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# BUSINESS-CHAIN BETWEEN LARGE AND SMALL FIRMS

*By* Kisou TASUGI\*

## 1. An Introduction

Recently there has appeared a marked trend that two or more firms jointly take certain co-operative measures in pursuit for the interests common to them, though a formation of cartel for controlling over-production or excessive price competition is generally banned by Antimonopoly law even during business depression, except for such cases where curtailment of production is approved by the government under its guidance or where an adjustment association is organized among medium-small firms with their business predicament duly recognized by the competent authorities.

Now, many firms, facing the necessity of diversifying their products in keeping up with the technological innovation, are trying to promote their sales by putting their capital, technical experiences as well as sales channels together with those of their fellow firms.

There are again not a few examples where several enterprises, who are somehow or other inter-linked among them through the supply of raw materials, semi-processed or finished products are promoting "give and take" relations or even taking positive steps for further industrial integration by respectively constructing their new plant in close proximity with each other in the same industrial zone (i. e. chemical industrial "Combinat," Iron-steel industrial "Combinat"). These have primarily been a joint activity among big enterprises, but certain co-ordinated action has been taken between large and small firms as well.

Even before the War, large manufacturers of metal and machine products had underlet the processing or fabrication of machine parts to subcontractors, and large tire makers and ceramic makers (porcelain insulator), for instance, had usually subcontracted with medium-small makers for the fabrication of metal parts (those belonging to different industry from themselves).

In textile as well as sundry goods industries, local wholeale dealers and wholesale merchant of trading centers had since before the War not only

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handled the sales of the products of medium-small textile and dyeing mills, but also catered for their necessary raw materials, instructed them production program and even financed them, thus had organized "merchant-manufacturer system".

In recent years raw material fiber makers (cotton spinning companies, chemical fiber manufacturing companies) came to organize weaving and dyeing mills of medium-small size, garment manufacturers, and oftentimes selling agents into co-ordinated activities, so that the fiber makers could exercise greater influence upon these firms in the processing of their supplying raw materials and on the promotion of their marketing share.

There have appeared another case where large synthetic resin makers have medium-small plastics makers fabricate their supplying raw materials into various plastic products for the sales promotion.

Besides these, many other large enterprises are having separate companies handle such jobs necessary for their business activities and yet rather auxiliary to their main productive operation, for example, transportation, packaging, ware-housing etc., or incorporating a new company in a fast-expanding industrial field in their efforts to maintain the growth power of their capital investment. As described so far, between and among big enterprises as well as between large and small firms joint activities of various types have come to take place in more and more cases.

However, as far as the relations between the large and small firms are concerned, since the former has greater capital and market-controlling powers than the latter, there is always a danger that domination-subordination relations may take place between them under an undue pressure of the former. In fact, since the big business is playing a leading role, in such case the former is called central or parent firm as against the smaller one and the latter is called co-ordinate enterprise, while the relations between them are generally called business-chain ("Keiretsu" 系列). However inasmuch as the term "business-chain" has not yet been given any exact academic definition, it is still used in comprehensive way covering various cases.

Nevertheless, should such new term "business-chain" be used, is it not necessary to find out characteristics that make the newly developed relations specific from the various ones which have long existed between the large and small firms and to apply the term to such specific relations?

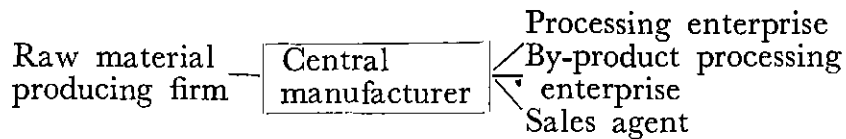
Further, is the new business-chain to be introduced or promoted only for the sake of national economy and of rationalized business administration? Is there no danger that such business-chain entails again domination-subordination as it once existed? These problems too are to be carefully studied.

## 2. Various Patterns of So-Called Business-Chain

As to whether or not all the forms of relations by which big and smaller firms are kept connected should be called business-chain, it is to be dealt with later, but if the concept of business-chain is understood in a broader sense, it may cover such patterns as described below :

### A. Vertical Connection

- (1) The case where a firm engaged in a certain stage of production establishes business-chains between medium-small firms before and after the production in which it engages, which is called production-chain or manufacturer-chain.



More concretely speaking, it is the case where a big maker engaged in the production of certain stage integrates the medium-small enterprises dealing with raw materials, or the enterprises on processing stage into its own business-chain. For example, large iron and steel company oftentimes integrates lime stone and manganese mining operators into its chain, and supplies on exclusive basis to a simple rolling mill or to the secondary products maker with its steel ingot, or a big chemical company who produces raw materials for plastics places medium-small makers of various plastic consumer goods under its control, or again a big producer of chemical fibers brings into its business-chain several weaving, dyeing and other processing mills as well as dealers of raw material fibers and wholesalers of textile products and even retail stores. These belong naturally to the above mentioned category. Further the case where such makers as those of electrical appliances particularly for household, automobiles, moter-cycles etc. organize chain-stores who primarily or exclusively handle the former's products is also called business-chain. The capital stock of some of those medium-small firm placed under such control sometimes is owned by the controlling company and these firms become subsidiaries of the latter.

At any event, the objectives of business linking in these cases are (1) to secure raw materials of certain quality and quantity or (2) to ensure marketing of products and by-products and (3) in case of a maker of some products which are the raw materials for secondary product, hence they are to be further processed for final goods, in order not only to maintain its sales but also to give technical service to such processors.

As it can be understood from the above examples, business chain is worked out sometimes for technical reason that has greatly to do with quality control or with processing technology and sometimes for the securement of raw materials. In order to attain these objectives big firms generally take initiative in extending assistance and guidance to the smaller firms on a constant basis. There are of-course some cases where the big business dominates medium-small firms who are brought into the former's business-chain entirely for its own interest, but recently many of them have come to place more importance on the establishment of mutually beneficial relations in their due recognition that the lasting prosperity of the latter is also essential for the good business of the large enterprise itself, and this is the newly developing aspect of business-chain.

- (2) The case where trading firm and dealer integrate processors and sales agents into business-chain which is called business-chain of trading firm.

Medium-small maker—Trading firm—Processor—Wholesaler

There are cases where big trading firms bring medium-small makers into their business-chain in order to secure their handling merchandizes such as textiles, metal products, machines and appliances, chemical products, sundry goods etc. and thus extend certain assistance to the latter for the increase of sales or for the improvement of product quality.

In the pre-war days many of the trading firms knocked down the price of products of medium-small makers in their efforts to squeeze bigger profit out of them particularly of those who made sundry goods. Today, however, things are quite different and many trading firms are extending, to a certain extent, to the makers linked by business-chain, management advice and assistance to help their business growth and thus are maintaining their market share, while taking advantage of their own brand and marketing capability.

Such holds true both with general trading firms, and with specialized trading firms who are dealing metal machines or chemical products, etc., and big trading firms sometimes bring into their business-chain not only the makers on one production stage, but also the producers and sales agents of several stages, and thus makers of raw material fibers, fabricators such as of weaving, dyeing, and their trading firms who have special maketing foothold. However in case the said raw material section be a giant maker, the trading firm, instead of trying to

control such enterprise, plays a role of maintaining connection among the big maker and other medium-small textile processors. Trading firm does not engage in the production in a narrow sense of the word, but organizes the business activities before and after the production, give consultation and assistance thereto, hence it is, by nature, same with merchant-manufacturer of pre-war days, but the big trading firms today are not merely trying to obtain their handling goods at economical price, but also directing their efforts to the growth of their associated medium-small makers, by giving them quite an assistance through technical, sales, stocking and other capabilities possessed by the former. Though the cases of financial assistance are rather limited nowadays, the supply of market information and other managerial consultation, advice, etc. is non-the-less a very effective assistance that the big trading firm alone can effectively render, and this is what is greatly appreciated by the medium-small firms.

There are three types in "trading firm business-chain".

(i) The type in which production and business management is substantially left to the risk of medium-small enterprises, while the trading firm just extend business guidance and assistance.

This type of business-chain has been considered since long as a most effective means for fostering medium-small enterprises. There are cases where medium-small makers themselves take initiative in having the trading firms carry out for them marketing activities, realizing that their own capability is not sufficient to make successful marketing. This is certainly a practical policy on the part of medium-small enterprises particularly when they develop new products.

(ii) The case where the trading firm incorporate a co-ordinate enterprise as its subsidiary whose management is taken over by the former. Although in many cases such subsidiary enterprise is situated right in a local center of the industry, its profit is generally absorbed by the parent trading firm. Thus sometimes troubles take place in between the local trading firms.

(iii) The case where a trading firm, who is left behind in the trend of formation of business-chain, purchases or invests in a maker who is suffering from bad business, and places the latter under its control in its efforts to regain the competitive power. This may lead to a relief of the furtherance of local industry, but such case belongs to rather an exception.

#### B. Horizontal Linking

(3) The case where a big manufacturer on a certain production stage

brings medium-small firms of products of the same kind, or of competitive products into its business-chain.

Central manufacturer	< Makers of products of the same kind < Makers of related products
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In such case central manufacturer, in co-operation with the enterprises under its control, tries to establish business-chain for the purpose of gaining bigger market share or for strengthening its competitive power in the market. In this manner it can increase the market share with less capital investment than expanding its own plant facilities, while there is an advantage that the competitive power can be promoted without taking the trouble of merging medium-small enterprises whose business scale, background and characteristics are respectively different from each other. Such horizontal linking sometimes takes place when other enterprise belonging to the same industry falls into financial difficulty.

However since this is a business linking in between the enterprises who are inherently in competitive relations, some controlling measures such as financing, capital participation (stock-holding) and dispatch of directors etc. are necessary. The business linking belonging to this category is observed in various industries, but as it is the business linking inside the same industrial field, it tends to occupy larger market share or to monopoly the market, hence not too desirable, while from the stand-point of the parent enterprise there is definitely a large advantage that it can make use of the productive capacity and the market share which were used to belong to the competing enterprise.

In case both the central manufacturer and the enterprises to be brought into the former's business-chain are either producing exactly the same or almost same products, the business linking among them will naturally eliminate the competition to that much extent, but in case the linking takes place in between the enterprises who are on the same production stage and at the same time in a complementary relations, the following subcontracting manufacturer system comes in :

- (4) The case where a big enterprise and medium-small enterprises standing on the same production stage respectively take over different assignment of the manufacture of principal product, processing of parts or the fabrication of *specialized* parts (complete as parts and can be marketed as they are), and in between them subcontracting relations are formed, i.e. subcontract business-chain for product part fabrication.

Enterprise of principal products	< Enterprise of specialized parts < Subcontracting fabricator
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In the machinery industry, even a simple machine product is assembled from several hundred parts and the fabrication of a highly complicated machine needs several thousand or more than ten thousand parts. In the case of the latter, part of the machine itself is sometimes regarded as a complete merchandise and sold in the market, for example like electric motor, compressor, condenser, measuring instrument, lamp, heater, wheel and brake, etc. and the maker of these parts can be an independent machine manufacturing enterprise.

Even a big maker, though technically it is possible to produce all these parts by itself, will not always find it economical to do so. As the matter of fact, comparatively simple parts can easily be fabricated by cheap machine tools possessed by medium-small enterprises whose over-head charges are lower because of their simple management organization. Besides, should the wage of smaller enterprises be cheaper than that of the big enterprises as it had generally been, the fabrication of some of the machine parts can be expected that much cheaper.

As to the complete parts that can be produced on a fairly large scale, it is not only technically possible but also economical to produce them with the equipment and technics of the medium-size enterprise. However in case of fabricating complicated machines, particularly when they require advanced technology and high efficiency besides those for designing and final assembling and marketing experience, it is extremely difficult to handle these jobs except the big enterprise. Thus, for the fabrication process of machines there is a part suitable for medium-small enterprises and a part that requires the capability possessed only by a big enterprise, and this is the very reason why these two carry out social division of labour, whereby the big parent enterprise entrust the medium-small enterprises with the fabrication of some of the machine parts under subcontracting system.

Of course the parent enterprise will not necessarily manufacture all the parts that require high technology and costly equipment, for instance, some of the auto engine parts are procured by placing order with such big companies as Sumitomo Metal Industries or Mitsubishi Heavy Industries Ltd. In such case they call it purchase rather than subcontract.

Under the subcontracting system the parent or central enterprise had often-times forced subcontractors to reduce their processing fees taking advantage of its capital or marketing superiority, or in the time of business recession it reduced the subcontracting jobs in order to maintain the economical level of its own factory operation, thus using the sub-



contractor as buffer for business cycle. However, with the tremendous growth of machine and metal industries and with the technological innovation which are so rapidly changing the industries from its foundation, the self-centered attitude of parent enterprise toward subcontractors has recently made a remarkable turn, and many of them have begun to pursue a new policy to foster their sub-manufacturers instead of trying to exploit them, as described later.

Such subcontracting relations are not necessarily a phenomenon specific to the metal-machine industry. Though it is not exactly belonging to the same production stage, when the parts for a certain product are manufactured by different industrial departments, for instance, like metal part of insulator, metal part of rubber tire, etc. they sometimes subcontract for fabrication.

Big makers sometimes, besides making the existing medium-small enterprises as their subcontracting factories, incorporate separate subsidiary, even though it is on a same production stage, for the production and sales of a new product developed by the parent company. The current technological innovation has brought about deversification of products but when the project of a new product or its marketing involves a risk and if the business nature of such new product is quite different from the existing one, it is safer to have an independent subsidiary handle such new business operation rather than to manage it as one of the divisions of its own.

Diversification has its objectives to better meet the technological advancement and market changes but it must not be overlooked that it aims simultaneously at maintaining the stability of capital returns. However, the inherent nature of subcontracting system and the incorporation of subsidiary for diversification is different from each other as described above.

#### C. Others

##### (5) Financial-Chain

Centering around a certain financial institution or at its intermediation several enterprises often come to be linked by business-chain but this is greatly different from other business-chains. In the past when "Zaibatusu" (big financial concerns) still existed, many direct affiliate companies and subsidiary companies were placed under the control of the general head-office of "Zaibatsu", and at the same time, in order to reinforce the combined power of these companies as a business concern their financial institution and general trading firm, particularly the former had an important role to support and achieve

the goal. Even today there are not a few cases where the banking institutions used to belong to "Zaibatsu" are acting as major financial organization to cater for the needs of its former affiliates.

Indeed there is a tendency that various enterprises once belonged to the same Zaibatsu again come into closer relations among them. But, since the central holding companies like Mitsui Gomei, Mitsubishi Goshi, Sumitomo-Honsha, etc. who used to exercise dominating influence over their affiliate companies had long been liquidated, and since each enterprise once under their control has long gained independence, it can safely be said that these financial institutions are no longer acting in accordance with the co-ordinated plan of the central headquarter, but are just in close business relations with their former affiliates.

Moreover apart from whether they belong formerly to Zaibatsu or not, they are now placed under strict administrative control of the Ministry of Finance for the protection of the interest of deposit customers and thus they have to face restriction if they try to finance a specific enterprise with enormous amount beyond certain limit. Therefore, though financial institutions respectively have several enterprises with whom they have constant financial transactions, this does not mean that these enterprises are ruled by the former (except the case they fall into business difficulties). As the matter of fact there are many cases where a financial institution acts as an intermediary for several enterprises, when they take joint action for the supply of raw materials and products or for setting up subcontracting organization or for market allocation. In such case there are a constant financial transaction between financial institution and such group of enterprises which can be regarded as financial-chain, but is nothing but an indication of the stability of financial transaction in between "central financial institution" and "enterprises in chain." Recently financial institution often dispatch director to the company who receive financial aid from the former, but again this should rather be regarded just for the reconstruction of the company in question, or for providing a job for the staffs of the financial institution who retire by age limit and at the same time, for extending them management assistance to the company to whom loan is advanced.

#### (6) Business-Chain of Auxiliary, Related Enterprises

There are many instances where a manufacturer places existing enterprises, who engage in such service-rendering business as transportation, finishing, packaging, warehousing, etc. which are auxiliary to the

maker, under its business-chain, or separate these service departments from its inherent productive operations and incorporate subsidiary companies. In many cases, however, the incorporation of such service-rendering departments as subsidiaries is also motivated by the fact that their business scales are smaller than parent company, hence the labour can be secured with cheap wages. There is another instance where an enterprise who is asked to save medium-small enterprise facing business difficulty, makes capital participation for the reconstruction of such enterprise and dispatches director thereto, thus comes to control it. Such business-chain is not maintained merely for the mere friendly feelings, but generally because there is some hope for profitability after the reconstruction or for some advantage to be anticipated for the business of the parent company.

More recently a new trend has come to be witnessed. Local railway enterprise, for example, diversifies its business activity into air-service agency business, tourist industry, etc. and thus they incorporate subsidiaries in entirely new field for their business diversification. This type of business diversification is dedicated to the purpose of maintaining its capital returns of the enterprise whose growth rate is low, by extending its activities to a rapidly expanding industrial field.

In the above, various types of business-chain have been reviewed as far as possible. They are all understood to be pursuing a common interest of enterprises by taking joint activity among them.

In the contemporary industries where the social division of labour has been extended to the utmost, the production of a great number of merchandises, their sales as well as service-rendering businesses etc. are being carried out by many enterprises, but on the other hand, the competition among the enterprises is getting keener. The competition originally takes place among the same merchandizes on the same production stage or among the products which are, to some extent, replaceable with each other. However, even among the products of different production stage, there is a competitive relation because the seller tries to supply raw materials, products or services at higher prices while the purchaser of these products or services tries to buy them at the lowest possible price, then subcontractor who fabricate the parts tries to sell at the price as high as possible, whereas the central enterprise who does assemblage desires to purchase them at the most economical terms. The makers appeal to the selling agents to focus efforts on the marketing of their products, while the trading firms want to make selection of the merchandise which are most

advantageous to their own interest. As can be seen here, there is a countervailing power working in between such different production stages (even regarding the production of the same merchandise, it can be deemed as consisting of two stages of assemblage and parts fabrication). It was J. K. Galbraith<sup>1)</sup> who pointed out the importance of contradictory relations in the contemporary industry and the transfiguration of economy thereby.

Those who possess strong countervailing power are at the same time strong in competition. Galbraith stressed in his book the trend that the both contradicting parties try to strengthen such countervailing power by organizing themselves, and thus he tried to explain the various kinds of organized activities (merger, cartel, co-operative, labour union etc.)

However, even within the same production stage, the enterprises can protect and promote each interest by taking a joint action, such as of forming-up cartel, etc., or they can open up new industrial frontier by mutually furnishing their respective technology, capital and market. Further, even among the different production stages which are in countervailing relations, there are some interests common to them that the business growth of the one depends upon that of the other. The business expansion of an enterprise handling raw materials facilitates the growth of an enterprise who processes these raw materials and vice versa. In such case there is a sufficient reason that these two should somehow or other carry out organized activity in order to pursue common interest. In other word, by organized activities the countervailing relations can be mitigated or adjusted to promote their common interests and to fortify the power of competition of a group of enterprises. In this connection attention must be paid to the business relationship for the purpose of strengthening the competitive power.

The various business-chains as described above therefore can be, in a sense, considered as a phenomenon of collectivization. Collectivization is also seen among big enterprises. In such case, the problems of management within the collectivized enterprises and the influence of such collectivization upon others, etc. are to be the subjects of serious studies, but since, in the first place, they are comparatively well governed sound by reasoning and no problems such as domination-subordination relations take place, and secondly this paper aims at dealing the

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1) Galbraith, J. K. : American Capitalism : The Concept of Countervailing Power, 1952.

business-chain as one of the problems of medium-small enterprise, the problem of collectivization among big enterprises has been excluded from the objects of this study. Therefore the problem of big business is limited to the cases where the former places medium-small enterprises under its business-chain.

In the formation of the above-described business-chains, there are two categories, the one is that the big enterprise incorporate the subsidiary with some investment made, and the other is that former bring the existing medium-small enterprises into chain by some means in which is included the case where the salvaging of the medium-small enterprises facing business difficulties bring them into business-chain.

Since subsidiary companies are generally smaller than parent companies, and as the matter of fact the formers are off-shutes of the parent companies, it is quite natural that they be placed under the direct control of the latter, though a problem on the relations between the big business and the medium-small enterprises may arise.

From the standpoint of the modern management, however, instead of trying to control powerfully subsidiary company, if it is given wide range of autonomous decision and self-responsibility, better business results are expected and this idea is rapidly gaining ground.

Now, therefore what we have to deal with in this paper is to be the case where the big enterprise tries to strengthen its own competitive power at the cost of the medium-small enterprise having the latter entirely serve the interest of the former by placing them under the former's business-chain, and the case where it extends assistance and guidance to the latter for the sake of mutual benefit and thus it contributes to the industrial advancement. The case where the medium-small enterprises enter into business-chain in seeking for help is also discussed as far as it is necessary.

### **3. Historical Observation of Business-Chain**

Subcontract manufacturer system will be historically described as follows.

- (1) As already described, in the metal-machine industry the product is completed by assembling numerous parts and it is not economical for one enterprise to do all the operation such as the fabrication of machine parts in addition to assemblage, etc. In many cases the fabrication cost is cheaper when the parts, which do not require high precision and which can be fabricated by a simple machine, are produced by medium-small enterprise rather than by big enter-

prise. Again casting and plating etc., can be operated by the specialized factories than by the big enterprise. Moreover, among the parts there are some finished parts that have their own mechanism and function, to a certain extent, which can be mass-produced and marketed, though there might be required to follow more or less a specification as set by an individual customer. Here again specialized manufacturers come into existence. Hence, the big enterprise who uses these products as parts of finished machine would find it more economical to have such specialized makers fabricate them rather than to produce them by himself, except the complicated parts of high precision, or those whose fabrication requires large machine tools and so forth.

Besides above, in case the big enterprise was to fabricate all the innumerable parts, the plant size would become unduly large which entails administrative inefficiency that results in higher cost. Thus it becomes incumbent upon the big enterprise to place orders with subcontracting enterprises for the parts as far as possible. Thus the integrative industry such as that of metal-machine has ground to see social division of labour take place between the large and medium-small enterprises according to the nature of job and this is the very reason why subcontracting manufacturer system develops.

Such social division of labour is not only found in Japan but also in Western countries. Besides metal-machine industry, in such industries where some parts of one industry are at the same time the products of other industry, similar subcontracting system is in function to a certain extent.

(2) However, the subcontracting relations, in the Western countries, between the big enterprise and the medium-small enterprise who engage in the production of parts, are quite different from those in Japan, and even within our country a great change has taken place when such relations today are compared with those before the Second World War.

In the first place, the characteristics of the subcontracting manufacturer system before the War are found in the following points which made it so different from those in the Western countries. Though it is still remaining obscure as to when the subcontracting manufacturer system has come into existence, it is presumed that the system had gradually been put into practice since after the First World War when our metal-machine industry had began to develop rapidly, and that it had fairly well established itself around 1935. (It was after 1935 that

the subcontracting manufacturer system had come to call academic attention: Studies on Japanese Medium-Small Industries by T. Komiyama, 1941; Subcontracting Manufacturer System by K. Tasugi, 1941; Subcontracting Manufacturer System edited by K. Fujita, 1942).

One of the specific nature of our subcontracting industry lied in the fact that the parent or central enterprise tried to reduce its cost by forcing its subcontractor to accept the cheap price by taking advantage of its capital superiority and its stronger position in the transaction. Namely, the central enterprise has much bigger capital than its subcontractor, superior in its production facilities, technology and marketing capability while the subcontractor manufacturer is isolated from the market so long as it depends on the order to be placed by the central enterprise.

The subcontractor manufacturer had no other choice but to accept the order of the central enterprise no matter how cheap the price of such order was, because it was almost impossible to expect orders from other parties nor had it technology and marketing power to choose other means. What was worse still, there had been an excessive competition among these medium-small enterprises, and in those days when the labour union was yet on an infantine stage, cheap price could be shuffled off upon the worker's wage of the subcontractor manufacturer. Under all these conditions the central enterprise drastically reduced the subcontracting fees and prices, taking advantage of its strong position. In short, the low-price of subcontractor manufacturers was the motive of utilizing them. As mentioned above, the cost of parts manufactured by the medium-small enterprise must naturally be low, but in practice the large enterprise further reduced the price even beyond that, using undue pressure.

The second characteristic is found in that when the business depression came and the manufacturing operation of the big enterprises had to be reduced, they tried to maintain their operation by taking up the fabrication of the parts by themselves which were used to be entrusted to subcontractor manufacturers. In other words, the central enterprise took advantage of the subcontractor as a buffer of business cycle. Thus the big enterprise could avoid the curtailment of operation by taking up such job which used to be ordered to outside subcontractor, while the latter had to encounter drastic reduction of orders and its operation had to be greatly affected. That much of sacrifice had to be borne by the subcontractor manufacturer for the benefit of the central enterprise.

Then, what kind of eventual results were produced with such relations between the central enterprise and the medium-small firm engaged in subcontracting job? In a sense, these medium-small metal-machine makers, though their equipment and technological level were poor, they could engage in the production of machine parts and could survive, using what facilities they had by entering into subcontracting relation with the central big enterprise. Namely they could play a little part of social production by being accepted into the productive organization of the big enterprise. However since the central enterprise extended no substantial assistance to the subcontractor for the technical improvement, but instead force the latter to accept the cheap price that could barely allow them to survive, the possibility for such subcontractors to expand and improve their facilities through capital accumulation was almost non-existent.

Medium-small enterprises could narrowly continue to exist but the way to the prosperity was entirely blocked except only a few during business boom. By an exceptional few is meant those closely connected subcontractors who were given comparatively regular orders, but even these subcontractors had to anticipate cheap price and reduced orders during depression.

Such subcontracting relations, however, had not necessarily brought about only benefits to the central enterprise. For them it is economical to utilize medium-small subcontracting manufacturer for the production of some machine-parts and therefore in order to improve the productive power of the big enterprise it is also necessary to expand the productive capacity of the subcontractor firm. Moreover when the big enterprise wants to produce products of high precision, it is naturally important to elevate the technical level of the medium-small enterprises who engage in the production of such parts. If it is so, the pre-war approach to the utilization of subcontracting system must have been against the long-term interest of the central firm itself and also against the propensity of the industrial progress, though it might have produced a temporary profit to the big enterprise.

(3) During the Second World War when the speedy expansion of the productive capacity of war products and the higher quality of them were urgently required, the above said point came to be recognized, and under the guidance of the military authorities some change started to appear in the subcontracting relations. Concretely speaking, the military authorities then started to lead readjustment of the subcontracting relations in the metal-machine industry in the face of the



keen necessity of the production of better quality munitions, and practised so-called Co-operation Factory System. The central enterprise extended technical assistances or leased machineries or sold them which had become unnecessary in the war arsenal or in the big factory, for the technical improvement of those subcontractors, while the financial institutions were asked to advance funds to the subcontractor enterprises when they presented the order certificate issued by the central enterprise, for the improvement of production facilities of these subcontractors. Thanks to this Co-operation Factory System, the subcontracting relations were no longer determined by the one-side interest of the central enterprise, but by the higher standpoint of social productive power and this accelerated the progress of the medium-small subcontractor manufacturers, and so far as such aspect was concerned, the policy adopted then was sound. When such development during the War is viewed from the current status of medium-small enterprises, the exclusive integration of the subcontractor to the central enterprise as demanded by the military authorities at that time (it was then called the "group of enterprises" or "enterprise-chain") involves some problems, but in view of the economic situation of medium-small enterprises and of the emergency of war production in those day, we think nothing better could be done. Consequently as the result of practicing this system the productive capacity as well as the productivity of the meium-small enterprises had shown substantial improvement. (Later, because of the confusion before and after the termination of the war, this development had once been broken.) One thing to be noted here is that such policy was not worked out at the initiative of the central enterprise with its due recognition, but by the military authorities.

#### **4. Current Change Taking Place in Business-Chain**

##### **(1) Metal-Machine Industry**

For a short period after the Second World War the essential nature of the subcontracting manufacture remanied the same as that before the war. Though a rapid progress had been made by the metal-machine industry after the war, the earning power of the central enterprise had not been sufficient enough when they could no longer expect orders for war requirement, and thus whenever they encountered business recession, they used all-out efforts to maintain their own operation by cutting off the orders to be placed with subcontractors, Then during the business booms in 1951-52 (caused by the Korean War) and in 1955-1956 the central big enterprises tried to expand produc-

tion in the face of the sudden increase of demand, but the subcontractor manufacturers responded to the former most reluctantly, because of the bitter experiences they had suffered from the self-centered way of doing business of the former. Subcontractor manufacturers were then rather critical and they tried to select only such central enterprise that gives due consideration of and assistance to the business growth of subcontractors. Thus more and more central enterprises had to change or modify their policy toward subcontractors. On the other hand, the subcontractors came to hold stronger position in the negotiation with the big enterprise, because the structure of Japanese economy had shifted to that centered around heavy and chemical industries, and with the tremendous growth of metal-machine industry the competition among the big business to secure subcontractors became much intensified.

In addition to above, the technological innovation has come to take place in every industrial field after the war, and the demand for metal-machine products has not only increased, but also the quality improvement of the products has come to be strongly demanded. When big enterprise tries to improve the quality of its products, it naturally calls for the improvement of the standard of parts for such products, and the technical level of its subcontractors must be raised. In other words, the technological innovation has made it impossible for the central enterprise to merely pursue a short-sighted profit, avoiding to use proper efforts to improve the technical level of the subcontractor, neglecting to provide them with regular orders so that the latter can afford to modernize its equipment, to have it specialized or to place the payment of subcontracting fees on a rational basis. Since the medium-small enterprises are not yet in the position to improve their technical and their business status by themselves, the big enterprises had to definitely adopt the policy to foster subcontractor manufacturer, realizing that it eventually brings about benefit to themselves. The details of the fostering policy in the metal-machine industry will be described later in 6.

## (2) Textile Industry

Similar change has appeared also in the textile industry. Let us take the synthetic fiber industry of Fukui Prefecture for instance.

Originally before the war Japanese rayon makers engaged only in the manufacture of yarns, while the sales of thus manufactured yarns had been entirely left to the hands of wholesale merchants located at a trading center or at the local place of weaving production, and the

weaving and the processing thereafter had been dominated by the wholesale merchants. The weaving by the rayon maker itself or the weaving by jobbing too were therefore almost non-existent. However, because of the inflation spiral took place during and after the war, the wholesale merchant became weakened, and though, the weavers on the contrary, had been then improving their business position, many of them as well as dealers went bankrupt in the reaction of the Korean War boom (1951-1952).

Under such circumstances the rayon makers came to designate an agent—influential weaving shop to have them engage in the processing job for the specified brand on piecework basis, in order to protect themselves from the loss to be incurred from the bankruptcy; that was the production of chop fabric on the basis of piecework. That is to say, in the rayon textile industry of Fukui Prefecture, the rayon makers came to take the wholesale merchants and weaving shops into their business-chain, starting with said salvation of the wholesale merchants and the weavers. Though the direct motive was either the salvage of the subcontractors or the protection from incurring loss, here began the movement of rayon company to secure processors and sales channels for its own products. The rayon company who used to exercise no influence upon the stages beyond disposing of their primary product came, for the first time, to recognize the significance of establishing the business-chain from the view-point of marketing or of the securement of marketing share. Therefore at the early beginning no technical assistance or aid for the improvement of the equipment of the weavers were extended. However, later in 1951 when a project of Nylon, a new synthetic fiber (polyamide fiber) was completed at Toyo Rayon Co. Ltd. it was found out that since Nylon was an entirely new synthetic fiber so different from viscose rayon or acetate rayon, many techniques must be developed such as those for humidity and temperature control in weaving, anti-static electricity treatment, for dyeing, resin finishing, etc., if the merchandizing value of same was to be fully displayed and that their techniques must be extended to the medium-small subcontractor mills, besides giving them assistance for installing necessary equipment. Moreover, Toyo Rayon was then aiming at the market development by diversifying Nylon products into blended fabrics, knitted goods as well as industrial materials, in addition to Nylon stockings for lady, for which too the technical assistance to the processors was necessitated. Thus as illustrated by the case of Toyo Rayon toward Sakai Textile Ltd. thorough-going assistance of various techniques

and control have come to be extended by the big rayon companies to their subcontractor mills. The only difference in the form of assistance of this industry from that of machine industry is found in that neither direct capital investment nor any leasing of equipment was made though personnel connection through the dispatch of director etc. was strengthened. Sakai Textile Ltd. completed a plant of Nylon scouring mill, and Nylon fabric finishing plant in 1952 and in 1959 they completed Teton processing plant and the plant facilities of both Nylon and Teton have been further expanded, but financially Toyo Rayon have taken no positive measures but to retain a part of its stocks when Sakai had increased capital. Instead Toyo Rayon has placed main emphasis on the technical guidance of the latter, and is substantially controlling its sales activity. Such pattern of business-chain is exactly applicable to other weaving mills integrated into the business-chain.

The measures by which Toyo Rayon guides and controls the enterprises of its business-chain are specialization, technical assistance service and the placement of continuous orders, and they call them "Production Team". The business-chain developed in the synthetic fiber industry was not limited to Toyo Rayon. New fiber called Teton (polyester fiber), acrylic fibers (Cashimilon, Vonnell, Exlan, Kanekalon) etc. made debut one close on the heels of the other, and they are also blended with natural fibers or viscose rayon at a certain ratio, all of which stand in competition. These new fibers too call for the bigger marketing share, product development and more technical service just as it was with Nylon, and thus the makers of these fibers such as Teijin, Asahikasei, Nihon Rayon, etc. are using utmost efforts to bring weaving shops into their own business-chains to whom assistance has been given and control exercised.

However, as to these late-coming synthetic fiber manufacturers they have not yet succeeded to secure their own exclusive subcontracting processors to cover dyeing and textile finishing treatment, and are depending upon Fukui Seiren (Scouring) Ltd. who, on its part, is afraid to entirely be placed into the business-chain of one specific synthetic fiber maker. On the other hand, the trading firms were not necessarily sitting back idle in the face of the trend that the synthetic fiber makers were bringing the dealers, weavers and even the dyeing and scouring mills into their own business-chain. During the period of business recession around 1952, the trading firms were entirely subordinated to the fiber makers. However the monopolistic situation

of synthetic fiber production by one or two companies had gradually been broken with the emergence of several makers of acrylic fibers and later of polypropylene fibers, and also by the entry of new makers of Nylon and Tetoron.

Since all of these synthetic fiber producers tried to secure their own subcontractors, the local trading firms, with strengthened capital power, came to foster influential weaving shops. They not only tried to control marketing channels, but also came to offer technical services, render good offices for the procurement of processing equipment and even extend financial assistance, placing particular importance on helping subcontractors to buy equipment that required substantial funds, for instance, dyeing machine. However, when compared with the business-chain established by the makers, that of the trading firms is weaker in its continuity and its size of order is smaller and the fees payable for processing is lower. Such business-chain developed by the trading firms is currently found in the fields of acetate processing and finishing, and some are of the opinion that they are doing so in order to have stronger voices at the time when the later-coming synthetic fiber makers will form their business-chain in the near future.

As seen above, whereas the direct business-chain of the makers is well established in Fukui Prefecture, in Ishikawa Prefecture the business-chain has been established centering around the local trading firm by placing the weaving shops under its own control while it itself operates weaving and dyeing mills as they traditionally possess strong capital power.

In short, because of the fact that in the synthetic fiber industry, the technical service is required for the fiber processing and finishing, the move to bring weaving shops, dyeing mills and even secondary processors into business-chain has rapidly advanced, particularly when the competition among synthetic fiber for larger market share has become so intensive. All of them tried to foster influential medium-small firms placed in business-chain by rendering technical services and aid for modernizing equipment as well as by placing with them comparatively stable orders. The processing fees and the price too are not one-sidedly determined, but are quoted in a way that these co-ordinate firm can afford to make sound growth, the parent company even offers business and managerial consultations and assistances, though such firms brought into the chain are limited to those who measure up to the standard set by the synthetic fiber makers.

## 5. Socio-Economic Conditions That Have Brought About Business-Chain

What must have been the reasons why the formation of business-chain has recently so markedly advanced in such fields as metal-machine industry, synthetic fiber industry etc. as described above? The socio-economic background that accounts for this phenomenon could be as follows:

### A. Necessity to Strengthen Competitive Power

Competition is an inherent factor of capitalistic economy. Except the enterprise that is granted exclusivity by the government for a specific area such as public corporation or public utility etc., keen competition is always being fought among enterprises. Only during war-time or right after the War when a strict economic control was exercised due to shortage of goods and materials, the competition was mitigated. However, even a public enterprise like national railway or such public utility as electric power corporation, who is granted to carry out business operation in a given area on an exclusive basis, must face competition from other replaceable goods and service. Namely national railway service is always being challenged by the competitions from private railway, bus and truck corporation and even by air-line company, while power company by town-gas company or, to a certain extent, by the usage of fuel oil.

It goes without saying, therefore, that the enterprise that supplies service or goods of general nature must struggle for survival in the midst of keen competition among the fellow enterprises and against other industries.

For a while after the War many enterprises could rest in peace under the protection of economic control enforced due to the shortage of goods and materials and they once had come to be accustomed to it. But with the national economy reconstructed, the competition has become even keener than before the War because the influential enterprises in each industrial domain have tremendously expanded their scale, which in turn has produced oligopolistic economy (touch upon later), and also because new technology, new materials and products have so frequently come to be introduced.

In order for an enterprise to survive in such competitive market, it is only too natural that it tries to modernize management and further cut the cost but, on top of that, it has to resort to the following means: In the first place, to strengthen competitive power by monopoly and secondly achieve the same target through tie-ups between different production stages.

By the term "monopoly" used here is not meant monopoly in its

strict sense, because as mentioned above, it is practically impossible for one enterprise to monopolize the entire market of one industry. In fact, when the greater part of a market is occupied by several large enterprises, many enterprises are still sharing among them the remaining part of the market. Even so, when a few enterprises control the greater part of a market for a given merchandise and when the market is in a state of oligopoly, so-called monopolistic profit, though it may be limited to a certain extent, can be secured. For example, a few big enterprises can strongly impress to the public their own brand or corporate name, and even if they do not work out price agreement, they can maintain price by exercising influence upon other companies with their "price leadership".

When we think of the fact that a great number of medium-small enterprises have almost no other means but to resort to the competition by price-cutting, because their brand has far less commercial value. The greater marketing share by these big enterprises (or so-called monopolistic position) means great advantage. In the second place, besides securing monopolistic position through business expansion within the same industrial field or through merger, the enterprise can acquire stronger position in the business competition by placing an enterprise of different production stage under its control. Galbraith, the writer of "American Capitalism", pointed out as mentioned before, that the enterprises on the same production stage are not only compete against each other, but also that there is a countervailing power working in between the enterprises on the production stages in sequence, and he has placed sub-title of "Concept of Countervailing Power" on his book. For instance, when the automotive industry develops, steel industry that supplies material thereto will try to fortify itself, while other auto-parts makers will try to cope therewith. On the other hand when the management of the automotive company get stronger, the labour union will become powerful in opposition to the former. Again if a food-stuff maker gains strong position, supermarkets that handle such food products or farmers who supply raw materials to the maker tend to organize themselves. In such a way certain extent of countervailing power spontaneously to work in between the parties on different production stages to strengthen themselves. He further stresses the necessity of taking some policy on the part of the government to fortify countervailing power if one party is not strong enough to confront the other, for instance, like the protective policy of agriculture as adopted by U. S. government. This theory points out the importance of countervailing power that works in between the production stages, but to put it in another way, it means that when one party's countervailing power is weak, the other party can

attain more advantageous position in competition, only if it places the other under its control. For example, when big automotive or electric makers utilize medium-small subcontractors for automobile or machine parts, it is desirable for these subcontractors to have stronger voices with its own efforts or through the concerted efforts among themselves regarding the price and quality problems etc., but on the other hand, if the big makers can bring these subcontractors into the business-chain for their own advantage, the parent enterprises can strengthen their own competitive power by being able to cut the processing fees or use them as buffer for business cycle, as well as for other changes (ex. model change). Likewise the big makers of synthetic fibers and other chemical materials can secure their own marketing share by placing medium-small processing plants into their chain, or they can also have these medium-small enterprises develop new products taking advantage of the characteristic quality of the supplying materials.

Thus when a party on one production stage integrates other party on other production stage into the former's business-chain and keeps vertical connection, we sometime call it vertical integration. Why has such vertical integration come to switch its attitude of utilizing the enterprise in business-chain only for the near-sighted benefits to that which gives due consideration to the sound growth of these enterprises?

#### B. Motives That Accelerated the Formation of Business-Chain

In order that a central enterprise grows soundly in the midst of competition, such enterprise should not pursue immediate profit but maintain relations with its co-ordinate subcontractors in a way which enables these enterprises to prosper at the same time, and such long term approach has widely come to be recognized. The objective of enterprise is not to raise profit just for a short term, but to secure profit on a stable and long term basis, otherwise the enterprise may fail to get even short-term profit. Such business philosophy seems to be gradually gaining ground with the following four reasons:

##### (1) Oligopolistic Economy

In a free-competitive market where many enterprises whose scales are more or less same are co-existent, the price reduction and other competitive means that may be taken by an individual enterprise have little influence upon the industry as a whole to which it belongs or upon entire economy. However, the things are greatly different in the case of oligopolistic market where a few large enterprises are supplying the majority of products of a given industry. In such key industrial fields as iron-steel, automobiles, electric machines, synthetic



fibers, oil refinery and petro-chemicals, etc. several big enterprises occupy more than half of the market, and in other modern industries too similar status is seen in many cases. Within the industrial field that takes the form of oligopolistic market the competition among those big enterprises is usually severe, because, should one of them introduce into the market a new product or reduce the price, the market share of other enterprise is taken away, and it affects the business of other company because of the reduced marketing share. The competition among the limited number of large enterprises tends to get keener than that among a great number of enterprises. Moreover in case the competition among those large companies takes the form of price cutting, the loss incurred by all the parties concerned becomes so large that they will soon come to realize the foolishness of such price-cutting competition and find it much wiser to follow the price leadership of one company. Thus it is generally pointed out that the price-cutting competition tends to give its way to non-pricewise means for competition. Competition by the quality improvement, development of new products, establishment of marketing channel as well as by the propagation of trade name and advertisement etc. is the dominant pattern in the oligopolistic economy, while it must not be overlooked that the competition by price cutting is still seen in many cases in Japan. For the purpose of improving product quality, of establishing marketing channel, and for the sales promotion as described above, the big firms find it necessary to bring medium-small firms into its business-chain as the source of raw material supply and also as processor, or for the sales promotion of its own products.

## (2) Importance of Marketing

As described above, the means of competition in oligopolistic market tends to be shifted from price-cutting to non-pricewise measures. One of them is to use efforts to see to it that its own product be surely delivered to the customers. Activity of a given enterprise is not to terminate with producing alone, but it can survive only when its products are actually sold to the consumer and their proceeds are safely collected, in the modern economic society based upon the social division of labour. Enterprise can not exist if its products do not sell, as a common saying goes "No sale, no job". Even in the case of raw material if its product does not meet the needs of end-users, no party will undertake its processing or sales. Though intermediary manufacturers and wholesale merchants too have the right of selection, the one who ultimately makes selection of merchandize must be the

consumer. Therefore the enterprise must know exactly what the consumer wants, and manufacture the products that satisfy the consumer needs and sell at the price accepted by the consumer through the selling channels for the convenience of the latter. Sales promotion must, therefore, be the activity to appeal to the consumers to have them select one's own products. Without such marketing activity the enterprise can not survive in the competitive economy, particularly in oligopolistic economy.

The makers of raw materials such as iron and steel, synthetic fibers, resins for plastics must use great efforts to see to it that their supplied raw materials are processed to finished products and sold. Since they have to utilize only such manufacturing processes that fit for mass-production, many aspects of their management are much different from those who produce finished goods that have to meet the multifarious demands of the consumers, and so in the latter's case medium-small business scale serves better to the purpose. However, inasmuch as medium-small manufacturers are not necessarily strong enough in their capital power as well as other technical and administrative aspects, the big raw material supplying makers come to integrate them into their business-chain in their efforts to secure marketing share for themselves while extending to these medium-small enterprises various assistances. On the other hand, in case some medium-small makers can develop and manufacture specific consumer goods, for example, food-stuffs or capital goods such as various industrial machines, they may try to market their products by themselves. They may be able to carry on doing so, so long as their output is limited to be easily absorbed by the local market, but when the production scale gets expanded, they will encounter difficulty to dispose all the products by their own marketing efforts, and become to be willing to enter a business-chain of a large scale trading firm with whom all the marketing operation can be entrusted.

### (3) Technological Innovation

Technological innovation in the post-war era is really staggering. Seeing chemical industry alone, innumerable new materials and new processes have come to be made available as illustrated by the development of such synthetic fibers as Nylon, Teton, acrylic and polypropylene fibers and of many new plastics that appeared following mivynylchloride, while amazing progress has been made in the petrochemical industry taking over the place of coal-chemical industry. Also in the electric and electronic industries tremendous advancement has

been made in the manufacture of televisions and transistors, while the rapid growth of home electrical appliances, and of electronic equipment for automatic control and calculators is really far beyond our imagination. Various industrial equipment and machine tools developed after the War are, moreover, much improved in their precision, and in their processing speed. Japanese automotive industry has finally been placed on a right track, having gone through the age of government protection during the War. In the midst of such technological innovation, the big makers find it absolutely necessary to replete staffs and facilities for research and development for new products and processes as well as for the improvement of the existing products; otherwise they are always in danger of being left behind the competition.

Even some of the medium-small machine makers and chemical companies are using no-small efforts to keep up with technological innovation, but generally speaking such efforts are not sufficiently rewarded because the employment of competent researchers and the investment in research and development by these medium-small companies are by no means easy. On the other hand, when the big makers place orders for the machine parts with these medium-small enterprises, if their technical level remains low, the product quality of big makers who assemble these parts for their final products must naturally be affected, and thus the problem of raising the technical level of these medium-small enterprises becomes very serious. This is another reason why the big makers have come to extend guidance and assistance to these medium-small enterprises to raise their technical and management level by bringing them into their own business-chain. This means that the old way of utilizing subcontractors by the central enterprise at the former's cost for immediate profit, and of forcing them to accept cheap price or of reducing orders in the time of business recession has come to be considered out-dated.

In the case of chemical industry too, when a new material or product is developed, it is very important to render technical service for the better processing of such material or product in order to see that it be properly treated. Otherwise the material maker cannot expect the market. It is with this reason that the synthetic fiber makers try to establish business-chain for the processing of their products to blended yarns and fabrics, as well as for dyeing, knitting and sewingtailoring, while plastic resin makers integrate medium-small plastics fabricators who manufacture multifarious plastic goods, by extending technical services and sometime even financial aid. Moreover regardless of whether

it is in synthetic fiber industry or plastics industry, since new products are being introduced one after another, the urge to establish business-chain is all the more accelerated also from the marketing standpoint.

(4) Liberalization of International Trade—International Competition

Besides the basic reasons as explained above, there is another reason that has come to expedite the formation of business-chain in some industries, particularly for the past several years. That is, the trade-liberalization which has brought many industries to face direct international competition regarding quality and price. While textile industry, for example, has long been internationally competitive, many other industries such as automotive industry, machine tool industry, etc. cannot as yet compete with foreign producers, even in the domestic market unless they use all-out efforts.

In the automotive industry in particular, our makers who turn out at most 30,000 units per month must confront with American automobile producers on mass-production scale, whose monthly capacity is more than 100,000 units. To cope with such situation Japanese makers are continuing their efforts to foster their subcontractors by extending to them technical service and business administrative guidance, so that they will become full-fledged specialized makers of automobile parts who can supply the central enterprise with good-quality products with reduced cost.

These four motives, as mentioned above, are commonly applicable to all the industries, though there must be some difference of intensity according to the type of industry. In some industries technological innovation advance much faster with keen competition going on among the oligopolistic enterprises. In such case stronger marketing based on the non-price competition becomes more needed. Such type of industry has higher growth rate, and because of its belonging fast-expanding industry and of being an enterprise having a big capital, technological innovation find its way into it. The big enterprise in the field of raw materials tends to establish business-chain to cover processing and marketing section in order to secure its sales outlet, while the big integrative enterprise tends to build up a business-chain to cover medium-small makers who take charge of the production of the necessary parts.

It is because of being fast-growing industry that they endeavour to maintain product quality in keeping up with the technological innovation, and as the matter of fact it is incumbent them to foster and render assistance to the enterprises of their business-chain if they were

to increase production to meet the ever-growing demand. On the other hand, for such assistances, the big firms have to bear some burdens, for instance, the expenses for the training of technical staffs, etc., while they have to refrain from forcing undue cutting of price or processing fees. These expenses and other burdens can be regarded as an investment for the growth of the enterprise in the long run, but it may be hardly possible to assume such burdens unless they are large enterprise in the field of growing industry. The business-chains are therefore mainly found in the growing industries. On the contrary in the traditional industrial field no substantial demand increase is observed and consequently no expansion in the scale of enterprise is being witnessed, nor technological innovation is taking place in such industrial domain, where, though competition exists among medium-small enterprises, it frequently takes the cut-price competition which further tends to be an excessive competition. Therefore no efforts are exerted to bring other enterprises into one's own business-chain nor generally can it afford to use such efforts. Should there be a case where a comparatively large enterprise or wholesale dealer place smaller enterprises under control, the form of control has to be such one based on price-cutting, and thus the new type of business-chain that places emphasis on the guidance and assistance can hardly find its way into such traditional industrial field. Through the contrast of above two patterns of business-chain, the motives that expedite the business-chain may have to include another condition that it must belong to the growing industry, so long as we distinguish the business-chain as that renders guidance and fostering assistance from a simply control-controlled business relations.

## **6. Guidance and Fostering Assistance by the Large Enterprise**

As mentioned above I would like to call as business-chain such connection between the big firms and the small firms where the formers try to elevate the technical as well as administrative levels of the latters by rendering them guidance and assistances, in contrast with that where the formers take advantage of the cheap labour of them as buffer of business cycle, even though the formers extend financial assistance or endow marketability to the products processed by the latters. Formation of such business-chain is a phenomenon comparatively new in our economy.

Then what kind of approach is taken by the big enterprise to the fostering of co-ordinate enterprise? It is quite different from industry to industry, but roughly the following measures are being taken:

(1) Regular and Stable Business Relations

If the parent enterprise places orders with medium-small firms only when its production capacity cannot meet the increased demand caused by the economic boom, or if only the specific jobs that do not fit to the parent company are entrusted to them as they become necessary, but cut the orders just as soon as business recession comes around, medium-small firms will certainly lose enthusiasm to technically improve themselves nor gain any capability. On the contrary, if the parent company secures for medium-small firms a certain minimum order on a regular basis though there be some fluctuation in the volume of order due to the business cycle, the latter not only find it easier to maintain their business, but also they are more encouraged to modernize their production facilities etc.

The primary requisite for the parent company is therefore to stabilize the management of its co-ordinate enterprises by issuing regular and stable orders. It is true that even the big parent enterprise too can not stay away from the influence of the business cycle, but if the parent company dares to slash subcontract in order to avoid to see its own operation curtailed, the medium-small firms would be greatly endangered. Therefore in such case the reduction of issuing orders must be limited to the same proportion with that of its own production curtailment.

(2) Specialization

There are many cases, where the parent firm has either no specific production facilities or finds it more economical to underlet the jobs to subcontractors, and prefers to make use of the medium-small enterprises. However should the models of the parts or products to be fabricated by these subcontractors be changing so frequently, these subcontractors will remain as jumble shops and consequently they cannot make any technical improvement. On the other hand, if these medium-small enterprises are allowed to be experts to perform specific jobs, the technical improvement through specialization can be easily expected. Thus one of the characteristics of the assistances through business-chain must be found in such approach as having one subcontractor factory specialized in, for instance, the casting of small or big parts, another in plating, still another in forging while other firm in more or less specified.

(3) Technical Assistance

When the medium-small firms are made to be specialized in the production of specific products or in special jobs, a way will be opened

up for them to get further technical assistances. In the days of technological innovation the quality improvement of the products to be turned out and sold by the parent enterprise is of paramount importance, and it naturally requires the technical improvement as to the parts or products of the subcontractor firms. Therefore many of the large central enterprises dispatch technical service staffs to these medium-small firms where it is necessary, or call in the workers of the co-ordinate firms to give them technical training. However, for example, in automotive industry, etc. where the technical level-up and cost-down are urgently necessitated, the parent firm has, in many cases, technical service force (or by giving technical service to the association of co-operative factories organized under the sponsorship of the parent firm), and the staffs regularly make round-call to the co-ordinate firms for rendering technical services.

#### (4) Determination of Subcontracting Price

In the past the cheap labour and the excessive competition among the medium-small firms could have been taken advantage of by the parent company, and therefore cheap price was often enforced on them as discribed already. The medium-small firms then generally shuffled off such cheap price onto the wage of the workers and sometimes they had to cut the remuneration to be paid to the management staffs in order to survive. Should they, however, be left in such status, no enthusiasm for the modernization of facilities and technical improvement could be expected. In the growing industry the expansion of plant equipment and technical improvement are grealy required to meet the growing demand and to keep up with the technolgical innovation, but without having a certain capital accumulation these things are next to impossible. In this connection, further cost-down must be materialized through the business modernization of these medium-small enterprises, but on the other hand the price of products or the processing fees to be determined must not only permit them to survive, but also be what allow them to make some progress and growth, that is to say, the price should leave some profit to the co-ordinate enterprise. Recently the big enterprises who recognize importance of fostering their co-ordinate firms came to pursue such pricing policy. This is demonstrated in two aspects. Firstly, instead of determining the price one-sidedly, the parent enterprises have medium-small enterprises submit an estimate and by the mutual deliberation the price has come to be decided. In this case the voice of the parent enterprise may often be stronger, but at least it is a great progress that the parent enterprise

has come to listen to the opinion of the medium-small firms in determining the price by taking the actual position of the latter into due account. Besides, in case regular and continuous big orders are placed, cost reduction through the skills improved thereby may make it possible to gradually lower the price. In the second place, the subcontracting price is often figured out by multiplying man-hours necessary for the fabrication of parts by unit cost per man-hour. Since the unit cost per man-hour is of the nature similar to the market price, it is, in principle, commonly applied to all the subcontractors who receive the order from the same controlling enterprise, and the actual subcontracting price is calculated by multiplying such unit cost by man-hours, which vary according to the type of job required for the fabrication of parts.

However, when the central enterprise is compared with the co-ordinate subcontractor and also even among the subcontractors, the unit cost per man-hour must be different according to the extent of mechanization. In the big factory since the indirect cost is higher, the unit cost naturally becomes bigger, while its mechanization is carried out ahead, the actual man-hours are to be reduced and it is generally vice-versa with subcontractors. Supposing the unit cost of subcontractors is adopted, while man-hours are based on those of the central enterprise, subcontracting price will be held unduly low, thus the survival of the subcontractor will be endangered. That is why the central enterprise has come to set either different unit cost or make some modification on man-hour calculation for the determination of reasonable subcontracting price by grasping true picture of each subcontractor's plant. In other words, the central enterprise is trying to set-up the price which allows the co-ordinate enterprise to put itself on a paying basis and to make some capital accumulation.

#### (5) Payment Terms

The terms of payment for subcontracting fees on the products supplied by the co-ordinate firms greatly affect the financial status of these enterprises. If the payment so far made in cash be shifted to that by draft, the subcontractor enterprise must face the necessity of increasing that much of working capital, while some of those subcontractors may not get discounting of bill beyond certain limit.

Therefore the central enterprises try to pay almost in cash when the payment amount is small, and if it is the case of a big sum beyond certain limit, they still try to pay as far as possible in cash and partly by bill, or at least they set certain ratio between bill and cash with



due consideration given not to see the working capital be greatly increased. Facts are, however, that the lowering of cash part cannot completely be stopped, depending upon the financial standing of the parent enterprise.

(6) Financial Assistance

In order for the medium-small enterprise to keep up with the technological innovation and survive the competitive market, the modernization of equipment is the matter of great necessity. The modernization of the equipment of big enterprises has started since 1952-1953 but that of medium-small enterprises has a little lagged behind. Most of the Japanese medium-small enterprises, whose production had been based almost on obsolete machines that passed the durable years, came to make quite an industrial investment in parallel with big enterprises, supported by the business boom of 1955-1956 and 1959-1961. This was made possible partly because the medium-small enterprises could also gain profit through these booms which saw demand increase and price rise but, on the other, by borrowing substantial funds when the investment in modern equipment means today tremendous amount of money. However since medium-small enterprises cannot easily get loans from the banking facilities, it becomes necessary for the central or parent enterprise to extend them assistances in this connection. It is also quite natural that the running capital will increase as the equipment expands.

Financial assistances are extended in various forms :

- (i) Parent enterprise may directly subscribe for the stocks of its co-ordinate enterprise when it increases capital, or
- (ii) Loaning by parent enterprise for the necessary fund of co-ordinate enterprise is quite limited except a few cases, such as that has particular importance to the parent enterprise itself or that where a part of the parent company is separated therefrom as an independent enterprise, both of which are subsidiaries or off-shoot of the parent enterprise, or the case where the parent company has to salvage such co-ordinate enterprise because its relations with the latter are so closely linked.

Loaning cases are quite limited as described above, because the parent enterprise itself needs huge amount of investment for its own plant modernization and expansion, and also because it wants to avoid the investment risk as far as possible.

- (iii) However there is still an exceptional case where, as the result of modernization of equipment of the enterprise, some machines become no longer necessary, which are still considered comparatively

of good quality and of high efficiency by the co-ordinate enterprise, and thus they are leased by the former to the latter or sold on instalments.

Further, when the parent enterprise constructs a new plant, it sometimes leases the land it purchased or helps a part of the necessary funds for plant construction of subcontractors to have the latter come close to the new plant site of the former.

This is also regarded as a financial assistance to the industrial investment.

- (iv) The most popular form of financial assistance is that the parent enterprise uses its good offices and recommends its co-ordinate enterprise, when the latter wishes to borrow funds from bankers or financial institution in which it has its own account, and in order to facilitate the matter it informs such banker of its intention to provide such coordinate enterprise with long-term, regular orders, or even give the financial institution its guarantee for the fulfillment of liabilities. If co-ordinate enterprise organize themselves a co-operative association, the parent enterprise uses good offices so that it can get loans from such financial institute as the Central Bank for Commercial and Industrial Co-peratives or give it guarantee ; thus the association can be made possible to subloan to the member co-ordinate enterprise. Such way of getting loan was mostly established around in 1950 when the payment for subcontractors was liable to delay because of the monetary stringent situation then prevailed, but later this has come to be popularized even in non-recessive time.

(7) Guidance for Management

The importance of technical assistance and modernization of equipment has already been mentioned, but the improvement of business management, in general, of the medium-small enterprises is non-the-less of great necessity. Due to the lack of proper business administration many of the medium-small firms had suffered unduly high manufacturing cost, from poor quality control, delay in delivery, and also from labour dispute which affects the production program of the parent enterprise. Further if the financial and accounting management of the co-ordinate enterprise is poor, it is hardly possible to expect it to see cost reduction as demanded by the parent enterprise nor to secure the price with which to keep its business on a paying basis, while its financial program necessary for running the business might be inconsistent. In order therefore to correct these shortcomings and place the subcontractor enterprises on a stable management basis, various guidance

for the business administration must be extended.

However, while so far as the technical aspects such as quality control or production control are concerned, the co-ordinate enterprises are willing to accept guidance in most cases, once it is concerned with labour relations or particularly with financial management, they tend to be reluctant to accept direct guidance from the parent enterprise, worrying that their actual business picture might be exposed, particularly in their anticipation that the demand for the reduction of subcontracting fee or price will follow. Some of the parent enterprise too refrain from interfering the business of the subcontractor to such extent.

Only a few exceptions to that can be found in the automotive and electric equipment manufacturing industries where since the domestic and overseas competition is so keen and at the same time as they find it absolutely necessary to effect cost-down and to foster subcontractor enterprises in the face of trade liberalization, the parent enterprises themselves give positive guidance to every aspect of business administration of their subcontractors, or almost compulsorily have them receive the diagnosis and guidance of management consulting institute of the local governments.

## **7. What Did the Medium-Small Enterprises Gain Through Business-Chain — Administrative Change and the Growth**

### **A. Improvement of Technical Level**

The technological innovation and the growing competition are the trend of times which nobody can stop. Some of the outstanding enterprises, particularly those run by the foresighted and competent management, though the business scale may be medium or small, made remarkable progress. However it is safe to say at the present stage of things that most of the medium-small enterprises in our economy cannot achieve technological innovation with their own capability alone. In fact their technical level has been tremendously raised by the assistances extended by the big enterprises through the business-chain they established for the sake of production expansion and/or sale promotion. Today those who lead the business world or those who assume the leadership of the national economy are the big enterprises, and through their business-chain many medium-small enterprises are also making a great progress. Though their advance is not being made by their own power unlike the case in the Western countries, it is to be still welcome so long as it is the progress.

However, the formation of business-chain has not always brought about

only the favourable effects upon the medium-small enterprises, as it involves the following two problems:

The first problem is found in the fact that the big firm does not take the fostering policy toward all the medium-small enterprises with which it makes business but to try to make business-chain with only those who are comparatively competent and who are expected to bring about some profits to it and therefore deserve its fostering, hence such enterprises as not being qualified for that are left behind. The second problem is that of self-standing of the medium-small enterprise. Now let us deal with the first problem.

The parent firm wishes to secure its long-term interests through the formation of business-chain, but at the same time, since it requires efforts and expenses for the guidance and assistance of its co-ordinate enterprise, it cannot afford to make a limitless help to the latter. Thus it is quite natural that the big firm selects the enterprises for its business-chain only those who have possibility of bringing some profits or those who will make progress if some assistance be extended. Consequently the parent enterprise, according to a clearly established criterion or by a comparatively simple judgement, rates the enterprises with whom it has business relations, and ordinarily it gives its guidance and assistance to only those who pass a given criterion or standard. For instance, they rate the relating enterprises into three or four ranks using the following standards and select only those who belong to the first two ranks for its business-chain.

- (1) The relative importance for the utilization by the parent enterprise, that is, the weight of utilization of individual medium-small enterprise by the parent enterprise.
- (2) Dependency of the co-ordinate enterprise  
The share of the parent firm in the sales of the medium-small enterprise, though exclusive control by the parent enterprise is not the most important aim.
- (3) Years of business transaction
- (4) Level of equipment and quality standards
- (5) Capability and character of top management
- (6) Level of business management including how the delivery terms are observed
- (7) Financial standing
- (8) Labour-management relations

The adoption of such criterion for the selection of medium-small enterprises by the parent enterprise can be well understood, but the medium-small enterprises that failed to be selected remain to be utilized

by the big firms only when the parent enterprises need them. Though these medium-small firms may be able to supply their products with high price when the business booms continue, but when it is not so, the order they receive may sometimes drastically be reduced, and they are forced to cut the price. Those who are left outside of the assistance and guidance of the parent enterprise are mostly of petty scale or close to it, and for them there is no hope for the technical or business management improvement to be derived from the business-chain. This constitutes a socio-economic problem whose solution is subject to the counter-measures to be taken by the local authorities, particularly by their consulting institute, otherwise there will be no alternative but to be left to the natural selection.

#### B. Independency of Co-Ordinate Enterprise

Enterprises in business-chain receive guidance and assistance at the initiative of the parent enterprise and in the meantime they are expected to make growth by improving their own capability of overall business management.

However, in order to raise the technical and management level, it is prerequisite for the medium-small enterprises themselves to have the will and due recognition therefor, otherwise no satisfactory results can be expected, no matter how the parent firm may try, just as it is so with any educational training.

Thus the parent firm avoids to enforce its guidance and assistance to the enterprise in chain but generally expect its co-ordinate enterprise to voluntarily improve its efficiency. However on the present stage, the formation of business-chain and the promotion program of the co-ordinate firms seem to be worked out at the initiative of the parent enterprise. In short, it is no denying that the driving force is coming still from the parent enterprise and that the enterprise in chain is generally taking "passive approach" in this matter.

Thus there are two trends in the formation of the business-chain. At the beginning, the enterprises in chain use efforts to improve their technical as well as management levels along the policy set by the parent enterprise, but later, as their enterprises grow, they not only come to realize their own capability but also come to be aware of the fact that since there is a limitation in the assistance of and the continuance of orders from their parent enterprise, dependency on one parent enterprise would not guarantee the existence of their own business.

Thus, (1) some of them, instead of sticking to just one parent enterprise, come to try to get orders from more than one parent enterprises by

fully taking advantage of their technical specialities, or if they place greater importance on one parent enterprise, they want to see the business stabilized by dealing with several other companies for additional orders. (2) In case such trend further advances, the enterprise who had been used to sell only to the limited few central enterprises comes to engage in the manufacture and sales to greater number of customers as a specialized maker of parts. However such existence of being a specialized maker can be justified only when it deals with merchandize having wide market such as the parts of electric machines, automotive parts, etc. and also when such maker possesses quite a high level of technology and speciality. Recently, not a few subcontractors in some industries have grown up the specialized makers of machine parts. (3) Among the enterprises in chain, some have developed their own products to be placed on the open market, besides the business transaction of specific merchandize for the parent enterprise, so that they come to engage in independent production in parallel with the production in chain. This is another example that the medium-small enterprises are trying to reduce the dependency on their parent enterprise and secure business stability at their own responsibility.

On the contrary, there are many among the enterprises in chain who are quite satisfied with the assistance extended by the parent enterprise and are contented with the continuous dependence upon the latter. The typical example is the enterprise in chain who exclusively rely on the parent firm and expect only the orders to be issued thereby.

Though not all the enterprises who exclusively belong to one parent enterprise, many of them are excessively depending upon the latter, neglecting to use spontaneous efforts to modernize their management. It is hardly possible to expect to see the business growth and progress where there is no will. Thus the parent firm not only extend the assistance to these enterprises in chain, but also must use efforts to have the latter realize how important it is also for them to have the will to improve themselves.

Through these processes many enterprises in chain can be expected to gradually follow the path of growth and improvement in compliance with the fostering policy of the parent firm.

The business-chain formation, however, is not the trend common to the medium-small enterprises of all the branches of industry, but is conspicuous in the industrial domain whose growth rate is high. The growth rate of the chain-enterprises in such industrial branches is also high and consequently they will gradually restore independence from their parent enterprise and will eventually grow into the full-fledged self-standing enterprises. In this sense, the formation of business-chain is desirable but at

the same time it could be regarded a transitional phenomenon, because the fostered enterprises of medium-small scale will reach the mature stage where they can deal with the big enterprises on equal standing basis, then the business-chain relations are considered to be ceased.

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