu, the producer gains access to markets previously penetrated by members of the keiretsu. One of the costs of exporting to a given market comes from establishing business contacts with distributors (stores and outlets that will sell the product). Since a fellow member of the keiretsu may already have contacts with distributors in a given market, a Japanese producer is able to reduce the time and money spent establishing such contacts (by utilizing the distributor used by another member of the keiretsu).

The impact of this strategic advantage is clear. Again, by lowering the costs of doing business, the keiretsu gives its membership a strategic advantage over foreign competitors. Franchisement. The organization of several companies provides some key long term advantages that should not be ignored. First, members of a keiretsu are able to sell their product in a given market at below production cost (even below their own artificially low production costs). This is made possible by obtaining financial support from the rest of the keiretsu in order to gain market share that can be utilized later for profit.

The impact of this advantage is perhaps a little less clear, but is very significant to understanding the scope and duration of Japan's success in international trade. The strategic investment in market share enables the keiretsu families to have long term strength, and ensures that they will be able to have the markets necessary to finance further expansion and market penetration in the future. So, we can see that at each phase of the production process, and even in the post-production phases of the cycle (distribution and franchisement), the organization of Japanese industry is used as a strategic weapon in trade.

This is done by enabling Japanese industry to produce at artificially lower costs, and to seek market share instead of short sighted profit maximization. As one studies Japanese strategic trade, it becomes apparent that the Japanese market is very susceptible to market penetration by direct foreign investment in Japan (which one would think would be very successful given the price gouging by suppliers of the keiretsus). However, as we will see in the next section, such market penetration is not as easy as one might first believe.

Clearly the biggest strength to Japan's approach to trade is that it has succeeded in giving Japanese producers a significant strategic advantage in penetrating markets. By enabling Japanese producers to produce at artificially low costs, the keiretsu has given Japan a strong position in many markets around the world, including the world's largest market-the United States. This market share has translated into huge trade surpluses, and has therefore gained very large capital reserves for Japan.

These capital reserves enable Japan to make large investments in education, infrastructure (Japan is in the middle of a five year plan to invest $2 Trillion in its infrastructure), etc. With the economic difficulties the Japanese are currently facing, the huge capital reserves can be used to provide a strong fiscal stimulus to their economy (in fact, the Japanese are now running a larger fiscal deficit as a percentage of GDP than is the United States). Another strength to Japan's approach to trade is in the validation of ' interventionism', or ' communitarian capitalism'.

The economic struggle between Europe, Japan and the United States is much more fundamental than a mere struggle for national wealth: it is a struggle between differing perceptions of how society can be most productive. 6 Clearly the success of the Japanese in overcoming a lack of natural resources, the devastation of a world war, and industry that was organized and built for the military to become the second most productive nation on

Earth offers lessons worth learning. It is important to also note the weaknesses in Japan’s approach to trade.

The most glaring is the lack of maximization of consumption and leisure for the Japanese people. The standard of living and leisure time is intentionally kept low to subsidize the keiretsu building of their respective ’empires’. Effectively, the Japanese consumer is forced to subsidize consumers in foreign markets (as a result of the price gouging of domestic consumers to supply keiretsu manufacturers with supplies at below cost). Another weakness in Japan’s approach to trade is derived from the lack of true competition.

Adam Smith, in his book Wealth of Nations, discusses the virtues of competition, and how competition brings about increased efficiency. By thwarting such competition, the keiretsu is bringing about less efficiency. Yet another weakness can be found in the ‘ second best theory’. Because Japanese firms are given a competitive advantage in their own markets, and as a result of the keiretsu’s ability to artificially keep costs lower, a product from a Japanese firm may be the lower priced, but not the most efficiently produced.

Since it is the lower priced, the customer is more apt to purchase the product, and society would be producing the product with the ‘ second best producer’. For example, if a Toyota automobile was the same standardized product as a Ford automobile, then society would be better off purchasing from the more efficient producer. Let us say that in terms of opportunity costs of the factors of production (man hours of labor, capital inputs, land), the Ford is produced for $8, 000, while the Toyota is produced for $8, 500.

Society would be better off purchasing the Ford (get the same car for $8, 000 worth of resources, instead of $8, 500 for the Toyota). However, since Toyota is able to purchase parts for below cost (and pass some of the production costs onto consumers of the auto parts from the auto parts supplier in their keiretsu), Toyota is able to sell their car for $7, 500. The customer would purchase the Toyota, even though the opportunity cost of the factors of production used to produce the Toyota made it the second best producer of the automobile, and society pays $8, 500 in opportunity cost for a car that it could have produced for $8, 000 from Ford.

So, in other words, society is hurt by paying a higher opportunity cost, and being less efficient. This hurts global production. Application to Other Countries As nations around the world seek to lower official ‘ trade barriers’ (EEC, NAFTA, and now even APEC has announced intentions to pursue the formation of the largest free trade area to date), many nations will undoubtedly be tempted to seek more ‘ unofficial’ strategies to trade. Witnessing the prosperity that Japan has gained from their success in export markets makes such strategic trade very attractive.

However, if all nations seek to follow Japan’s example, then the inefficiencies created by ‘ second best’ could actually serve to lower the global production, and all nations will share a piece of a global economic pie that would be shrinking from the weight of such inefficiency. At the same time, it is clear that, if done in such a way to increase long term investing, and emphasizing production processes, the Japanese approach to strategic trade could greatly increase a nation’s wealth and bring about prosperity from trade.

Conclusion Over the course of this paper, I have examined the industrial organization of the keiretsu, and how being a part of the keiretsu gives Japanese producers a competitive advantage over producers that are not part of the keiretsu (including foreign firms). I have also examined the obstacles that exist for producers that attempt to get around Japanese barriers by direct investment. Using the Japanese approach to trade, I then offered a discussion of how this approach applies to other nations.

It is from this entire discussion that I have come to the conclusion that while Japan abides by the standards of free trade that the GATT established, they have pursued a strategic approach to trade that has served to give the Japanese a very significant competitive advantage vis a vis their foreign competitors. This competitive advantage has enabled the Japanese to continue their long running trade surpluses. It is important to note that, just as the US auto industry is not a monolithic entity, the keiretsu is not either.

It is an association of ‘ independent firms’. However, since vast amounts of the stock of these ‘ independent firms’ are owned by the other members of the kereitsu, the firms are very greatly influenced by the decisions of the keiretsu. As I researched the Japanese approach to trade, I noticed an interesting historical reference. Prior to Adam Smith’s landmark book, Wealth of Nations, in 1776, nations emphasized the accumulation of market share and capital wealth (gold).

Adam Smith put forth the idea that a nation's true economic strength could be found in its level of consumption and leisure, not in the accumulation of wealth or market share. It was the dawn of ' capitalism', and the apparent death of ' mercantilism'. Since that time we have come to accept and assume the productive superiority of ' profit maximizing capitalism', and the virtue of consumption and leisure maximization. Japan is not ' mercantilism', as the monarch has been replaced with the ' keiretsu'.

However, the similarities in the Japanese approach to trade to that of mercantilism is striking. Perhaps the keiretsu has replaced governments as 'empire builders'… perhaps Lester Thurow is correct in his prediction that either ' individualistic capitalism' or the Japanese approach will survive, and the other will be forced to adapt and play by the survivor's rules… and perhaps the keiretsu is not a ' profit maximizer', but a modern day 'empire builder'.