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CORPORATE GROUPS AND INDUSTRIAL FUSION

— Development of Corporate Restructuring in Japan —

By Masahiro SHIMOTANI*

I Introduction

The structure of Japanese industry is undergoing drastic changes. As we all know well, they are due to the accelerating "internationalization" (the global competition) of Japanese economy as well as to the equally rapid evolution of technology including communication and data processing. The shift is all the more drastic as the yen continues to appreciate. All of these phenomena are generally referred to as the advent of "new industrial society"; matured industry (corporations) must strive hard to find a new growth opportunity while new industry is emerging all over the scene, and under these circumstances, the traditional industrial structure is exposed to a strong pressure for restructurization. It is worth remembering that the evolution is seen not only in the advent of new technologies, but that *the technology is transforming the existing industry itself*, and in consequence, there is a significant trend of "consolidation of diverse fields" and "industrial fusion" among the existing corporations. To put it simply, the conventional barriers between the different areas of industry are quickly disappearing, while new business is arising precisely on the disappearing borders.

On one hand, this evolution is a direct outcome of the technological innovation. For example, the "technology fusion index" (the degree of duplication in research and

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development among different business) in 1984 shows that the fusion index among telecommunication, electronics and mechanical engineering, which stood at zero in 1970, reached 0.17 in 1984, bearing witness to the fact that the so-called "mechatronics industry" was indeed born. At the same time, we can see that "the indices went up conspicuously toward 1984"[1] in the areas of telecommunication/electronics/ceramics and machinery/chemicals or automotive/non-ferrous metals. The 1986 White Paper on Japanese Economy also took up the subject of "industrial fusion" and showed the "diversification index" for research and development by different industry. According to the White Paper, 1) research and development are diversifying among a large number of industrial sectors, and 2) the degree of diversification is smaller in the processing industry which was enjoying good business, but it is much larger in raw materials oriented industry under the recession. The diversification is particularly large for instance with non-ferrous metals, ceramics, textile, chemicals, metal processing and other typically "matured industry".[2]

This would mean that the phenomenon of "industrial fusion" is resulting, *on the other hand,* from the changes taking place at the individual companies themselves who are the major players in the particular industry. The fusion occurred because individual companies tried hard to develop strategics for survival and growth in an environment where drastic changes are occurring. Some considerable time has passed since companies grew out of the boundary of a purticular "industry" and started to encompass more than one sectors of it. Today, the intense competition among corporations (survival strategy) has caused them to confront more than ever to the task of diversification and PPM strategies by cutting off the link of product life cycle to the life of the company. The more a company is mature, the more pressing is the need for diversification. Venture companies are born one after the other with due acclaim, but the author is particularly attracted to the process of transformation the existing and large companies are undergoing as the principal players of these "combination of transborder business" and "industrial fusion", as well as the resulting change in the competitive structure (in the market place).

We already know that the strategic development on the part of the existing big business has been achieved by means of various reforms within the companies (such as by adopting divisional or business unit organizations or internal ventures, establishment of SBU, etc.). Along with these efforts, another conspicuous move which comes to our attention in these days is the formation of corporate groups by setting up subsidiaries. This represents an attempt by big business to adapt to new environment, and thus a shift in the competing structure, which result from those numerous subsidiaries coming into the existence. As we are going to see, the circumstances leading to formation of corporate groups by big business are quite diverse, but the main drive is to achieve entry into a new field of business outside of the traditional domain, or to penetrate into overseas

1) "Blueprint of the New Industrial Society" *Japan Economic Journal* (Nippon Keizai Shimbun), May 28, 1986.
2) Economic Planning Agency, *White Paper on Japanese Economy, 1986*, pp. 240–241.

market by setting up foreign subsidiaries. These efforts require us to clarify the concept of "corporate group" as well as the process of transformation of competing structure resulting from it.

Japanese big business is pursuing hard to develop survival strategies in the wake of "new industrial society" symbolized by high technology and globalization and by the rapid appreciation of yen. Although the corporate alternatives are extremely diverse, the strategy of setting up corporate group appears to be the most comprehensive (if not the most important) approach that today's big business could take. 1) diversification (combination of different markets and industrial fusion), 2) globalization (overseas subsidiary), or 3) management of human resources (creation of new posts, utilization of redundant workforce) are the typical issues surrounding the corporate group strategy in the new operating environment. In this article, we will study the trend of corporate group strategies and its impact with special emphasis on the combination of different fields of business and the industrial fusion.

II Development of the Corporate Group Strategy and Consolidation of Financial Statements

Generally speaking, today's big business includes a large number of subsidiaries and affiliated companies forming a "corporate group". Such a big business does not exist as a single corporate entity, but as *a combined body of business entities* comprising many companies which are owned or controlled by the parent company and this inseparably from the latter by virtue of the capital or operating affiliations. Table 1 shows a list of big corporations who have large numbers of these affiliated or subsidiary companies. For the purpose of the present study, we shall call each of these combined bodies of

Table 1. 10 Largest Companies in Terms of Numbers of Consolidated Subsidiaries/Affiliates

Ranking	Numbers of Subsidiaries (consolidated)		Numbers of Subsidiaries consolidated on the ownership basis		Number of unconsolidated subsidiaries	
1	Nippon Meat Packers	123	Hitachi	545	Mitsubishi Heavy Industries	250
2	Honda Motor	120	C. Itoh & Co.	408	Nippon Express	209
3	Bridgestone	108	Mitsubishi Co.	279	Iwatani International	181
4	C. Itoh & Co.	94	Matsushita Electric	264	Nippon Yusen	106
5	Mitsui & Co.	90	Mitsui & Co.	260	Toyobo	94
6	Suzuki Motor	85	Marubeni	214	Toyota Motor	92
7	Kanebo	83	Toshiba	205	Nippon Kokan	91
8	Mitsubishi Co.	83	Sumitomo Co.	179	Nippon light Metal	89
9	Matsushita Electric	82	Honda Motor	168	Mitsubishi Chemical Industries	88
10	Hitachi Sales	77	Fuji Photo Film	126	Nagoya Railroad	84

Source: Toyo Keizai Shimposha, ed., *Corporate Groups in Japan-1986*, p. 12.

business entities "corporate group". It is important to understand a business as a corporate group because today's business entities have grown to their present scale not by the growth of the parent companies alone, but as a group of companies. As we are going to prove, this importance today is greater than ever.[3]

The existence of these coporate groups—apart from the number of subsidiaries in each group—is not a phenomenon unique to limited number of big companies. Far from it, the structure is common to most of today's corporations of big scale known as the "big business structure". To repeat our position, today's corporations are no other than the corporate groups.

Prior to start our study on the current status of these business groups, we should first see how the structure developed historically.

It appears that the phenomenon first occurred in the early 1930s when Japanese big companies started to become the nuclei of group companies. At that time, so-called "New Konzerns" or groups of corporations were the typical of such organizations. Of greater significance, the trend was not unique to the "New Konzerns" but extended to the established "Zaibatsu" groups. In fact, each companies controlled by Zaibatsu also started to form business groups around them, and this was a direct outcome of the drastic changes occurring in the industrial structures and capital market of the time.[4] Table 2 shows the post-war evolution of the trend, in terms of the number of subsidiaries

Table 2. Numbers of Subsidiaries/Affiliated Companies of Major Corporations

	1955	1960	1965	1970	1975	1977	1979	1981	1983	1985
Sumitomo Metal	9	15	36	42	53	56	89	91	100	108
Nippon Kokan	3	10	27	36	51	57	93	96	104	107
Sumitomo Chemical	8	13	28	39	45	41	94	98	100	102
Mitsubishi Chemical	7	28	27	48	66	78	106	109	118	124
Asahi Chemical	8	13	33	58	89	104	152	144	153	149
Teijin	4	8	12	13	34	42	124	114	106	85
Matsushita Electric	70	187	332	562	656	674	684	476	450	435
Nippon Electric	8	19	28	49		96	115	121	134	143
Hitachi	13	55	90	111	129	141	180	190	198	210
Mitsubishi Heavy Ind.	11	19	19	35	42	50	116		124	137
Toyota Motor	26	16	20	28	46	54	63	68	150	164
Nissan Motor	20	24	27	86	80	100	194	209	225	217
Mitsui & Co.	28	37	59	88	150	149	483	488	503	501
C. Itoh & Co.	17	33	70	113	159	185	311	312	321	364

Remark: Prepared from the "Annual Report" of each corporations.

3) "Substantial studies have been made concerning the organieational structures of individual corporations ahead, but we have not yet seen any sufficient analysis of the mechanism in which corporations are organized and controlled among themselves as a group." (M. Asoh, "A Study on the Interfirm Organization", *Keizai Ronso*, Vol. 137, No. 1, 1986, p. 85.)

4) Masahiro Shimotani, "New Konzerns and Corporate Groups" *Keizai Ronso*, Vol. 137, No. 2, 1986.

and affiliates of typical big corporations. While the table is by no means exhaustive, it shows very clearly that the number of these "group companies" increased consistently and exponentially throughout the '60s and '70s, and that the increase was especially strong after 1970s.

The numbers were derived from the "Annual Report" of each corporation for each fiscal year on the basis of the "statement of securities of affiliated companies" and "statement of investments in affiliated companies" in the Security Report. It must be said, however, that there statements do not present the complete picture of affiliation because quite a few of them are not included for one reason or the other. Also, the scope of a corporate group could be different from that of the affiliated companies. Yet, these statements remain as the sole reliable source of information to follow the transition in the scale of affiliations. Individual corporations must base their statements on the "established standards" selected by them, and for this reason, the data are sufficient to see the trend itself.

From the table, we immediately notice that there is a marked discontinuity in numbers between the years 1977 and 1979. This reflects, as we all know, the introduction of consolidated financial reporting system which started from the fiscal year ending March, 1978. The system of consolidated statements (along with the adoption of ownership-based accounting system for financial reporting in fiscal 1984 and years thereafter) greatly enhanced the need to understand a corporation as a corporate group. The introduction of consolidated statements is no more than the retroactive recognition of the fact that a corporate group is a definite business entity, and that, according to the expression used in the "Principles of Consolidated Financial Statements", such a group is "a single organization"[5] from a business accounting point of view. Not withstanding, however, the introduction of consolidation system served to clarify the definition of "affiliation" (subsidiaries and affiliated companies) which had not been very accurate. Above all, the adoption of ownership principle caused those "Hidden or camouflaged affiliated companies to show up at a strike".[6] On the other hand, by requiring the parent company to publish its consolidated financial statements, it has become ever more important to the company to keep in mind the effectiveness of its group strategy as measured by the consolidated statements.

As we have seen, the profound structural change of Japanese economy, symbolized by technological innovation, globalization and rising yen, is forcing corporations to adopt effective strategies for survival, and this environment drives them to set up strategic subsidiaries to penetrate into higher technological area and to overseas[7] at an ac-

5) Corporate Finance Division of the Ministry of Finance, Securities Bureau, *Corporate Accounting Rules*, 1985, p. 24.

6) "The arrival of consolidated financial reporting system (2)", *Japan Economic Journal*, March 17, 1984.

7) At present, Japanese companies are operating in 121 countries outside of Japan. There are 8,187 Japanese-owned companies operating in overseas countries. There were, historically, 483 such companies in 1964, which increased to 737 in the years 1965 to 1969, and to 2,402 in the years 1970 to 1974, 1,945 in 1975 to 1979, and 2,196 in the years following 1980 who were set up overseas.

celerated pace. On the other hand, the advent of consolidated reporting system makes it essential for these corporations to develop their "group strategies" which include their subsidiaries.

III Structure of Corporate Groups

Next, we must study the present status of corporate group in the light of the recent characteristics of diversification strategy to set up subsidiaries.

Firstly, we see that the setting up of diversified subsidiary has now been recognized as a positive management strategy. Traditionally, Japanese corporations elected to set up subsidiaries and affiliates in order to make the use of their redundant personnel.[8] Today, the main drive is entirely different. It is true that a considerable number of subsidiaries are set up year after year as the "recipient" of surplus manpower of the parent companies. This is particularly so for the recession-stricken industry. For instance, Hitachi Shipbuilding Co. established no less than 25 subsidiaries in three months from January to March in 1986, because they were needed to "utilize the yard's personnel made redundant as the recession of shipbuilding industry aggravated", and "these subsidiaries had to accept almost 2,700 workers". We should not forget, however, that "not all of these subsidiaries founded so quickly were just for the sake of coping with the redundancy".[9] In fact, Hitachi's Business Development Center played the key role to select the target areas of diversification which set high priority to those high-technology fields like "electronics", "mechatronics, new materials and so on".[10]

Thus, even among the industry in recession, these subsidiaries play not only the role of "recipient" of redundant personnel, but also a more positive function of penetrating into high-technology areas. The recent technological innovation has caused the subsidiaries to transform themselves from "peripherals" controlled by the parent company into aggressive strategic units.[11]

Another significant phenomenon concerning these strategic subsidiaries is the growing trend in which the parent company spins off a critical portion of its own business. Most of these spin-off subsidiaries are 100%-owned by the parent company. Clearly, they are the "alter ego" of the parent, who expects them to be an essential part of the total strategy for survival and growth.

It is well known that there are three ways to set up a subsidiary. The first approach is to acquire an existing company (plant) and operate it as a subsidiary (M & A); the

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Thus, foreign investment was especially significant since 1970. (*Directory of Japanese Offshore Companies in 1986*, Toyo Keizai Shimposha p. 7.)

8) "The rush to listing of affiliated companies", *Japan Economic Journal*, February 8, 1986.

9) "Strategic Restructuring for exodus", *Ibid.*, March 29, 1986. By July, 1986, Hitachi Shipbuilding established no less than 32 subsidiaries. "Thirty-two subsidiaries and the new frontier", *Ibid.*, July 22, 1986.

10) "Hitachi Shipbuilding Yard—its restructuring strategy and orientation to high-technology areas", *Ibid.*, May 26, 1986.

11) "Subsidiaries Aiming at future growth" *Nikkei Industrial Journal*, April 4, 1985.

second, setting up a joint venture with another company; the third, spin-off of a part of the parent company itself. The third type of subsidiary can be established either as a spin-off of the existing operation of the parent company or alternatively, the company may elect to set up such a subsidiary based on an entirely new scheme. In any event, the number of subsidiaries founded by taking one of these three approaches is steadily increasing, and large companies now tend to have many new subsidiaries under themselves as the result of the changes in industrial structure. The first type of subsidiaries resulting from acquisition always increase when a drastic restructuring of industry takes place to need a new order and structure, while more and more joint venture companies are established in response to the technological changes and industrial fusion. However, what impresses as the most is the tremendous increase of the third type (spin-off) subsidiaries. For instance, Fujitsu established 32 spin-off subsidiaries in two fiscal years of 1983 and 1984. We see that almost all of them are fully owned by the parent company. In the case of Nippon Electric Company, it started to set up 100%-owned "local NEC" subsidiaries in 1969, followed by a multitude of spin-offs set up since 1971 to undertake maintenance, travel and other service functions, and then by software-oriented subsidiaries, all of them fully owned by NEC.[12]

As another example, results of an opinion survey concerning the approach to entry into new business fields are shown in Table 3.[13] It is interesting that 29% of respondents consider setting up of joint ventures in cooperation with a suitable partner in complementary position, but still more important, 67.5% do not intend to seek cooperation with other companies nor to acquire business. 22.1% of the respondents favor setting up of subsidiaries, that is to say, spinning off by the parent company.

In the past, discussions concerning subsidiary companies were principally in the

Table 3. Approaches to Entry into New Business Areas (%)

	All Industry	Manufacturing	Service
Independently on its own	45.4	48.6	39.5
Setting up subsidiary	22.1	18.1	29.5
Joint development/venture with other domestic partner	20.7	21.4	19.4
Joint development/venture with overseas partner	8.3	8.8	7.4
Merger/acquisition	1.7	1.7	1.8
Others	1.8	1.4	2.5

Source: Research Bureau, Economic Planning Agency, *Business Strategy and Behavior, 1983*, p. 50.

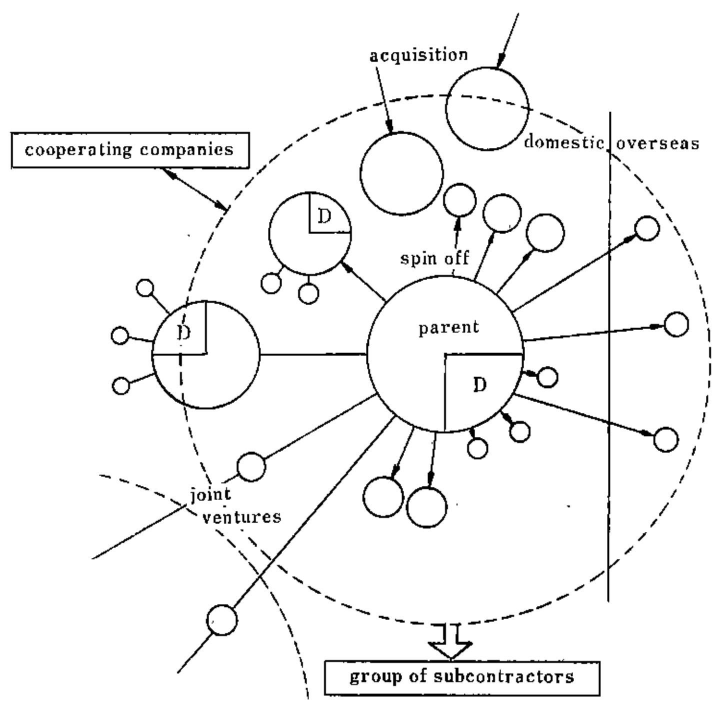
12) For NEC's spin-off strategy, see the author's "The Structures and Functions of Today's Corporate Groups" in Kazuichi Sakamoto, ed., *Innovation and Business Structure*, 1985, Chapter 6.

13) Research Bureau of the Economic Planning Agency, *Business Strategy and Behavior, 1983*, pp. 47–50. The survey was made for 1,568 corporations listed at the first and the second sections of the Stock Exchanges in Tokyo, Osaka and Nagoya, excluding financial institutions. The number of respondents was 1,038.

context of smaller enterprises and subcontractors. The main interest was to clarify how these weaker companies were exploited, often as buffers, by their parent companies. Even when the study is directed to the aspect of subsidiary management in the framework of corporate group, there is a clear distinction between the parent and subsidiaries, and the main emphasis was laid on the analysis of parent's control over the subsidiaries (effectiveness of management control). In other words, parent and subsidiaries were a priori different beings, sometimes with conflict of interest between themselves. It is true that still today, exploitation of subsidiaries by the parent company is continuing extensively and in varying forms, but we now must keep in mind that the growing use of spin-off subsidiaries by the parent company as its "alter ego" and "strategic units", leading to a strategic organization of corporate groups, no longer permits us to stay within the conventional boundary of parent-subsidiary relationship, and that the new structure is giving way to many issues which go beyond the traditional concepts (ref. Table 4).

At this point, we must pay our attention to the relationship between these subsidiaries and the headquarters organization within the parent company. In the early sixties in Japan, there was much discussion going on about the concept of divisionali-

Table 4. Structure of Corporate Group



Note: D means an operating divisions. Circles represent companies according to their size. The dotted circle represents "Internal organization."

zation as subsidiary units as a means of delegation of management authority.[14] According to the proponents of this philosophy, those autonomous business units (divisions in particular) which exist within the parent company by delegation of authority should eventually be separated as subsidiaries so that the delegation would become more consistent. This is an attitude to see subsidiary as a logical extension of divisional organization and it is outmoded today as we know that the reality is not quite that simple. To be sure, even before the sixties, not every subsidiary represented separation of independent divisions (exteriorization of autonomous units), but at present, it is especially significant that many spin-off subsidiaries are in fact an operational unit of the parent company, and in that sense, they are not autonomous nor self-conclusive. Various staff functions are separated, while even production—the heart of manufacturing company—is frequently undertaken by subsidiaries (an example is those local NEC companies already mentioned). Even the parent's administrative functions are sometimes spinned off. This spinning off of unautonomous units represents a positive strategy which the parent adopts to cope with the new business environment. It is done often to make the parent more "lean" and "mobile". In some other cases, the main purpose might be to improve total management efficiency by converting these units which are not presently autonomous into some kind of "profit centers". Regardless of the motives behind spinning off, these subsidiaries cannot exist on their own because as business units, they are still integral part of the parent organization. Thus, the subsidiaries form a kind of hierarchy within their group according to their distance from the parent company, or their degree of dependence to it. Table 4 illustrates such a hierarchy. On one hand, we see quasi-independent subsidiaries who are almost of equal importance as the parent, while on the other hand there are subsidiaries who are no more than operational units of the parent. In other words, some of them are equal to the major operating divisions of the parent or larger than them in reality (with their own subsidiaries sometimes), but others could be totally dependent on the parent's operating divisions as the latters' functional units.

The case of Matsushita Group companies, with Matsushita Electric Industrial at the center, is shown in Table 5. The parent company, in 1984, adopted the "Corporate headquarters" system. TV, Video, Audio and Appliances Headquarters have been set up, each with a multitude of divisions (as well as domestic and offshore affiliates) reporting to it. On the other hand, 11 affiliated companies on the table are characterized by their strong ties with the parent company, forming so-called "Matsushita Family", which is a group within a group including almost 700 subsidiaries and affiliates. Of these 11 companies, the top six have the common salary structures and labor (union) organization adopted by the parent company, who also recruits college and university graduates on behalf of these six "Family" companies. For these reasons, there is frequent exchange of personnel among the member companies. Conversely, those

14) A summary of this type of arguments can be found in Morimasa Tsuchiya, "Divisional Organization and Subsidiary Organieation as an Issue of the Management Structure" in Tsunejiro Nakamura, ed., *Divisional Organization System*, 1966, Chapter 5.

Table 5. Matsushita Group Companies

Matsushita Electric Industrial	Corporate Staff				
			TV Headquarters Video Headquarters Audio Headquarters Appliances Headquarters	Operating Divisions	Matsushita Denshi Kogyo Co. Matsushita Tsushin Kogyo Co. Matsushita Denshi Buhin Co. Matsushita Jusetsu Kiki Co. Matsushita Sangyo Kiki Co. Matsushita Denchi Kogyo Co.
		Directly Managed Groups	Air conditioning Group Motors Group Data Equipment Group Others	Operating Divisions	Matsushita Reiki Co. Kyushu Matsushita Denki Co. Matsushita Seiko Co. Matsushita Denso Co. Matsushita Kotobuki Denshi Co.
			Appliances Sales HQ. Special Prod. Sales HQ. Installed Equipment S. HQ. Electronic Components S. HQ.	Sales Offices	
			System Engineering HQ. Service HQ. Others		Other subsidiaries and affiliates

four headquarters already mentioned are treated as "*spin-offs within the parent*", receiving same treatment as if they are "independent business entities like the subsidiaries and affiliates". Thus, these headquarters and six major subsidiaries are quite homogenous in their structure, and this ennables Matsushita to deploy flexible group company structure which goes beyond the traditional framework of corporation by combining autonomous organizational units within and outside of the corporate organization.

This structure forms a part of the "Action 61" movement pursued by Matsushita Group to vitalize and reactivate the group organization. On one hand, the former corporate structure (1,300 staff) was made leaner into the "Strategic Corporate Headquarters" (600 staff) as the "Central Organization for the Group" which controls the total group, while on the other hand all of the line functions in the parent company were reorganized into "Headquarters" regardless of whether they are responsible for production, marketing or others. Four principal business "Headquarters" were made de facto "spin-offs within the parent company".[15]

These structuring attempts have caused the central part of Matsushita Group to pursue "Matsushita as one", but at the same time, there exist a great multitude of sales subsidiaries and other non-autonomous subsidiaries in the Group. Also, the Group's long history and other circumstances produced, as members of the "Matsushita Group in a larger sense", Matsushita Denko, Matsushita Kosan, Nippon Victor and some other companies who are relatively independent of the parent, Matsushita Electric Industrial. In the case of Matsushita Denko, it is not a "subsidiary" but a "sister company". Thus, because the Group has several companies who have relatively high

15) The information is based on a variety of sources including interviews, *Aspect*, Oct., 1985, pp. 44–49, March, 1986, pp. 56–65, *The Diamond Weekly*, February 16, 1985, pp. 78–81, and so on.

degree of independence, it is often called a "federal management group". Against this, Fujitsu, Nippon Electric and some other groups may be called "single-centered groups" because almost all subsidiaries are 100%-owned by the parent and subject to the latter's control.

In summing up, the significant increase of spin-off companies, and especially those non-autonomous spin-offs, has been changing the industrial structure very quickly. Also, it is no longer possible to regard all subsidiaries in a group as "subsidiaries" in the conventional sense, because they actually constitute an intricate hieararchy within the group, depending on the varying degree of their autonomy and integration into the parent company's business.

The fourth point to be made of these corporate groups is the fact that in the recent years, the extent of organic integration is rapidly growing within themselves.[16] In a sense, this is a direct outcome of the increase of spin-off subsidiaries, and particularly those non-autonomous spin-offs. Although these units have their own corporate entity, their existence largely depends on the link with the parent company. These subsidiaries often do not have market specific to themselves; they sell their products or services to the parent company or to the market controlled by the parent. They are no more than an organic unit of the parent or a detachment whose fate is closely tied to the parent's strategy. The introduction of consolidated financial statement system already referred to has been instrumental to promote the integration still further, as it requires the parent company to recognize the subsidiaries and affiliated companies as "family members" in the real sense. Thus, the parent company now need to heed the "group performance", rather than the traditional unconsolidated results. What is necessary for the parent company is a group strategy. Today, parent companies are eager than ever to "improve the return on investment" for the total group as whole[17], instead of the previous practice to watch over short-term recovery of individual investment. This change in attitude can be seen for instance in such moves like extending cheap financing to subsidiaries, creation of "group research and development funds", and the like to give technological and financial support to affiliated companies as well as restraint on dividends payout by the subsidiaries, even if these could result in a lower return on investment. In short, this means that the total group is involved in improvement of its financial infrastructure[18], which includes management of the group financial resources (especially by organizing overseas financing subsidiaries), issuing of group publications, TQC movement establishment of management training facilities for use by the group companies, creation of value-added network and others. It is obvious

16) "Recently it was appeared that serial corporate group had tendency to strengthen for centripetal force to group. They are for the reason that impacts of technology and information on products and increase of non-price competitive on markets." (Ken-ichi Imai, "On the group of firms", *Business Review* (Hitotsubashi Univ.), Vol. 25, No. 1, 1977, 40p.)

17) "Return on investment in affiliated companies show consecutive decline for 3 years", *The Japan Economic Journal,* May 18, 1985.

18) "Strengthening of group infrastructures", *Ibid.*, October 9, 1984.

that these efforts have one common goal of integrating the group companies with a view to attain better efficiency as the whole group in the face of drastic changes in business environment.

Restructuring of group organization is preceding at an accelerated pace. The spectacular growth of postwar economy of Japan resulted in unprecedented number of subsidiaries and affiliates, and now, parent companies are trying to give them a new framework of organization in order to enhance the group strength. For this reason, while the parents are continuing to spin off new business, there is also an increase in number of companies that are consolidated or merged within the groups in the present decade. In the case of offshore subsidiaries, often they are grouped themselves according to geographic regions (USA, Europe, Asia, etc.), each with its regional headquarters and/or financial control center, and these regional offices are responsible for management of production, distribution, financing and other aspects of operations of the regional subsidiaries. Thus, the effort for enhancement of the group strength now continuous on a global scale.

There is one important aspect which need to be considered at this point and in conjunction with the movement for group integration. It refers to the theory which regards group companies as a sort of intermediary from an organizational point of view. As we know, this theory argues that "an intermediary organization" exists between the "market" and the "internal organization" as a kind of "grey zone", and that this zone belongs to the internal structure while it is exterior to the structure at the same time. In a sense, the theory is an attempt to save from the "failure" the functioning of market and that of internal corporate organization based on the "cost of transaction" approach. According to this school of thought, "cooperation, coalition, strategic alliance, affiliation, grouping and other forms of flexible combination between individual corporations amount to the creation of intermediary area which is ignored by the (traditional) concept of recognizing only the "market" and the "internal corporate organizations" ... if we follow the recent arguments concerning the role of corporate groups as they are unique to the Japanese environment, it is clear that the "intermediary area" gives rise to a number of issues that need to be elucidated.[19)]

This argument is not without some foundations to be taken seriously, but in the context of this paper, our interest is focused on the issue of whether the "corporate group" we have seen so far can be identified as one of the "intermediate organization".

This problem arises because, according to the theory, the internal organization and intermediary organization are "essentially different in their manner of handling the conflict and accepting the authority"[20)]. It is one of the fundamental characteristics of internal organization to resolve an internal conflict by means of some kind of *authority* even at the risk of loss of autonomy for the conflicting parties[21)]. In other words, the organization seeks to achieve integrity by centralization of powers and not by decen-

19), 20), 21), 22), 23) Ken-ichi Imai, Takayuki Itami and Kazuo Koike, *Economics of Internal Organization*, 1982, pp. 126–127.

tralization, and this by establishing appropriate authority to that end[22]. On the other hand, "in the case of *an intermediary organization like corporate groups*, it is not possible to resolve the conflict by sacrificing autonomy of the member companies, and the members interests must be harmonized while taking it for granted that the conflict does exist".[23]

If so, should we consider the corporate groups as discussed earlier as "intermediary" organizations?

I have already shown that groups of companies are diverse, and that it is even possible to classify them into several categories according to the distance separating member companies from the parent company. Still, the recent trends of these groups such as the introduction of consolidated financial reporting system, more and more spinning off, increasing loss of autonomy on the part of the subsidiaries, restructuring of the group and other trends clearly suggests that in most cases, parents are trying hard to achieve stronger integration of the groups. We should say at least that so far as those subsidiaries which are "alter ego" of the parent companies are concerned, any "conflict" among themselves are to be settled by the very "authority" of the parent companies.

The author already showed in Table 4 that group companies should properly be understood as an "internal organizations company". Although exceptions may be found, the evidence suggests that in most cases with these groups, "conflicts" arising within a group are to be resolved, in principle, by the direct exercise of "authority" by the parent company as "internal" issues. The growing degree of organic integration within the groups in the recent years is necessitating this approach more than ever.

In short, the author believes that corporate groups are essentially "internal organizations".[24] It was in this context that we called corporate groups a distinct unit of business. As Table 4 shows, these groups have numerous subcontractors and suppliers; also, they may have close relationships with one or more of the six "major business groups". Conflicts that could arise in these relationships may be settled by the "intermediary organization" approach. However, this does not change the fact that the corporate groups themselves constitute a business unit having its own internal organization. As a matter of fact, several groups already have their organizational charts in which subsidiaries are indicated as internal to the parent company, and this is because "if a company assigns to its subsidiary or affiliate an integral part of work

24) The very advocates of validity of internal organizations sometimes admit that group companies are internal or quasi-internal organizations. "Modern big business usually comprises a multitude of subsidiaries, and in many instances they should be considered as a part of the parent company". (*Ibid.*, pp. 6, 38–39). Mark Fruhen states as follows: "When taken individually, big business in Japan is small with limited degree of integration or diversification (in comparison with its American counterparts), but it is nevertheless well integrated and diversified by virtue of "group company" structure through capital affiliation with other corporations. In this sense, if we consider a group of companies as a business entity, then the large companies in Japan are not always small; such a group is quite different in organizational structure from a large U.S. corporation in which various units of business are firmly integrated as operating divisions within the company, but yet, both are rather similar in their function". ("Grouping is the secret of the strength of Japanese corporations", *Japanese Economic Journal*, March 16, 1985.)

necessary to achieve the company's objectives, then such a company must consider the subsidiary or affiliate as a part of its own (management structure)"[25].

IV Corporate Groups and Industrial Fusion

The recent speed of "fusion of industry" and "business integration" is nothing short of being spectacular, but these are the logical countermeasures Japanese companies can take in order to cope with the drastic shift in the country's industrial structure of which technological innovation, globalization, sudden rise of yen and others are eloquent indicators. On one post, great many "venture businesses" are coming into existence specially in high-technology areas (as it is called "light, thin, short and small stuff"—meaning they belong to the new bleed of products using high technology) and these are duly acclaimed by journalism, but of even larger significance, the "industrial fusion" is frequent also in those mature industries as a means of growth and survival, as they are incorporating new technologies for transformation of their business.

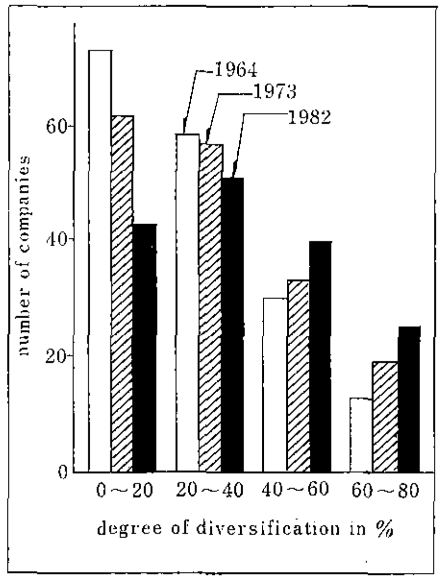
For example, Japanese companies who have recently changed with a rush their names or part of their articles of incorporation. The change of corporate names became popular among major companies toward 1982 when CI (corporate identity) campaign made its début. These corporations decided to change their names mainly because the traditional names were considered no longer suitable to indicate their real status after all these diversifications and transformation of operation which had taken place as the result of technological innovation.[26] The tide of technological advance caused far-reaching, profound changes in business and in market, and resulted in a "perception gap" between what the name suggests and the reality. Thus, "technological changes have been the main driving force of the vogue of taking up new names".[27] As for the articles of incorporation, the stated "purpose of business" in many cases became quite obsolete, and those companies, to enter new fields of business, found it necessary to amend the by-laws to that end. This trend is particularly conspicuous among those raw material processing and textile companies.[28]

It can clearly be seen that these trends reflect vigorous moves these major companies are making for diversification by going beyond the boundary of their traditional main business. Table 6 is a comparison of 180 big corporations engaged in 36 different fields of business (top five companies were selected from each field) on the basis of the share of their revenues from non-traditional business to total revenue. The table shows how this share grew from 1964 to 1973 and then to 1982.

According to the data, the number of companies having less than 40% of their revenue from non-traditional (i.e., new) business was decreasing while those whose revenues from new business were in excess of 40% of total increased steadily (from 49

25) Tsuchiya, *op. cit.*, p. 129.
26) "Boom of getting new names for old companies", *Japan Economic Journal,* May 27, 1985.
27) "Why do so many companies take on new names?", *Ibid.,* April 9, 1984.
28) "Bylaws need changes in the wake of new technologies", *Ibid.,* April 29, 1985.

Table 6. Diversification of Major Companies



Source: *Japan Economic Journal*, October 17, 1983.

in 1984 to 73 in 1973 and then to 86 in 1982). Moreover, this trend is especially strong in those rawmaterial related industries. For instance, the average ratio for the top fives in the synthetic fibre industry grew from 25% in 1973 to 40% in 1982. The increase for other industries were from 26% to 51% for woolen textiles, from 31% to 44% for non-ferrous metals, and from 28% to 36% for glass. In some cases, the traditional old business decreased to minor share or even disappeared completely. Shipbuilding industry, for instance, gets 76% of its total revenues from businesses other than building vessels, and most of the yards are "no longer appropriate to be called shipyards".[29]

It is also noteworthy that the new areas of penetration are more and more far-off from the companies' old business. "In 1982, 35% of all corporations were planning to go into new areas which had nothing to do with their main lines of business, and this ratio showes a significant increase from 1973 when only 15% were considering such a move"[30].

Table 7 shows the list of industries that came into electronics field, and what is happening is "an electronics avalanche", in which many different companies are doing all they can to get involved in the industry.

Table 8 demonstrates how this trend is going on among various industrial sectors like cement or synthetic fibre. It can be seen that more and more companies are breaking the old boundaries and going into new business. For example, the cement

29), 30) "Growing departures from the traditional business". *Ibid.*, October 17, 1983.

industry is trying to survive on one hand by setting up joint sales channels and closing redundant plants under the recession cartel, while on the other hand individual com-

Table 7. Entry into Electronics Industry by Outsiders

(Mining)
Ceramic condensers
(Textiles)
light emitting diode, optical switch, magnetic head for VTR, printed circuit boards, computer parts, post-processing of IC, printed circuit boards, custom LSI, sensors, medical electronic equipments, optical fibers, condensers, base boards for fuel battery, filtration system for semi-conductor production
(Chemicals)
magnetic discs, connectors, manufacturing equipment for semi-conductors printed circuit boards, 8 milimeter video, video tapes, floppy discs, electronic copiers
(Glass and Ceramics)
video signal delay line components, liquid chrystal display, custom IC, fixed magnetic discs, multi-layer condensers, IC packages
(Electrical Wires)
optical fiber, custom IC, multi-functional personal computers
(Machinery)
color printer, floppy disc driving units (FDD), electronic typewriter, printers, word processors, VLSI
(Automotive Components)
numerically controlled systems, sensors, microcomputer keyboards
(Precision Instruments)
semiconductor production equipment, medical electronics equipment, tape recorder, electronic components, floppy disc drives, printers, office automation equipment, LSI, floppy disc drive, magnetic head, motor, post-processing of IC
(Office Equipment)
custom IC, personal computer, audio equipment, electronic musical instruments, television games, printer

Source: *Japan Economic Journal*, October 23, 1984.
Many companies have set up subsidiaries to start electronics-related business. In addition to the above examples, steel, non-ferrous metals, chemicals, textiles, printing and other industries are prominent in the wide range of electronics industry.

Table 8. Entry into Different Fields by Cement and Synthetic Textile Industries

(Diversification by Major Cement Companies)
recording materials for data-processing, anti-cancer drug, health foods, FA and OA equipment and software sales, multi-layer ceramic condenser, spark-eliminator, thermistor, IC tester assembly, inspection, fine ceramics (temperature and humidity sensor), manpower placement service
(Main non-textile fields of Synthetic Fiber Companies)
polyesther film, carbon fiber, interferon, reverse osmosis film, plastic lens, MMA resin, excessive filtration film, TNF (tumour-killers), oxigen enrichment film, monoclonal antibiotics, prostergrandine, plastic optical fiber, hollow yarn film, artificial leather, medical products, artificial turf, cosmetics, foods, biochemical products

Source: For cement industry, *Japan Economic Journal*, December 27, 1984. For textile companies, *Ibid.*, December 20, 1984.

panies are aggressively entering into new areas although "these diversification efforts were not so conspicuous prior to 1984, and the companies' revenue from the new business is not yet up to ten percent of the total, but they are hoping to push up the ratio to 50% over the long term."[31] In contrast to this, synthetic textile industry has already been successful in achieving much more diversification, and many companies are now in the process of being transformed to highly diversified chemicals producers."[32]

As the textile manufactureres are transformed to diversified chemical companies, established chemical producers are after the "high technology chemicals" area of which biochemicals are the most important.[33] While cosmetics industry is starting "health foods" business,[34] existing foodstuff manufacturers are giving rise to an entirely new "health promotion"[35] business including biochemistry. We have already seen that steelmills are quite active in electronics and chemicals, and because of this, they have now become the locomotive for advancement of "new materials" industry.

The progress of industrial fusion and integration of different business areas are requiring increasing efforts on the part of companies to develop their corporate groups. Speed of spinning-off has been accelerating because most of diversifications are achieved by subsidiaries (either directly or indirectry by start-up of related companies). Many subsidiaries created today are expected to be the key strategic units of future diversification of the total group, and this is especially so since the majority of big business such as the raw material processing companies are so huge that it is quite difficult for them to transform themselves, and for this reason, they adopt the spin-off strategy by establishing subsideries or diversificating by acquiring ownership of other companies which allows them to develop new opportunities for growth attentively and carefully."[36]

Establishing subsidiaries by the fusion of industry is by no means a monopoly of manufacturerers. Financial institutions are rapidly diversifying themselves. For example, Japanese banks had 243 subsidiaries and affiliates in August, 1983, and the number increased 3 times in two years which followed to 743 in August, 1985. This occurred as the result of deregulation of the financial business and decrease of restrictions applicable to diversification by establishment of subsidiaries, allowing the financial institutions to start investment advisory service, computer software sales, leasing and other new business through their subsidiaries.[37] As another example, five largest life insurance companies had 31 subsidiaries among themselves back in 1965, and the number increased to 66 in 1980 and 123 in July, 1985. During these years, the insurance companies grew into more or less "all round" financial institutions, and this expansion

31) "Difficulties both at home and abroad compel companies to try diversification", *Ibid.*, December 27, 1984.
32) "The Age of Four Tigers in the synthetic fiber industry", *Ibid.*, December 20, 1984.
33) "Hi-tech Chemicals-Fierce Competition", *Ibid.*, February 13, 1985.
34) "Cosmetics giants going into health food business", *Ibid.*, March 3, 1983.
35) "Metamorphoses of Food Processing Industry", *Ibid.*, September 1, 1984.
36) "The age of cooperation among different business, Part 2", *Ibid.*, November 5, 1983.
37) "Accelerating diversification of the financial institutions", *Ibid.*, December 19, 1985.

of their scope of business was possible thanks to these new subsidiaries.[38]

Now, to where such rapid "industrial fusion" and "integration" will lead us in future?

First, they will result in a profound changes in the boundaries of existing industry, and second, they will produce a number of new and futuristic business accross the boundaries. To be sure, industrial structure has been changing all the time, if gradually, as the boundary shifted or new industry came into existence. However, we must say that the change is taking place at an unprecedented pace due to the advent of new technologies and globalization; on the other hand, it is significant that the change is intricately related to the strategic spin-offs in the context of corporate group strategy.

Seen from the standpoint of the structure of competition, this change of boarder lines of the existing industry means arrival of new competitors. Competition comes from a source which previously was totally unrelated and therefore least expected, and this often all of a sudden. Also, the emergence of new business across the boarder lines and having high growth potential immediately leads to fierce competition among the entrants from many different sectors, because the success to join the new market is so iritical to the survival of the companies.

Of even greater significance, the diversification is achieved by spin-offs in most cases. Obviously, scale of the spinned-off subsidiaries is small. Their scale may seem negligibly small compared to those companies already established in the areas the spin-off subsidiaries have been set up. However, it is worth remembering that they are the "alter ego" and the "strategic units" of their parents, and that they operate as an integral part of the whole group they belong to, and the group itself is acting more and more as a single, well-coordinated business entity. These subsidiaries can grow as fast as they can, if it is the parent's strategy. For today's business, it is their way of life to fight competition for survival through the diversification, and subsidiaries are the major players in the battlefield.[39]

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38) "Subsidiaries doubled in five years", *Ibid.*, September 16, 1985.

39) Of late, much has been said and discussed about the "industry network structure" or "inter-company network". "Everyone will agree, intuitively at least, that today's industrial structure is getting increasingly network oriented. Diverse connections are growing among corporations by means of technology transfer and joint development, and by this, companies are more and more inter-dependent on each other, and the structure can properly be called valid networks". (Ken-ichi Imai, "Industrial Network Organization", *Kikan Gendai Keizai*, No. 58, Summer, 1984, p. 4) Imai use the term "network" in a broader sense, but we might say, in the context of the present paper, that diversification in high-technology areas makes it necessary for the entrants to tie up with each other in order to complement their technological resources, and for this reason, we will see more of such cooperation through joint venture or otherwise. Also, the progress of telecommunication and data network is likely to alter the nature of inter-company behavior. However, Imai's view on the "inter-company network" ① does not take into account of any capital affiliation among the companies, and ②, Imai's "network" sees individual companies as points and not as structural parts, and for this reason, his theory appears to us somewhat too simplistic. Ref. *Soshiki Kagaku* (*Organizational Science*), Vol. 20, No. 3, 1986, (Special Edition on Networking), Keizai Doyukai, *1986 White Paper on Corporations—Development of the Network Strategy and New Corporate Organization*", 1986, etc.

In conclusion, we can say that the recent "industrial fusion" and "integration of different business" are intricately combined with the growth of group companies, and under these circumstances, today, the latter is becoming the main players in the game as opposed to the traditional competition among parent companies. At the same time, the competition is increasing its complexity because expansion and development of groups require parent companies to face virtually unlimited opportunities and challenges in a multitude of domains, including the appearance of new competitors from unexpected areas. Overall, the struggle for survival and growth tends to be more intense as well as complicated.