

Japanese Corporate Aggregates and *Keiretsu*

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I Two Types of Corporate Aggregates

Article 9 of Japan's Anti-Monopoly Act was revised in June 1997, to finally lift the ban on pure holding companies that had been in effect for over half a century since 1947 when the law was first enacted in the aftermath of Japan's defeat. The question of whether the ban on holding companies should be lifted has been hotly debated for years, but the primary concern is that this might lead to a revival of the *zaibatsu* and promote a more concentrated market structure. This unusual provision stipulating that "the establishment of holding companies shall be prohibited" (Anti-Monopoly Act, Article 9) was enacted in the first place to prevent the reemergence of the *zaibatsu*, which had enormous controlling power on the prewar Japanese economy. Yet considerable time has passed since the *zaibatsu* were dismantled by the occupation forces right after the war, and the *zaibatsu* no longer exist in present-day Japan. The specific objects of concern in the debate over lifting the ban on holding companies, therefore, are the new corporate conglomerates that have emerged after the war, the so-called *Big Six corporate combines*. The Big Six combines whose existence cannot be ignored have been subjected to close scrutiny, and the debates continue as to what, if any, affect the lifting of the ban on holding companies will have on these giant corporate aggregates.

Concern has thus tended to focus on these Big Six combines as classic manifestations of Japan's corporate aggregates. These six have attracted widespread attention as typifying Japanese corporate conglomerates partly because they are directly descended from the prewar *zaibatsu* and because they exert such an enormous controlling influence on Japan's economy. Yet there is another type of corporate aggregate in the Japanese economy that we should direct our concern. This is a 'corporate group' that forms around a large parent company and consists of a constellation of subsidiaries and affiliates.

Looking closely at the corporate aggregates that figure so importantly in the Japanese economy, we can thus discern two distinct types.¹⁾

The first type, which is represented by the Big Six combines, consists of a cluster of large firms from different sectors of the economy that are linked horizontally. Mitsui, Mitsubishi, and Sumitomo are three such combines that are directly descended from prewar *zaibatsu* and that succeeded in knitting themselves back together during

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1) See Masahiro Shimotani, "History of Business Groups in Japan", Shimotani and Shiba, eds., *Beyond the Firm*, Oxford University Press, 1997.

the 1950s. This was followed by three so-called *newcomer* combines, all of which are financial *keiretsu* centering around a large bank. These include Fuji (Fuyo) and Sanwa that emerged in the high-speed-growth years of the 1960s, and Daiichi-Kangin in the 1970s. The members making up these combines own stocks in each others' companies, and set up clubs where the presidents of the companies meet. They also reinforce solidarity as a combine through joint investment activities and by conducting transactions within the combine.

The second type is the corporate group, a pyramid-shaped aggregate consisting of a large number of related companies (subsidiaries and affiliates) that are subordinate to a large parent company. For example, the Toyota Group consists of some 335 related firms centered around Toyota Motors, and the Matsushita Electric Group is made up of about 670 related companies under the Matsushita Electric Industrial Co., Ltd. Most of the large companies that exist in Japan today are the corporate group type of structure.

Up to now interest has usually tended to focus much more on the Big Six corporate combines, but in this manuscript equal attention will be focused on the corporate groups. This is because, as will be shown later, the corporate group has critically important significance for properly understanding the nature of Japan's corporate aggregates.

Both of these patterns of corporate organization — the corporate combine and corporate group — are distinctively Japanese in certain respects, and this paper will highlight some of the ways in which they are distinguished from industrial groupings in other countries. I will also address the subcontracting system, marketing channel arrangements, and other aspects of the peculiarly Japanese *keiretsu* business relations.

II Corporate Groups

Let us begin with corporate groups, a type of confederation in which a constellation of subsidiaries and affiliates are linked to a large parent company. How are such groupings formed, and what are their specific attributes?

Certainly the pattern of a large parent company with affiliates is not confined to Japan. Indeed, corporate groups are similarly formed in various countries around the globe through the establishment of subsidiaries and affiliates attached to large company at the center of the group. Yet a close examination will reveal that Japanese corporate groups are distinctive in a number of respects.

The first distinctive attribute of Japanese corporate groups is the inordinately large number of related companies that are generally involved. Table 1 shows the number of related companies for the 20 largest firms in terms of total assets. Most of the groups have in excess of several hundred satellite firms. Several parent companies, in fact, have over a thousand satellites, and the average number of related companies for the entire group is 522.

If we expand the list from 20 to the 50 largest firms, 40 of the companies have 100 or more satellites, 29 have 200 or more, and 11 have 500 or more. The average number

Table 1 Related Firms of the Top 20 Companies by Assets (1995)

	subsidiaries	affiliates	total
1. Tokyo Elect. Power	30	18	48
2. NTT	146	74	220
3. Toyota Auto.	196	139	335
4. Hitachi	858	198	1,056
5. Mitsubishi Co.	546	411	957
6. Matsushita	na	na	670
7. Mitsui & Co.	473	269	742
8. Nissan Auto.	550	150	700
9. Marubeni Co.	514	236	750
10. JR East	144	39	183
11. Itochu Co.	726	335	1,061
12. Kansai Elect. Power	31	17	48
13. Chubu Elect. Power	24	14	38
14. Toshiba	535	154	689
15. Sumitomo Co.	349	234	583
16. Nissho Iwai Co.	336	160	496
17. Orix	105	47	152
18. Nippon Steel	248	191	439
19. Sony	901	49	950
20. NEC	na	na	320

source : The Fair Trade Committee, *The Report on the Economic Concentration*

of related firms for the top 50 corporate groups is 331. It is apparent that Japanese corporate groups are characterized by an unusually large number of related companies.

The second distinctive attribute of Japanese corporate groups is the way in which they are formed. In other words, by what process is such a large constellation of satellites formed?

In some cases, (1) firms become satellites of a larger company through the acquisition of shares or through a capital contribution by the parent company. This process of being conscripted into the group through merger and/or acquisition is a universal phenomenon that can be observed around the world and in different periods. A second way that satellites are formed is (2) through splitting off a division of the parent company to establish a separate company. This is commonly referred to as *spinning off* a division of the company. Compared to the first method which is a direct and proactive extension of the parent company's authority and power, the second method is simply achieved through a restructuring of the company. Generally it involves nothing more than splitting off a division and relabeling it a subsidiary. The important point to note is that this practice of spinning off a division of the company to establish a related company is exceedingly commonplace in Japan. The fact that Japanese corporate groups have such a large number of satellites can also be attributed for the most part to the practice of spinning off divisions of the parent company.

Converting corporate divisions to satellite companies is generally rationalized as

a means of decentralizing business operations. Business organizations inevitably become flabby as they grow in size. Internal inefficiency becomes harder to avoid (sometimes referred to as *large enterprise disease*) thus triggering a need for decentralization. The multi-divisional system is widely known as a way to decentralize business operations, and this approach began to be implemented in Japanese companies in the 1960s. Meanwhile, the practice of spinning off divisions to create satellites was also very prevalent during this same period. It is generally anticipated that this strategy of spinning off divisional units to establish separate subsidiaries will promote further decentralization. We are even seeing cases where divisions themselves are divided and separated off as independent subsidiaries to pursue decentralization even further. Yet the division is a convenient unit to spin off since it is already, by definition, a decentralized unit. It is fairly common to observe that, by liberating a division in the form of a separate company, business operations are further expanded while forging new relations with the parent company.

However in Japan's case, the corporate units that are split off are not merely confined to larger, autonomous divisional units. Indeed, one of the distinctive things about this tactic as it is applied in Japan is that it is often the smaller, non-autonomous operational units—a mere plant, sales office, service department, and so on—that is set up as a satellite: a manufacturing plant is incorporated as a manufacturing subsidiary, and sales and service departments are reorganized as sales and service subsidiaries. The fact that Japanese corporate groups have such a large number of satellites can in large part be attributed to this aggressive policy of spinning off corporate units down to a fairly low organizational level.

This raises the question of why Japanese corporations go to the effort of spinning off divisions that already have a fair degree of decentralized autonomy within the corporate organization, and why they spin off such small non-autonomous divisions and set them up as satellites.

One reason that divisions are commonly spun off is that divisions of Japanese firms do not necessarily have as high a degree of decentralized autonomy as one might expect. In principle, divisions are decentralized, autonomous profit centers with several functions—manufacturing, sales, accounting, and so on—but many divisions in Japan (that only started to be organized in the 1960s) were not all that autonomous. Indeed, their degree of decentralization was far from complete, as the designation of the system indicates: function-specific divisional system. Companies have therefore tended to set up independent subsidiaries by splitting off divisions as a way of implementing greater decentralization.

The practice of spinning off relatively low-level operating units is generally done to turn these units into viable independent profit centers that will enhance the operating efficiency of the group as a whole. But that is not all. Operating units are also aggressively spun off as a deliberate strategy to make the organization of the parent company itself *leaner*. By shedding its operating units, the parent company not only seeks to achieve a leaner central organization, it is also an effort to recast itself in the role of a *strategic headquarters* that provides central direction for the overall group.

The strategy of spinning off divisions and even smaller units has thus been adopted in Japan as a deliberate means to minimize the inevitable inefficiency that accompanies the growth of larger corporations.

Corporate groups observe a horizontal division of labor between the parent company and its many subsidiaries and affiliates. Regarding the role that satellites are expected to shoulder in the group, the following observations can be made in terms of its relevancy to the primary work of the parent company. There are essentially two patterns of the way in which satellites support the group: (1) the satellite is put in charge of a type of operation (e.g., a particular product line) that is a dimension or aspect of main line business of the parent, or (2) the satellite plays a vertical supportive role to the main line work of the parent, such as supplying parts, sales, or transport and so on. Satellites of the first type generally are large in scale and have a relatively high degree of autonomy, while satellites of the second type have a high degree of dependence on the parent. There are many instances in the latter case, where virtually all of the satellite's transactions are with the parent company.

What both these patterns have in common is a corporate group that is formed as a single organic conglomerate centering around the parent company's primary line of business. By shedding large and small operational units one after another and reappportioning the division of labor among the resulting constellation of subsidiaries and affiliates, Japan's corporate giants have effectively transformed themselves to exercise control in the form of a corporate group. In short, today's *corporate giants* have reshaped themselves as *corporate groups*. The reason why corporate groups to project themselves as single corporate bodies in which financial affairs are wholly interconnected attributes to that transformation. The history of a corporation, moreover, is not just that of the parent company; but rather must be grasped as the history of the group as a whole.

One final distinctive attribute of Japan's corporate groups that we should touch on here is the widely varying ratios or percentages of stock in related firms that are held by parent companies. It goes without saying that a subsidiary is defined as 50 percent or greater stockholding by the parent, and an affiliated company is defined as 20 to 50 percent shareholding. Taking the Matsushita Electric Group as an example, if we examine 84 of the company's most important subsidiaries, we find that only 32 are wholly-owned subsidiaries (*i.e.*, 100 percent ownership). The percentages of shares held by the parent company of the remaining subsidiaries varies widely: the percentage reaches 50 percent for 17 companies, 60 percent for 11 companies, and 70 percent holding for 13 companies. There are in addition a large number of other affiliated companies with stock ownership by the parent company ranging from 20 to 50 percent. This pattern of shareholding that characterizes Japan's corporate groups contrasts sharply with that of the U.S. and Europe where most affiliates are held as wholly-owned subsidiaries. Reflecting this broad spectrum of percentage ownership, the larger more successful subsidiaries are often listed on stock exchanges. Nine subsidiaries of the Matsushita Electric Group, for example, are listed. Very few subsidiaries of European or U.S. companies are listed on stock exchanges.

III The Big Six Corporate Combines

Now let us turn to the Big Six corporate combines. These Big Six are composed horizontally of Japan's large corporations. One will observe that all six combines are similar in that they all include each city bank and trust bank, each insurance company, each Sogo Shosha (general trading company), and various manufacturing and service businesses. In Japan this is referred to as the *one-set structure*. In contrast to the corporate groups we examined in the previous section that consist of a constellation of subsidiaries and affiliates in a particular industrial field centering around a large parent company, the corporate combines are made up of large companies across various diverse sectors.

Membership in a corporate combine makes one a member of a so-called presidents' club. The number of corporate members of these *presidents' clubs* varies from 20 for Sumitomo's *Hakusui Kai* to 48 for Daiichi-Kangin's *Sankin Kai*, and the total for all of the Big Six combines is 181 members. These 181 firms represent 7.4 percent of the 2,430 firms listed on stock exchanges, and a mere 0.007 percent of Japan's all corporations, but their financial clout is disproportionate to their numbers. A recent survey found that, excluding the financial sector, these 181 companies control 15.3 percent of the capital stocks, 12.5 of the total assets, and 13.8 percent of total sales for the nation. The member firms of the Big Six corporate combines thus have enormous importance in the Japanese economy.

Three of the Big Six-Mitsui, Mitsubishi, and Sumitomo-emerged in the 1950s. These three forerunners are direct descendants of *zaibatsu* that were broken up by the occupation forces after the World War II. In other words, three of the old prewar

Table 2 The Cross-shareholding Matrix

	S. Bank	S.Trust Bank	S. Life	S. Marine	S. Co.	S. Coal	S. Constru	S. Forest	S. Chemic
S. Bank	×	3.2	5.4	1.8	1.7	0.0	0.0	0.1	1.1
S. Trust Bank	2.3	×	3.2	1.5	1.8	0.0	0.0	0.2	1.1
S. Marine	4.4	4.8	3.2	×	2.2	0.1	0.1	0.1	1.2
S. Co.	4.8	5.5	5.2	3.1	×	0.1	0.0	0.3	1.6
S. Coal	4.8	5.7	1.7	2.4	3.4	×	0.8	—	2.5
S. Constru	4.4	2.0	4.4	1.4	0.7	1.5	×	0.6	1.1
S. Forest	4.6	5.9	5.1	—	2.5	0.1	0.4	×	—
S. Chemical	4.7	6.3	8.0	1.4	1.1	0.0	0.1	0.1	×
S. Bakelite	4.6	8.6	4.0	1.3	1.7	—	0.3	0.4	21.0
Nikon Sheet Glass	4.5	5.3	3.8	2.3	1.6	—	0.1	0.1	1.2
S. Osaka Cement	3.8	4.5	4.4	—	1.6	0.8	0.4	0.3	0.6
S. Steel	3.4	6.3	4.7	—	1.3	0.0	0.0	—	—
S. Metal	4.5	7.4	3.3	1.4	2.4	0.1	0.2	0.3	—
S. Light Metal	4.7	4.4	2.8	1.4	2.7	—	—	—	1.3
S. Electric	4.0	5.6	6.4	—	0.7	0.0	0.0	—	—
S. Heavy Machine	4.6	6.4	5.5	2.5	1.8	0.1	0.1	0.1	—
NEC	4.8	5.1	4.8	2.5	1.9	0.0	0.0	0.1	0.4
S. Estate	3.4	3.7	1.7	1.6	0.5	0.0	0.2	—	0.4
S. Warehouse	5.0	6.6	5.9	5.4	2.4	—	0.3	0.2	1.5

member companies, and as little as 11 percent for the Daiichi-Kangin's. Furthermore, in the case of the three newcomer combines, the inter-corporate shareholding tends to be confined to the financial institutions making up the cores these combines. We should thus be careful to not overstate the significance of interlocking shareholding as a common characteristic of the Big Six combines. Here we would also note that mutual stockholding is not just confined to the Big Six; rather, it is a common phenomenon that is widely practiced in Japan to cement ties between companies. Furthermore, the ratios of mutual shareholding and intra-group transactions have been trending downward in this long, drawn-out period of recession and climate of financial instability.

The present-day presidents' clubs, meanwhile, have little authority and serve primarily as a forum for coordinating group-affiliated activities and exchanging information. They no longer have the role of their prewar predecessors as a control tower exercising authority on behalf of the *zaibatsu* main. In short, the presidents' clubs no longer actively intervene in the important decisions of individual member firms or determine strategy for the combine as a whole. From the opposite perspective, this means that member firms enjoy total and unfettered decision-making authority to run their respective businesses as they see fit. The Big Six corporate combines of today are a much looser kind of confederation composed of largely autonomous and self-directed companies. This represents a decisive difference with the old prewar *zaibatsu* in which the *zaibatsu* main did exercise real control over its member firms. As was mentioned earlier, the three forerunner combines are directly descended from three of the most powerful prewar *zaibatsu*. Therefore, these three are said to exhibit a somewhat higher degree of cohesiveness than the other three combines, but in fact there is little difference. Indeed, one view holds that, aside from the initial phase when these combines were first launched, today "they can no longer be considered business *keiretsu*." "Regarding them as a group of descendants with a common ancestor would be close to the mark."

IV Two Types and Two Levels

I have discussed the two major patterns by which Japan's postwar corporate aggregates are organized, but how are these patterns interrelated? Although the two patterns are completely different in terms of structure and form of organization, in the past they have not necessarily been clearly and qualitatively classified. Indeed, we find that in most cases the two patterns are treated as if they were parallel and homogeneous. For example, in Japan's *Postwar Corporate Groups* published in 1976 by Yoshikazu Miyazaki, one of the first studies to objectively examine Japan's Big Six combines, the author sought to develop a *quantitative* objective criteria for measuring the degree of linkage between companies, so *qualitative* differences were simply not addressed. The groups were arranged just in order of scale rather than by pattern or type, so an assortment of bank-centered and manufacturing-oriented groups (such as Toyota Motors and Matsushita Electric) followed in parallel after the Big Six. One finds the same thing in the annual *Corporate Keiretsu Review*: the Big Six are at the head of the list, but are followed by a host of undifferentiated *independent corporate groups*. Here

again, the qualitative differences among the groups is not considered. Of course, it is perfectly alright to arrange the groups according to scale if we are only concerned with the external appearance of the groups.

There have been several studies that definitely do make issue of the qualitative differences between corporate aggregates, and attempt to differentiate the two. Hiroshi Okamura's study of *Japan's Big Six Combines* published in 1976 is a case in point, in which the author differentiates two types of groups: *vertical keiretsu* and *horizontal groups*. *Vertical keiretsu* designate corporate group structures with a parent company at the pinnacle, while horizontal groups refer to corporate combines with lateral ties among the member companies. This typology of vertical versus horizontal has been used extensively in recent years as an intuitive and easy-to-grasp schema for representing the qualitative difference between corporate aggregates.

However, it is important to point out that this typology is not completely adequate. Although it is perfectly fine for differentiating between the two patterns of groups, it doesn't say anything about the relation between the two patterns. We observed earlier that large present-day corporations do not consist of just a parent company; rather, they exist as a single *corporate group* together with a large number of subsidiaries and affiliates. On the other hand, we also examined the Big Six corporate combines whose members are giant corporations in their own right. But here we would underscore that these giant corporations making up the corporate combines of the Big Six are also parent companies with a constellation of subsidiaries and affiliates of their own. This was illustrated in Table 3 showing the 20 corporate members of Hakuuikai, the presidents' club of Sumitomo. It is thus apparent that the members of corporate

Table 3 Related Companies of Hakuuikai Members

Parent companies	Related companies
Sumitomo Bank	49
Sumitomo Trust and Banking	15
Sumitomo Marine and Fire Insurance	27
Sumitomo Corporation	503
Sumitomo Coal Mining	50
Sumitomo Construction	31
Sumitomo Forestry	37
Sumitomo Chemical	172
Sumitomo Bakelite	40
Nippon Sheet Glass	152
Sumitomo Osaka Cement	88
Sumitomo Metal	287
Sumitomo Metal Mining	75
Sumitomo Light Metal	40
Sumitomo Electric	199
Sumitomo Heavy Machine	125
NEC	235
Sumitomo Realty and Development	54
Sumitomo Warehouse	36

combines are themselves parent companies with numerous related companies. If this is so, then the members making up the Big Six combines should be apprehended not so much as corporate parent companies but rather as corporate groups including a cluster of related companies. Although the reality is that the members of the Big Six are not corporations but corporate groups, this is completely overlooked by the vertical/horizontal dichotomy.

We have seen that Japan's largest corporations assume the form of corporate groups, and that a number (181 to be exact) of these giant corporations (*i.e.*, corporate groups) are at an even higher level making up Japan's Big Six corporate combines. If we adopt a vertical/horizontal dichotomy, then all organizations are forced to fit into either one type or the other, and different levels of stratification for the two patterns cannot be represented. We find that there are not just two types of Japanese corporate groupings; but rather that there is a two-level hierarchical relationship at work as well.

The relative importance of the Big Six in the Japanese economy was described earlier. However, those figures were calculated assuming that the members were monolithic corporations. Most data regarding the Big Six up to now has been calculated on the assumption that the members are just parent companies (members of a presidents' club). But to the extent that today's corporations are really a form of corporate group, that data does not accurately represent the true state of affairs. A markedly different picture emerges if we run the figures again redefining the members as corporate groups. Now we find that they contribute 0.28 percent of the Japan's all companies, 19.3 percent of capital stocks, 16.7 percent of total assets, and 18.4 percent of sales.

V Corporate Boundaries and Keiretsu

The 20th century may well be remembered as the "age of giant business corporations." Most of the giant business corporations in the key industrial nations emerged through the concentration of economic power made possible by the trust movement, merger and acquisition, or by adopting the form of holding company. In this era of so-called monopoly capitalism, large business enterprises came to dominate through the concentration of capital and economic power.

The emergence of giant business corporations however is not necessarily merely the result of competition and cooperation with other large enterprises in the marketplace, but can also be attributed to the internal functional integration of organizations as corporations evolved and grew. Tracing the history of how business organizations have evolved so far, a number of observations can be made. At one time, companies were specialized in one particular functional capacity; manufacturing companies, for example, were specialized in the function of manufacturing. In order to sell the company's finished products, they were turned over to a separate sales company, because the manufacturing company itself did not possess the sales function. But as more specialized product knowledge came to be required to support sales activities and other changes occurred, the manufacturing company gradually began to take on the sales function itself. Similarly, the manufacturing company gradually takes over the

procurement of its own raw materials, although this task had probably been handled by a company specialized in raw materials procurement at an earlier stage. In other words, there has been a gradual evolution away from dependence on other external companies (inter-corporate division of labor) toward internalization or integration of different functions within the organization. It was this progressive internalization of corporate functions that gave birth to the *modern business enterprise*²⁾, and that eventually resulted in the "era of big business" as businesses continued to expand in scale.

This raises the question of what determines the size and the boundaries of companies. This is precisely the issue addressed by R. Coase back in the 1930s. By inquiring why the organization of the firm evolves in the vast sea of the market and what determines the size of firms³⁾, Professor Coase opened up a whole new area of economic inquiry, the theory of the firm.

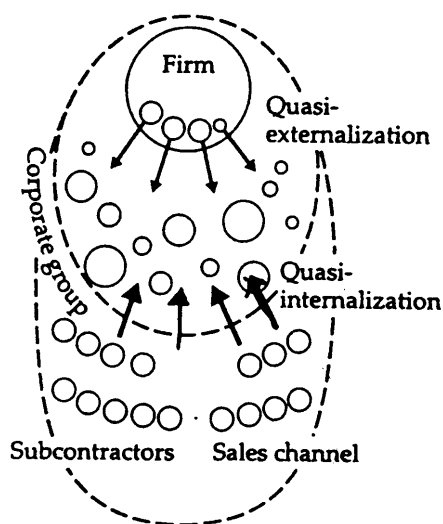
However, instead of focusing on the natural boundaries of individual companies, today a much more interesting point of contention is the boundaries that occur beyond individual companies—that is, the boundaries of corporate groups or *keiretsu*. Here I refer to *boundaries* not in the legalistic sense, but rather in the economic sense of the word. For example, the boundaries of a single business enterprise (*i.e.*, a joint-stock corporation) is very clearly defined legally, but as we saw earlier, today's large business enterprise is often an organic business entity consisting of a cluster of subsidiaries and affiliates; in short, these businesses have become corporate groups. Note too that many of these related companies were once integral operating units of the parent that were subsequently spun off. And once a unit is spun off, the control relationship between parent and related company is redefined as a corporate group. Or, to put it another way, new groups are formed by *quasi externalizing* the company's own internal operating units in line with an aggressive strategy of splitting off satellites. With the establishment of corporate groups, Japan's corporate giants have thus redefined the boundaries of the firm.

In addition, there is another prevalent pattern of corporate giant (corporate group) in Japan in which the parent is surrounded by a host of external subcontractors. Moreover several Japan's corporate giants have their own sales channels. The manufacture of a single vehicle, for example, requires up to 8,000 kinds of 30,000 different materials and parts, most of which are provided by a large number of external suppliers. In addition, a host of dealers are mobilized to sell the finished vehicles. It is common knowledge that these suppliers and dealers were originally external companies, but through continuous, repeated transactions and involvement in an enterprise association (such as Toyota Motors' *Kyoho Kai*), they have been virtually absorbed. The relationship between these suppliers and dealers to their primary manufacturing company is thus practically the same as a related company to a parent, and their business strategies are also closely integrated with that of the main company. External entities are thus *quasi internalized*, to redefine the boundaries of new kind of entity called the

2) A.D.Chandler, Jr., *The Visible Hand*, Harvard University Press, 1977.

3) R.H.Coase, "The Nature of the Firm" *Economica*, 1937.

Table 4 Boundaries of Firm



keiretsu.

We saw earlier that some large firms in Japan evolve into corporate groups by quasi externalizing its own divisions and other internal units by spinning them off. In other cases, external subcontractors and dealers are quasi internalized when they are virtually absorbed by a main manufacturing company. An *intermediate-type organization* is thus mobilized in which the suppliers and dealerships occupy a gray zone, neither internal nor external. The boundaries of Japan's large business firms can thus be represented, as shown in Table 4, as a series of widening concentric circles with the *firm* (corporation) in the center, the *corporate group* for the next ring, and the *keiretsu* for the outer ring. The flexible corporate structure of the Japanese economy thus essentially consists of properly applying a sort of vaguely defined corporate boundaries to meet the particular needs of time and place.

VI Lifting the Ban on Holding Companies

The prevailing patterns of Japan's corporate grouping discussed in this paper have been severely shaken by the extended economic recession and financial uncertainty that has continued through the latter half of the 1990s. In this context, the effects of removing the ban on holding companies that was accomplished by the 1997 revision of the Anti-Monopoly Act cannot be ignored.

An early symbolic indicator of changes to the Big Six corporate combines can be seen in the recent merger of Mitsui and Taiyo-Kobe Banks in 1992. They adopted 'Sakura' as the name of the new bank, thus breaking with the very traditional name of 'Mitsui'. Then in 1996, the Tokyo-Mitsubishi Bank was formed through a merger of the Mitsubishi and Tokyo banks, and they adopted a rose motif for the new corporate logo instead of the familiar "three-diamond" Mitsubishi logo. While both Mitsui and

Table 5 The Rate of Cross-shareholding

(%)

Combine	1975	'80	'85	'90	'95	'97
Mitsui	17.5	17.6	17.9	16.5	16.3	15.1
Mitsubishi	27.8	29.3	25.2	26.9	26.9	27.3
Sumitomo	25.9	26.7	25.0	24.7	22.3	22.2
Fuyo	13.8	16.3	15.8	15.4	14.1	15.5
Sanwa	14.1	16.8	16.8	16.4	15.7	15.8
Daiichi	14.2	14.1	13.3	12.1	11.5	11.3
average	18.9	20.6	19.0	18.7	17.8	17.9

Mitsubishi Bank have served as a core member of respective corporate combines, a long-standing historical symbol was changed.

Another interesting recent development can be seen in the membership of presidents' clubs. The spate of recent large-scale mergers in the cement, paper, and transportation industries have led to convoluted overlapping memberships. One can see that the number of companies that are members of multiple presidents' clubs has suddenly become very noticeable in the last few years. Initially this phenomenon was confined to the newcomer combines, but now we are beginning to see cases of overlapping presidents' club memberships in the old guard forerunner combines as well.

Reduced ratios of mutual shareholding among combine members has also drawn close attention in the last few years. This trend is shown in Table 5. Although a clear downward trend is not yet apparent, a major change began to occur just in 1997 and 1998. In the midst of the on-going financial crisis and sluggish stock prices, long-term relations cemented by mutual shareholding suddenly began to waver. According to Tokyo Stock Exchange figures, the volume of selling on balance at the stock exchange in 1998 was ¥9.419 billion for banks and ¥1.176 trillion for other businesses, for a total of more than ¥2 trillion. This exceeded the previous high from 1997 of ¥1.567 trillion by a substantial margin. What happened is that the financial institutions started selling off their corporate shares in an effort to liquidate their enormous bad debt. This forced the companies in turn to sell off their shares in the financial institutions, thus setting off a chain reaction that has severely strained the prevailing relations cemented by interlocking shareholding.

Another development that is predicted to have an enormous impact on the future structure of Japan's corporate combines is the enactment of the Financial Holding Company Act at the end of 1997, following the revision of Article 9 of the Anti-Monopoly Law. With this act's enactment, the scenario of grouping a corporate combine's financial institutions—city banks, trust banks, insurance companies, etc.—under a single financial holding company is beginning to sound like a real possibility. As the barriers between different financial sectors began to come down in 1993, financial companies began to enter each others' areas. However, at that time they sought to enter each others' areas just by setting up subsidiaries. Now that is changing. Now with the

recent passage of the Financial Holding Company Act, the impact of being able to group all a large combine's financial institutions under a single holding company is immense. This is because mutual shareholding with financial institutions in corporate combines has played a key role, and has been pivotal in maintaining the solidarity of the combine.

We observed earlier that Japan's giant corporate combines are made up of fairly loose confederations of large autonomous companies. There is no central control tower telling the member what to do, and the various member companies have roughly equivalent status and exercise independent decision-making in running their own businesses as they see fit. But now with the establishment of financial holding companies, financial institutions will be able to rally together, and thereby substantially increase their power vis-a-vis the non-financial companies within the corporate combine. Another very interesting development is the recent phenomenon of corporate combines supporting their financial institutions. Essentially, this amounts to mutual support for corporate combine as a whole. In November 1997, for example, support was given to the Yasuda Trust Bank on behalf of the Fuyo Combine, and in August 1998 support was extended to Sakura Bank of the Mitsui Combine in the form of a capital increase. These actions reveal increasing solidarity and unity among combine members.

More recently in November 1998, Fuji Bank and Daiichi-Kangyo Bank announced a tie-up in the investment trust field. It is generally predicted that the two large banks will become even more closely involved in the years ahead. This development is a sort of signal that we will see an increasing number of bank-to-bank ties that cut across the boundaries of different corporate combines; indeed, it suggests the possibility that the very framework of the Big Six combines may be undergoing a transformation.

The effects of lifting the ban on holding companies are even trickling down to the *corporate group* level. Business corporations that cannot avoid stagnation in the current on-going recession are attempting to thoroughly reorganize themselves by selecting out their most promising areas of business. Implementation of the recent legislative changes is currently hung up at the *division* company stage while various related statutes and regulations are worked out, but it is only a matter of time before large firms go beyond the division company stage to form pure holding companies.

We saw earlier how Japan's large companies have sought to achieve leaner corporate structures by aggressively spinning off corporate divisions, and to assume the role of a strategic headquarters for their respective groups. Yet this spin-off strategy is inherently limited. Companies could not spin off all of their operational units, for then they would be pure holding companies, which until recently were in clear violation of Article 9 of the Anti-Monopoly Act. Division company stage is essentially the same as the so-called *internal subsidiary* stage, in which even the operating divisions remaining in the parent company are treated the same as fictitious subsidiaries. In that sense, division company is a corporate stance that takes the pursuit of leanness to its logical conclusion. Now with the revision of the Anti-Monopoly Act, even that restriction is set aside, and Japan's large companies will evolve toward pure holding companies as the various related statutes are implemented.

Migration to pure holding companies is at hand. In the last few years, many companies have expressed their intent to move into new areas that they have previously been excluded from: finance, securities, insurance, and so on. Up to now, it has been exceedingly rare for a general business company to move into these areas. This is because generally one of the departments related to the parent company's primary activities was selected to take care of any diversified needs of the business company. But if the parent is converted into a pure holding company that doesn't perform any primary activities, then is likely that the business company itself will take care of these diversified needs-including finance, securities, insurance, and so on. The rapid penetration into areas that are unrelated to the primary activities of parent companies will be inevitable once the prohibition on pure holding companies is lifted. We can safely predict that the prevailing pattern of corporate groups up to now based on areas that support and are related to the parent corporation's main pursuit will undergo a fundamental transformation.

The patterns of corporate aggregates in Japan that have prevailed for over half a century are now poised to undergo a fundamental structural change. While of course this transformation was helped by the easing of regulations and reform of the financial system (*i.e.*, *the big bang*), there can be no question that the lifting of the ban on holding companies has also had an enormous impact. The Japanese economy underwent a major transformation and got a fresh start in the aftermath of defeat 50 years ago. Now at the threshold of the 21st century, the Japanese economy is poised to undergo a transformation in similar proportions.