

Competition in Japan

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Main Message

- It has been widely argued that Japan revealed a new and more effective form of capitalism. But this is wrong!
- In the internationally successful industries, competition was fierce in spite Japan's peculiar institutional setting.
- We see the same positive relationship between competition and prosperity even in Japan, as we see it in other advanced economies.

Before WWII

- The Japan's peculiar enterprise groups, *keiretsu*, date back to the Meiji era (1868-1912)
- Before World War II, the *Zaibatsu* banks did not have a dominant position even in the banking industry (only 20% share of deposits).
- Equity finance was more important than bank or bond financing.
- The banking sectors started to play a dominant role in late 1930s, because the government suppressed private stock and bond issues in favor of government war finance.

Occupation

- The Allied Occupation Command enacted the Antimonopoly Law in 1947.
- They saw Zaibatsu as serious obstacles of competition and democratization in postwar Japan.
- However, the Korean war led to the relaxation of the Antimonopoly Law.

Keiretsu

- *Keiretsu* firms are linked through equity cross-ownership and control.
- The six largest keiretsu accounted for 30% of large corporation assets by 1965.
- At the core of each keiretsu are a bank and a general trading company (*so-go sho-sha*)
- Outsiders are excluded from the governance of keiretsu firms.

Japan's Competition Policy 1

- The widespread view among the political leaders and large firms was that industries needed to be protected and nurtured.
- Many industries were exempt from antitrust rules.
- Cartels were legalized in recessions, when cost reduction and quality enhancement were deemed necessary.
- The Japanese Fair Trade Commission (FTC) was weak.

Japan's Competition Policy 2

- The government (especially, MITI, Ministry of International Trade and Industry) directly intervened in business conduct in ways that limited competition.
- There were many government interventions that are not backed by specific laws (“administrative guidance”)

Japan's Competition Policy 3

- Japan has been a litigation-averse society.
- Japanese private parties filed only seven antitrust damage suits by the mid-1980s. The plaintiffs settled in only two cases; all others lost.
- There are still many institutional barriers to litigation: Few lawyers, considerable delays in the judicial system.

Why low profitability?

- If Japanese competition is limited, Japanese firms could earn higher profit margins. But the fact is not.
- Japanese firms registered lower profitability than firms in other advanced nations.
- Keiretsu firms recorded lower profits than independent firms: They stabilized corporate performance at a lower level in a group.

Reconciling Practices and Evidence

1. Some parts of Japan's economy is very competitive as well as very profitable, although it is less competitive on average.
2. The types of competition prevalent in Japan are different from those prevailing in the US and other advanced countries.

Two Japan

- Highly competitive and internationally successful – automobiles, consumer electronics, and robotics.
- Not competitive and internationally unsuccessful – chemicals, civil aircrafts, software, all nontraded domestic industries (construction, retailing, and transportation)

Failure of Industrial Policies

- (Beason and Weinstein, 1996) Tariffs and quotas, subsidies, corporate tax breaks, and government loans occurred only in low-growth sectors.
- (Sakakibara and Porter, 2001) The more intense domestic rivalry is, the more successful the industries are in the international market. Japan's inefficient basic material industries were protected by cartels.

The Nature of Competition in Japan is distinctive in many ways.

- Corporate goals.
- Rapid imitation.
- Internal diversification and Me-too entry.
- Barriers to exit.

Corporate goals

- Japanese firms rank size, growth, and market share, ahead of profitability. They tended to neglect shareholders' interests, because the main financial source was the borrowing from their main banks.
- Japanese firms care employees' welfare as well as profits.
- Japanese firms held huge unrealized capital gains until early 1990s, which were reflected by high stock prices, and worked as excuses for low operating profits.

Imitate each other's strategy

- The imitation lag of nonpatented product innovation is 1,98 years in Japan, while 2.80 years in the US.
- They tried to exploit all the growth possibilities, even if they have no distinctive advantages.
- Japan is a homogeneous society. Acceptance and penetration of new products and services, once it begins, is often very rapid.

Internal Diversification

- Market entry through acquisition of an existing company has been limited by cross-shareholding.
- The only way to enter a new market is to start a new company through internal diversification.
- *Me-too entry* – Entry occurs in industries even if many rivals are already in place and profit prospects are modest.

Barriers to exit

- Keiretsu firms, with weak pressure from capital markets, tend to survive in the market, even if they are in vulnerable positions in product markets.
- Japan's government often pressures banks to save troubled borrowers.
- Japanese firms are not allowed by the legal system to dismiss employees, if the reason for dismissal is not “objectively reasonable and socially appropriate”.

Reform of Japanese Competition Policy

- The pace of reforming Japanese competition policy was accelerated only from the mid-1990s.
- Although macroeconomic issues are important, Japan's main problem is rooted in microeconomics.