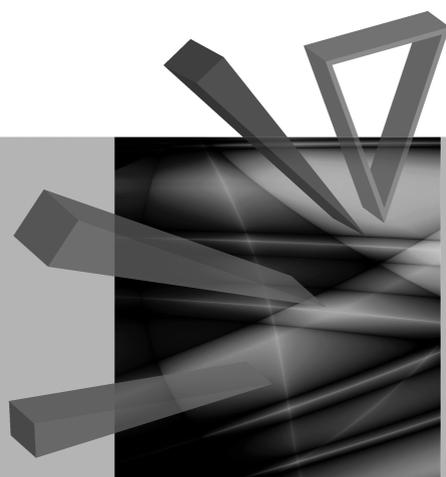


Faces of Competitiveness in Asia Pacific



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KEIRETSU AS A FORM OF PARTNERSHIP IN THE JAPANESE BUSINESS SYSTEM

Summary: *Keiretsu* is a concept of relationships between partner subjects, used in the Japanese business system. In this article, its essence and use in creating partnerships between companies that work as a group, like Toyota Group, are shown. The structure of a company, its corporate culture, rules and values, which are the base of its functioning, are described. The essence of Toyota Way and Toyota Production System philosophies that express the *keiretsu* ideas are shown. Finally, its benefits and prerequisites are listed.

Keywords: *keiretsu*, co-operation, transnational corporation, Toyota.

1. Introduction

In the pursuit of achieving competitive advantage, companies focus on the most successful and effective management concepts. A vital part of this is an analysis of key success factors, among which the most important are management innovations. In this respect, Japanese companies are particularly well-known for their achievements stemming from the use of partnership forms between business system entities. The aim of this article is to present the importance and use of *keiretsu* in the process of forming partnerships, and their influence on how subjects function in the Japanese business system.

The starting point of this discussion is to determine the essence of Japanese management concepts, and to present the way the Japanese *keiretsu* groups function as forms of partnership between companies. The analysis is mostly based on the example of the Toyota Group, showing the influence of the *keiretsu* model on the company's market condition. The case of the Toyota Group is a good example of strategic management which was realized thanks to the concepts of the unique Japanese system, *keiretsu*.

2. The essence of *keiretsu* groups as an innovative business structure

Industrial-capital *keiretsu* groups are one of the basic elements of the socio-economic system in Japan. They are unequivocally related to the Japanese concept of the co-

operation between organizations. *Keiretsu* is a group, or a family of companies dependent on one another, between which there is a close alliance based on striving for common success. Furthermore, this system is also based on a close partnership between the government and companies. It can be understood as a complicated web of relations, which includes banks, suppliers, as well as distributors from the Japanese government. Although some people see *keiretsu* as a threat to trade, others see it as a showcase concept of changes (see Figure 1).

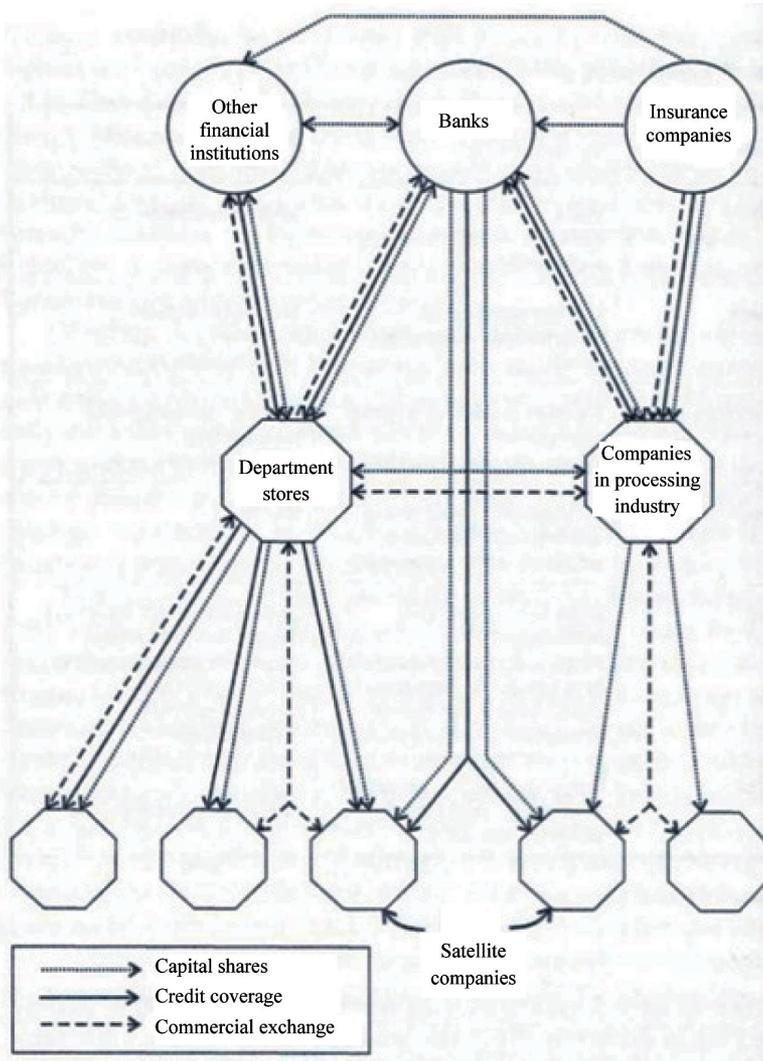


Figure 1. The *keiretsu* system

Source: M.L. Gelach, *Alliance Capitalism. The Social Organization of Japanese Business*, University of California Press, Berkeley 1992, p. 5.

Keiretsu expresses specific traits of a Japanese company's structure. It is an example of a network organization, which is made up of a high level of mutual formal and informal dependencies between partners: producers, distributors, banks, and other companies. These organizations have a sense of mutual obligations and are in close relationship with big organizations, normally banks that are fundamental for group's functioning. These groups may be present in basically all branches of industry, however, in Japan, vertical *keiretsu* groups are frequently very specialized to a narrow field, unlike horizontal ones.

Keiretsu groups are distinguished by the scale of their economic concentration potential, a relatively low level of internationalization despite their global reach, development based on internal resources, lack of a central decision-making system, highly developed capital, trade, and personal relations as well as distinct institutions and corporate governance mechanisms.¹ In large companies high employee loyalty can be observed, both towards the company, and towards the entire *keiretsu*.² In a period of economic growth, the seniorial system has proved successful in the Japanese companies.

Japanese *keiretsu* capital groups expect their partners to keep a high level of performance, despite very high criteria that they have. The success factor of the extended organization is good leadership of the producer, partnership between a producer and co-operator, and also a culture of continuous improvement and joint education of all the suppliers in the network.

3. Groups of firms in the network of Japanese connections – Toyota Group

Analyzing the organization structure of *keiretsu* groups, what has to be noted is that they can be oriented horizontally or vertically. Horizontal *keiretsu* are controlled by main Japanese banks and include: Mitsui, Mitsubishi, Sumitomo, Fuyo, and Dai-Ichi Kangyo. The unofficial leader, however, is Mitsubishi. Its bank, Tokio-Mitsubishi is a firm that dominates the whole *keiretsu*. Mitsubishi Motors and Mitsubishi Trust and Banking, along with the *keiretsu*'s trade company Mitsubishi Shoji and the insurance company Meiji Mutual Life, which provides insurance to all the members of the *keiretsu*, all have their role in the quest to distribute the *keiretsu*'s goods around the world.

The vertical *keiretsu*, on the other hand, are composed of industrial companies, linking producers with suppliers of components, or producers and wholesalers with

¹ J. Grabowiecki, *Grupy kapitałowo-przemysłowe keiretsu w nowych uwarunkowaniach rozwojowych gospodarki Japonii. Przyczyny regresu*, Wyd. Uniwersytetu w Białymstoku, Białystok 2006, p. 92.

² *Evolution of Keiretsu and Their Different Forms*, www.rotman.utoronto.ca/~baum/mgt2005/keiretsu.htm, (date of access: 1.02.2010).

retailers. This type of *keiretsu* includes car and electronics makers, e.g.: Toyota, Nissan, Honda-Matsushita, Toshiba or Sony, and their subcontractors.³ As a subject of the following analysis and discussion, the Toyota Moto Corporation example has been chosen.

Toyota Motor Corporation is the biggest company in Japan. It is the leader of car producers around the world, producing 8.3 million vehicles annually. This organization employs more than 315 000 people, and its yearly sale is around 203.2 billion USD. It has its branches in adjacent areas such as: telecommunications, computer development (with IBM Japan), insurance, finances, real estate, leasing, car sale or aircraft innovation. Its headquarters is located in a small town or Koromo, also known as Toyota City, where, in an environment good for development, one can focus solely on work. It is often seen as one of the reasons for the organization's growth. The aim of Toyota Motor Corporation is to establish a position of the leading "green" car-maker on the world market, a position that requires a steady supply of the best quality products in the world.

Because Toyota is the symbol of an unbelievable success of the Japanese car industry, science has thoroughly documented the essence of its business system – *keiretsu*.⁴ The organization has a strong and united *keiretsu*. The company's internal relations with its main partners in the *keiretsu* group have been based on the rules of trust and exploiting organizational potential.

In total, in the Toyota organizational pyramid, there are 234 basic parts suppliers (so-called *Kyoho-Kai*) and 77 construction machinery producers (*Eihokai*).⁵ However, the main company in the group is Toyoda Automatic Loom Works (founded in 1926), later renamed Toyota Industries Corporation, from which the Toyota Motors Company has emerged. Toyota Industries Corporation has its branches in five business areas: motorization, materials, internal transport equipment, textile industry machines, and electronics. According to the ranking published by two German business magazines, *Logistik Journal* and *DHF*, Toyota Industries claims the position of the world leader in the internal transport branch. Also, in 2008 the company has taken the 31st place in the "Most respected companies in the world" ranking, published by the *Fortune* magazine.⁶ It has to be noted, though, that the

³ B. Twomey, *Understanding Japanese Keiretsu*, <http://www.investopedia.com/articles/economics/09/japanese-keiretsu.asp> (date of access: 18.04.2010).

⁴ M. Yoshiro, *Shitauke Kankei: Jidousha Sangyou*, [in:] K. Imai and R. Komiya (eds.), *Nihon no kigyō* [Subcontracting Relationship: Automobile Industry Japanese Corporations], Tokyo 1989, pp. 163-186; J.P. Womack, D.T. Jones, D. Roos, *The Machine That Changed the World*, New York 1990; W. Kazuo, *Jidousha sangyou ni okeru kaisouteki kigyō kankei no keisei: Toyota Jidousha no jirei* [The formation of a vertical relationship in the automobile industry: Toyota as a case study], *Keiei Shigaku, Japan Business History Review* 1991, Vol. 26, No. 2, pp. 1-27.

⁵ T. Watkins, *The Toyota Group The One and Only Horizontal-Vertical Keiretsu*, www.sjsu.edu/faculty/watkins/toyota/ (date of access: 28.04.2010).

⁶ <http://www.toyota-forklifts.pl>.

corporation's activity regarding internal transport is dealt with by the Toyota Material Handling Group. Moreover, Toyota Industries Corporation, according to a deal with Toyota Motor Corporation, takes part in production of the Toyota Vitz (Yaris) and Toyota RAV4. The company also produces car engines used in the following Toyota models: Avensis, Corona, Land Cruiser.

As far as the analysis of the business model is concerned, what has to be noted is that Toyota Industries Corporation bases itself on five ground rules which express the company's philosophy. They are respect for the law, respect for others, respect for the natural environment, respect for the clients and respect for the workers, who identify themselves with the company through their independent and creative decisions.⁷

Toyota Group has not only the oldest, but also the only association founded before the Second World War. It is based on mutual, close co-operation between its members. The association, called *Kyoho-Kai* was founded two years after the company's creation, which was in 1939.⁸

Kyohou-kai, consisting of 31 members, often treated as Toyota's *keiretsu* is really the most open association in the world, its members also belonging to a few other organizations or associations.

4. Organizational culture of the organization

Toyota is an ideal example of a knowledge-oriented organization. It comes from its specific organizational culture, formed through the years of its existence. It is based not only on mutual co-operation, problem-spotting and solution-finding, but also on the three rules below, which are an ideal starting point for knowledge sharing across the company. They are:

- Preventive measures – the strength of the organization is the ability to foresee future trends and potential threats.
- *Kaizen* – it is a philosophy of continuous upgrade. It is based on the concept that every employee should be a part of the company's reputation. It helps to overcome traditional Japanese workplace problems such as *muda*, *mura*, and *muri*.⁹ Moreover, this concept is assisted by the so-called *kakushin*, which is a continuous urge to develop new, radical upgrades and revolutionise the idea of the product.
- Lean manufacturing – it is a rule that assumes a minimal amount of stock necessary for running production, in order to be prepared to a potential crisis.

⁷ <http://www.toyota-industries.com>.

⁸ O. Yoshio, *Nihon Jidousha Sangyou no Seiritsu to Jidousha Seizou Gyouhou no Kenkyuu* [A Study on the Japanese Automobile Industry, Its Establishment and Legislation Affecting the Manufacturing of Automobiles], Tokyo 2001, p. 308.

⁹ *Muri* means "giving up excessive effort"; *mura* means "a lack of consistency and random lack of standards"; *muda* means "an elimination of losses and activities bringing no added value".

While searching for a way to encourage the employees to the process of quality improvement, some managers once used the “six sigma” program, allowing them to train the exporters in the field of statistic problem solving, while others decided to follow the rules of the lean manufacturing – the concept of the pull system and the constant flow system, as well as investing in the lean processes. Now, however, the most popular is the “lean six sigma”, which is a sum of the best from both of the programs, which are a successful way of cost reduction. Introducing them, though, is not an easy task, because despite the fact that they bring quick gains, it is hard to maintain them for a longer time. The element that allows lasting results is Toyota’s culture, that is: beliefs, values, and assumptions that people working for a common aim share.

Working for common prosperity is a base of the company-employee partnership. In Toyota Group, employees work not only for the company’s financial success, but also for their own individual successes, which allows for a lasting prosperity for everyone in the company.

5. “Toyota Way” concepts and Toyota Production System

Toyota’s management philosophy has gone through quite an evolution since the company’s founding, finding its image in systems like Lean Manufacturing or Just In Time, which were used to build quality and business methods known as the “Toyota Way” (see Figure 2).

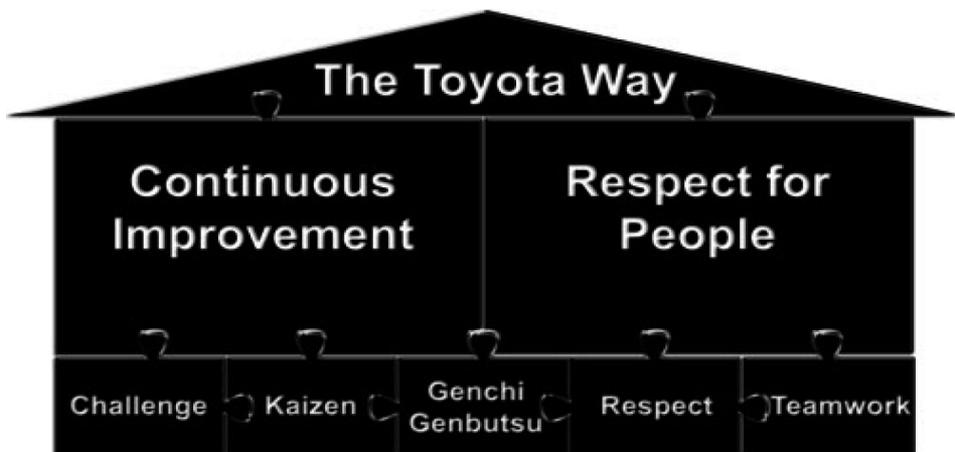


Figure 2. Toyota Way

Source: www.toyota.eu.

“Toyota Way” is a philosophy used in all the organizations in the world. It is important to note that its educational process never ends, letting employees absorb

the knowledge for as long as they work in a company. It is based on the belief that a company is made up of people, so the culture should be based on them. The philosophy has been based on two pillars: continuous development and respect for people, comprising five of the leading values of that group:

- challenge – striving for specified, ambitious aims (specially formulated by the company) through developing a long-term work plan; we meet challenges with courage and creativity;
- *kaizen* (“development”) – continuous improvement of our business operations, always striving for innovation and evolution;
- *genchi genbutsu* (“go and see”) – one of the first elements implemented by Toyota, according to which, in order to fully understand and solve a problem, you must always go to its source and find the facts that help you make the correct decisions regarding it; problems need to be solved through consensus;

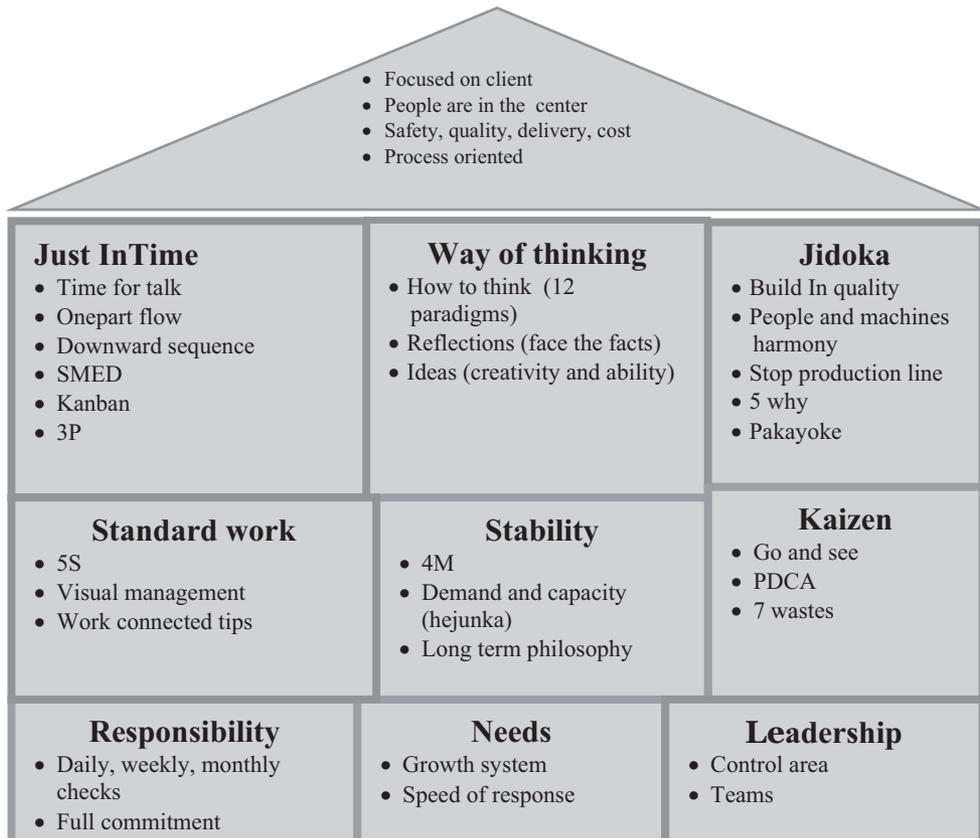


Figure 3. Toyota Production System

Source: www.gemba.com.

- respect – it is vital for a successful co-operation; employees show respect through their behavior and attitude, through mutual gratitude and helpfulness, which allows them to build mutual trust and communicate;
- teamwork – it is a basis of work organization in Toyota, allowing for interpersonal connections between employees, collective education, and conscious approach to problems; it boosts development of the workers as well as the company and allows to use the full potential of the team.¹⁰

Another important element of Toyota's philosophy in the pursuit of higher quality, and also higher productivity with a better use of space and equipment is the Toyota Production System (TPS). It combines philosophy of management and practice. The basic framework and elements of the Toyota Production System are shown in Figure 3.

TPS organizes production and logistics for car producers, basing its operations on: relations with suppliers and clients; elimination of excessive effort (*muri*), inconsistency, lack of standards and randomness (*mura*); elimination of losses and activities not resulting in added value (*muda*). To achieve them, the most important task is to increase the effectiveness of production through *heijunka* (production leveling) and lean manufacturing.

Thanks to *keiretsu* system, Toyota, from a small producer of textile machinery, became one of the most successful companies in the world. Although its way to the top was long and hard, Toyota achieved its aims little by little, eventually winning the struggle for the position of the most profitable car producer in the world, and one of the best examples of effective long term management.

6. Toyota in times of a crisis

The way Toyota dealt with the global economic crisis confirms the effectiveness of its management system. Regardless of the problems on international markets, which led to major losses for many companies, Toyota keeps strengthening its advantage over competition. Its second place in the effectiveness ranking is a proof for that. Thanks to the effectiveness of the Japanese management system, oriented on being the best, not the biggest, Toyota does not need to carry out a massive lay-off, or get help from the government. Moreover, thanks to the ability to expand aggressively, keeping track of the costs at the same time, it does not have to close down even one of its 1200 points of sales. Consistent dealing under the efficient organization culture paid off with a stable growth over the last dozen years. Its actions are carefully thought-over and oriented on the needs of current and future clients.

According to Katsuaki Watanabe, the 65 year old president of Toyota, the 21st century can be called the "second beginning" for the company, which marked

¹⁰ M. Morawski, Przedsiębiorstwo skoncentrowane na wiedzy, *E-mentor* 2006, nr 4 (16), www.e-mentor.edu.pl (date of access: 19.04.2010).

out a new direction of action, supposed to ensure a better market standing in the future. Despite its success, it has to continue expanding and upgrading for the future. Especially important, when building strong foundations, are three elements: continuous improvement of product quality, continuous reduction of costs, and continuous development of human resources. In order to realise these goals, complex and wise investments in technology and human resources are vital. Toyota's managers claim that profit can only be earned by continuous improvement of products, even at the cost of growth rate.

Toyota wants to conquer new upcoming markets, like the BRIC markets (Brasil, Russia, India, and China) that have a high development potential. However, the company does not want to act aggressively. They say that it is better to wait until demand for their products surfaces. The problem is, consumers in aforementioned countries are more interested in buying cheaper cars. So in order to claim those markets, Toyota has to find a way to decrease its production cost even more.

7. The influence of the *keiretsu* model on expansion of the Japanese organizations

Although the Japanese companies attribute their success to the deeply rooted *keiretsu* tradition, based on relations between the producer and the supplier dominating the Japanese industry, the *keiretsu* model does have its pros and cons. The advantages undoubtedly include: providing suppliers with loyal clients, a clear cost structure and predictable production and supply schedules, clear quality and effectiveness standards, a stable business environment, in which the supplier is encouraged to co-operate with other suppliers, who are often isolated from the market by *keiretsu*, and producers pursuing continuous development of products, quality improvement and cost reduction. The disadvantage of *keiretsu* is lack of flexibility. Despite the impression that it encourages supplier development, it actually stops it, not letting them directly interact with the market. The survival of the suppliers cannot depend on their positioning on the leading edge of their field. Moreover, the prices stop being competitive on the market – they become transfer prices. Suppliers exist in a comfortable dependence on their (often only) client, not knowing the needs of the real world. This can lead to erosion of the market position of the producer, and it can eventually threaten the durability of the supplier. A relation that at first appeared very convenient often cripples the supplier, ridding it of independence regarding decisions and way of conduct, isolating it from the competitive markets.

8. Influence on innovation and the financial condition of a company

Basing on the example of Toyota, it can be noted that the *keiretsu* model leads to innovation, because its philosophy bases on continuous quality improvement, with specified rules and methods established by its managers and other employees.

In order to decrease Japan's development gap and increase the rate of economic growth, the *keiretsu* have begun active operations based on initiating and co-ordinating investment projects in the strategic branches of industry.

Because of that, the capital-industrial *keiretsu* groups have a big influence on the financial condition of the companies involved. It is because this system helps minimise risk regarding network and cost reduction. How well companies like Toyota do financially is a proof for that. Despite the economic crisis, they keep their market growth stability, winning with foreign competition.

It is worth noting that thanks to the development of the equity links between firms, the leading bank system and cross shareholdings have become the main financial bonds of all the *keiretsu* groups. The leading bank then becomes a creditor, as well as a shareholder, while still fulfilling other bank duties like financing, payments, currency exchange deals, deposit, and stock submission. It gives the *keiretsu* groups an easier access to credit which has become the main source of external financing. Thanks to a continuous monitoring, the bank can control the companies' actions and their status, which is also important for other creditors. This way, the bank does not interfere with the company in times of stable growth, passively watching its action. Only when financial problems appear, the bank does actively participate in the remedial processes. It can be said that the bank, while trying to protect a company from bankruptcy, becomes an agent of other creditors. That is why this system has become one of the main elements of the Japanese company control system. Thanks to the control the economic authorities had over appropriate allocation of capital, and thanks to the diminishing importance of the capital market and the companies' dependence on continuous credit, the managers could create long-term strategies, forfeiting the short-term gains.

These mechanisms, active in the Japanese financial system, have contributed to reforms in risk distribution in the economy, moving them from the microeconomic level to the national level, influencing the shape of Japanese corporate governance system. Because of its liberalization, the government's influence of particular companies in a group, formerly done using the national savings system and refinancing of the municipal banks, has collapsed. On the one hand, it has contributed to a massive growth of risk and the transaction costs of the financial sector, while reducing the country's risk, and on the other hand, it has led to a growth in competition and has resulted in a drive to reduce the transaction costs on the financial markets. Moreover, thanks to the increase of financing and financial risks of the companies, and the yen's appreciation and the stagnation of the economy, competition has increased, reducing financial viability and liquidity of the companies which form *keiretsu* structures.¹¹

¹¹ J. Grabowiecki, *op. cit.*, pp. 112-115.

9. Conclusions

The analysis of the Japanese *keiretsu* system carried out in this article has shown high effectiveness in reaching a competitive edge by the Japanese companies. It has its source in the rules and mechanisms of this system, thanks to which it fulfills a substantial role in forming partnerships between companies and has a big influence on their market effectiveness and success.

The industrial-capital *keiretsu* groups have always been a symbol of not only a paternalistic management system, but also of caring for the image and the brand of the company. The *keiretsu* groups exceed their foreign competition, reaching a competitive advantage in terms of subcontracting and through personal relationships with companies from the outside of the *keiretsu* group. In effect, foreign organizations showing even high competitiveness, have trouble with breaking the bonds in the *keiretsu* structure. It can be said that the *keiretsu* system is one of the most important barriers of access to the Japanese market.¹²

This system based on an exceptional corporate culture, focusing mostly on knowledge and supporting initiatives for skillful knowledge management allows for an easier adaptation to changing expectations of the market and a highly competitive environment. Toyota's production system, which is based on the entire company philosophy, is known globally. Many international companies try to implement it in their organizations, however, in the long term, the results are not satisfactory, as it requires a specific approach, elaborated in a long process, determined by corporate culture as well as the human resources management concept. Companies in the *keiretsu* networks are connected not only by mutual trust, but also long term relationships, and this is the foundation of the system.

Implementing the *keiretsu* model requires fulfilling these conditions:

- long-term strategy, even at the cost of losing short-term gains;
- the ability to foresee future trends and windows of opportunity on the market;
- keeping a balance between caring for external clients and internal ones;
- concentration on developing human resources in corporations, which allows using the full potential of the company;
- developing partnerships regarding all the links of the business system;
- using intelligent systems and using the newest technology, fulfilling the needs of worldwide clients.

¹² J.D. Southwick, Addressing market access barriers in Japan through the WTO: Poll "The Typical Japan Market Access Issues and the Possibility to Address them through WTO Dispute Resolution Procedures", *Law and Policy in International Business* 1999, Vol. 31, No. 3.

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KEIRETSU JAKO FORMA PARTNERSTWA W JAPOŃSKIM SYSTEMIE BIZNESOWYM

Streszczenie: *Keiretsu* jest koncepcją powiązań podmiotów partnerskich, stosowaną w ramach japońskiego systemu biznesowego. W artykule przedstawiona została jego istota oraz zastosowanie w kształtowaniu relacji partnerskich między firmami funkcjonującymi w grupie, na przykładzie Toyota Group. Opisane zostały: struktura firmy, jej kultura organizacyjna, zasady działania i wartości, które wyznaczają podstawę jej funkcjonowania. Zaprezentowano istotę realizowanej przez firmę filozofii Toyota Way i Toyota Production System, które wyrażają ideę *keiretsu*. Na koniec przedstawione zostały korzyści płynące ze stosowania modelu *keiretsu* oraz warunki niezbędne do pomyślnego wdrażania tego modelu.