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## 12 Why do traders invest in manufacturing?

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Why do traders invest in manufacturing? In this chapter we argue that the manufacturing investments of traders result from their efforts to secure the custom of manufacturers. As markets mature and information diffuses, trading companies risk being bypassed by their customers. One defence is to take an equity stake in them to guarantee their trading rights. Because the goal of these investments is to tie customers, not to exploit advantages, such stakes are likely to be minority ones.

A second defence for trading companies faced with the decreasing value of their contribution as industries mature is to orchestrate the development of new value chains whose trade they will handle. The superior intelligence of trading companies gives them a comparative advantage in this task. Their broader viewpoint and their ability to structure the whole chain reduce the risk they face in financing new businesses. Setting up the chain will lead them to invest strategically in selected stages of the chain. All of these investments will serve to support trading.

As markets in these value chains mature, trading companies will sell their minority stakes to their manufacturing partners, either because they are in danger of losing the trade of their affiliates, or because they can cash in on their investment while still safeguarding their trading rights. The resulting pattern of trading company investments in manufacturing should be one of short-lived minority investments that are eventually sold back to their majority joint venture partners.

This chapter checks this story against the pattern of stakes taken by Japanese trading companies in all manufacturing affiliates that were active in the United States in 1980. We find that, compared to the stakes taken by non-trading Japanese investors, trading companies had a preference for minority stakes. The manufacturing stakes of Japanese trading companies were also shorter lived and more likely to be sold to their majority partners than was the case for non-trading investors.

We start this chapter by considering the fundamental logic of trading companies, and how this logic leads them to invest in manufacturing. The second section describes the investments made by 1980 by Japanese trading companies in US manufacturing subsidiaries and finds support for our

speculations. In the third section we trace these investments to 1989 and find that they are shorter lived than those of non-trading Japanese investors. Our conclusions are presented in the fourth section.

### **Why do trading companies invest in manufacturing?**

Trading companies are brokers who link buyers with sellers. Traders can also be resellers when they take title to the underlying commodities or goods. In Chapter 2, this volume, Mark Casson describes the types of activities into which trading firms (either brokers or resellers) can integrate (e.g., production, transportation, financial services), and the range of markets, defined by product and/or geography, over which they can diversify their operations. Here our concern is why they integrate into manufacturing.

The business of trading companies can be described in static and dynamic terms. In terms of statics, trading companies attempt to satisfy buyers' demands for goods and services and to identify customers for existing output. To fulfil this function, traders typically invest in a sophisticated proprietary intelligence network that allows them to identify exchange opportunities at lower cost than would be available to individual manufacturers. Trading companies often manage and finance the actual transportation of products from seller to buyer. They often own transport infrastructure (ships, trucks, docks, warehouses) and play an important role in the financing of exports and of new projects. Often they take equity stakes in their suppliers and customers. Why they take such stakes in manufacturing firms can be understood by considering the central characteristics of trading.

One fundamental aspect of the trading company's business is that it is continually threatened with extinction. Once traders reveal their information by pairing a buyer and a seller, the clients can deal directly with each other. Direct interaction between buyers and sellers, especially in stable markets, can save on trading commissions. The bargaining position of the trading company thus becomes weaker as clients become better informed, and they will be forced to accept lower commissions if they want to keep the business. In late 1996 and early 1997, for example, Japanese steel companies (Kawasaki Steel Corp., Sumitomo Metal Industries, Ltd., Nippon Steel Corp.) lowered their commission payments to their respective trading companies and reduced their interest payments by cancelling prepayment arrangements with the traders ('Steelmakers . . .', *The Nikkei Weekly*, 2 September 1996, 34 (1738): 9). These steel companies and other manufacturers who are the principal clients of Japanese trading firms 'increasingly deal directly with customers and handle import procedures and domestic sales' (T. Anzai 'Holding companies by any other name', *The Nikkei Weekly*, 20 January 1997, 35 (1757): 9). The threat of replacing traders provides these firms with enough bargaining power to negotiate lower commissions.

Faced with this threat to their livelihood, trading companies have four main defences. First, the minimum efficient scale of trading is sometimes larger than

that of manufacturing. This was one of the reasons for the emergence of Japanese trading companies. The small textile firms for which they handled exports were too small to afford and to make full use of an exclusive network of sales agencies abroad. Trading companies could efficiently pool the exports of many small textile firms and handle them at much lower cost than those that would have to be paid by each firm if they handled their exports on their own.

A second defence is for the trading company to gain a stronghold on distribution infrastructure in order to prevent buyers and sellers from bypassing them. For example, in autumn 1990, the Japanese trading company Mitsui allied with the Japanese trucking firm Tonami Transportation to buy a US \$40 million stake in Airborne Express (USA). With a credit line from Mitsui of up to US\$100 million for aircraft financing, Mitsui, Tonami and Airborne Express created Airborne Express Japan. Airborne provides Mitsui with a global air cargo network (Brazier 1994).

Third, trading companies can take an equity stake in both suppliers and customers so as to be able to veto being dropped as an intermediary. This rationale for taking equity positions in upstream and downstream activities appears systematically in the company histories of trading firms (in the case of Metallgesellschaft in Chapter 4). Japanese trading companies have followed the same strategy. For example, the Japanese trading company Marubeni owns 65 per cent of a yarn-making company in Shanghai and 50 per cent of the company that dyes the yarn. Marubeni has smaller stakes in both a blanket manufacturer and another yarn supplier in China (Sender 1996a).

A more radical defence is to abandon mature, stable industries and to orchestrate the creation of new value-added chains. Trading companies can then get commissions for the trade flows that will be generated by these new businesses. This was the strategy followed by nineteenth-century British trading companies when they took the lead in developing South East Asia rubber plantations: the trading companies acted as selling agents for the rubber of the companies they helped set up and as exclusive importing agents for the inputs the plantations needed. We can observe Japanese trading companies doing the same thing. Consider the role played by the Japanese trading firm of Mitsubishi in setting up Kentucky Fried Chicken Japan. In the mid-1960s, Mitsubishi was the leading Japanese importer (and domestic distributor) of animal and chicken feeds made of corn and milo.

Mitsubishi took the initiative in starting large broiler farms in Japan, at first mainly as the captive customers of Mitsubishi corn and milo feeds. In order to find captive markets for their increased chicken feed business, the trading firm continued to open broiler farms around the major cities in Japan. . . . Mitsubishi broiler farms continued to increase the supply of broilers so much that by around 1967 the trading firm was saddled with surplus broiler meats. One logical way around this problem was to create an expanding and new demand for broilers.

(Tsurumi 1977:249)

Mitsubishi's headquarters in Tokyo cabled its Chicago office to obtain suggestions for increasing chicken consumption in Japan and requested that it identify the largest consumer of chicken in the US. The Chicago office found that this was Kentucky Fried Chicken (KFC) and contacted the firm. It took three years for the two parties to reach an agreement, but in 1970 KFC Japan was founded with Mitsubishi and KFC each owning 50 per cent (Tsurumi 1977). In the following two decades the joint venture opened more than 900 outlets in Japan. In August 1990, 36 per cent of the company was sold at a handsome profit on Tokyo's stock market ('The Giants that Refused to Die' *The Economist*, 1 June 1991, pp. 72-3).

There are two points to note in the preceding example. First, setting up new industries requires an ability to see the big picture, to look at the whole value chain from upstream suppliers to downstream customers, from corn growers to fast-food patrons. The vast intelligence networks of Japanese trading companies allow them to view the entire value chain in a way a bank may not. Second, even if individual buyers and sellers are aware of the profitability of the new value chain, they may not possess sufficient internal resources to fund the new venture. They would have to approach banks for loans. For reasons we now consider, trading companies are in a much better position than banks to finance these new value chains. This comparative advantage of trading companies in funding new, speculative activities explains their integration into financing, and, more to the point, their strategic minority investments in manufacturing ventures.

Traditional neoclassical economics ignores the intermediation role of trading companies because it assumes perfect information and enforcement, i.e., zero transaction costs (see Chapter 2, this volume). The same assumptions of zero transaction costs must be dropped if one is to understand the role played by trading companies in financing new, speculative businesses.

Lending money is characterised by high transaction costs because, in contrast to many other transactions, the two parts of a lending transaction are not simultaneous. Money is lent today to be repaid in the future. Money is also fungible and can be used for purposes that differ from those approved by the lender. Finally, incentives in a loan transaction are not symmetrical. The lender bears the brunt of default costs if the venture fails. A borrower's loss of reputation is supposed to curb such dishonesty, but in the case of lending, such reputation effects are weak because it is often difficult to know whether the borrower's default was due to dishonesty or ineptitude and/or to poor business conditions.

With perfect information, lenders could screen out risky ventures and dishonest or incapable borrowers. Perfect enforcement would discourage borrowers from taking undue risks and defaulting. In the real world, lenders will be forced to fall back on three second-best strategies: screening borrowers and projects, controlling the use of borrowed funds and securing collateral.

By screening out risky projects and unknown applicants, lenders concentrate on safe projects presented by well-known borrowers with solid track

records. The chances of securing a loan are practically zero for the potential borrower who has a less than sterling record or who is not personally known by the lender.

Restricting the use of funds to purposes specifically authorised by the lender is another possible strategy, but it has two limitations. First, banks in some countries can only control expenditures *ex post*. Second, banks may have insufficient knowledge of what expenditures are necessary to carry out the proposed business. The more unconventional the proposed business and the more volatile its environment, the more likely that tight bank monitoring will be ineffectual.

Banks could require the borrower to pledge collateral that will be forfeited should the borrower fail to repay the loan. That collateral may consist of assets held by guarantors or of the assets financed by the loan itself. Prospective borrowers may vary greatly in their ability to get wealthy individuals to serve as guarantors. Projects will also vary greatly in the extent to which they provide collateral (Williamson 1988).

Return now to our earlier example, and consider the situation of an individual who seeks in the early 1960s to borrow money from a Japanese bank to raise chickens in Japan. If the prospective borrower has not had prior (successful) dealings with the bank, then he or she will have almost no chance of passing the screening process. Raising chickens is a new business to the bank, so the bank is unable to specify appropriate uses for its funds. Hen houses are poor collateral because they have few alternative uses.<sup>1</sup>

A trading company will be in a better position than a bank to lend to this individual. It will look at the business that will be generated by the chicken grower, its purchases of grain from the trading company and its sales of chicken to its fast food business. The traders' strong international network of contacts in upstream and downstream activities provides them with deeper and broader perspectives on the industry than those of banks. For example, trading companies can tap the expertise of their US affiliates to get information on the prospects and success factors of raising broiler chickens on a large scale. Through participation in all stages of the value-added chain, from grain trading to restaurants, a trading company can configure the chain to minimise risk. It can structure its loans, monitor the use of its funds and construct contingency plans more effectively than a bank. Hence, the trader's outlook on growing chickens will be better informed than the bank's (Roehl 1983).

The costs of using collateral will also be lower to the trading company than to the bank because the trading company could operate the business itself, at least for a while, should the lender default. Last, a trading company can take an equity stake in the business to which it lends in order to get inside information. Hence, we would expect trading companies to be in an excellent position to provide financing to help develop newly emerging industries.

It is also important to consider the point of view of our prospective borrower. The entrepreneur's reward is the difference between the return and the repayment obligation, so the venture requires customers as well as capital.

This problem of creating demand is especially acute in the case of new products for which uses are not yet established. A trading company can motivate the borrower by guaranteeing customers. The trader can support these guarantees in two ways. First, repayment of the loan can be contingent on effective sales to the trader.<sup>2</sup> Second, the trader can take equity in the supplier.

The amount of the trading company's equity investment required to assure the supplier is inversely related to how well established the business is. At one extreme, if the venture is extremely risky, the trading company may have to supply all of the equity. The need for such reassurance (i.e. equity holding) by the trader decreases with time and with the supplier's increasing familiarity with his customers and with the market. At the same time, the trading company will also want to reduce its stake in the supplier so as to be able to redeploy its resources towards emerging fields and more diffident suppliers. Selling its stake will allow the trading company to cash in on its foresight.

The preceding section suggests that trading companies will take equity in suppliers and customers for the three main reasons surveyed above: (1) to prevent their customers from bypassing their services; (2) to monitor the use of funds they have lent to them; and (3) to incite suppliers and/or customers to start new businesses.<sup>3</sup>

How much equity would we expect trading companies to take? Trading companies make money on commissions earned on the trade they facilitate, so their goal is to generate new trade or to consolidate their hold on old trade, not to earn money on their manufacturing investments.<sup>4</sup>

Taking majority or full equity positions would have two deleterious effects for trading companies. First, the more resources devoted to one affiliate, the less that can be invested elsewhere. Second, taking a 100 per cent ownership stake in a manufacturing firm weakens the incentives for the former owners, as they no longer have a strong claim on the profit stream for which they would otherwise be responsible. The less the trader knows about the business, the greater the opportunity for the employees to shirk. Hence, it makes sense for the trading company to own as little as possible of any given manufacturing firm.

On the other hand, the trading company will want to hold enough of the manufacturer's shares to retain the contract to buy from and/or to sell to that firm. Trading companies will also want to hold enough of the stock of new suppliers to persuade them to produce the needed supply. Last, trading companies may end up owning more of their manufacturing suppliers/customers than they like because the traders took the firm as collateral or because they are unable to sell off their shares in emerging firms and recover their capital.

### **The manufacturing investments of Japanese trading companies in the United States**

The crux of the preceding argument is that trading companies invest in manufacturing to: (1) safeguard their right to handle the trade of existing

manufacturing customers; and (2) help establish new manufacturers who will need their services. Because their goal is to secure trading rights, not to invest in manufacturing, the traders' stakes should typically be minority ones. Their stakes in manufacturing firms are likely to decrease with the passage of time for two main reasons: first, because their stake in emerging firms is especially crucial at initial stages, but can be safely sold when the business takes off; and second, because their role as trade intermediary loses its importance as markets become more established and having a stake in a customer may no longer be sufficient to guarantee them trading rights.

The preceding suggests that we should observe systematic differences between the stakes taken in US manufacturing firms by traditional manufacturing multinationals and those taken by trading companies. Stakes taken by trading companies should be principally minority ones, while a higher percentage of those of manufacturing multinationals should be full ones. The evolution of these stakes should also be different. Traditional manufacturing firms enter foreign countries through minority stakes to learn about foreign markets from their local partners. Once they acquire this knowledge they typically transform these partial stakes into wholly-owned subsidiaries. On the other hand, the typical evolution of the manufacturing investments of trading companies should be one of stability or decrease. When stakes of traders are wound up, they should be through a sale to the former joint venture partner. Minority stakes of non-trading firms are more likely to disappear because of the bankruptcy of the affiliate, or because of the sale of the stake to a third party.

Table 12.1 shows the distribution of the 370 Japanese equity stakes taken at entry in the 313 Japanese-owned affiliates that were manufacturing in the United States on 31 December 1980.<sup>5</sup> Seventy-one of these stakes (19 per cent of the total) were held by Japanese trading companies and 299 (81 per cent of the total) by Japanese non-trading investors. Mitsui was the trading company with the largest number of US manufacturing stakes (27), followed by Marubeni (10) and Mitsubishi (7). 61 per cent of the equity stakes taken at entry by Japanese trading companies were minority ones, compared to 20 per cent for Japanese non-trading companies. Thus, the pattern of manufacturing investments by Japanese trading companies differs significantly from that of their non-trading counterparts in so far as it consists principally of minority equity stakes. Table 12.2 shows the ownership patterns of the 54 equity stakes Japanese trading companies took in US manufacturing affiliates in 1988–89. Trading companies were even more apt to use minority investment in this later period.

What is the logic of these trading company investments? Most of them are joint ventures with Japanese and/or American firms. All of them have been made to expand trade: trade between Japan and the US, and increasingly between the United States and the rest of the world. Japanese trading companies have invested in US manufacturing firms to expand or to replace traditional Japanese exports to the United States. Typical of this first category



Table 12.1 Japanese equity stakes at entry, affiliates in business in 1980

Equity Stake at Entry	Trading Company		Non-Trading Company		Total	
	no.	%	no.	%	no.	%
Minority	43	60.6	61	20.4	104	28.1
50	6	8.4	22	7.4	28	7.6
Majority	7	9.8	36	12.0	43	11.6
100	15	21.2	180	60.2	195	52.7
Total	71	100.0	299	100.0	370	100.0

Table 12.2 Japanese trading company equity stake at entry for affiliates in business in 1980 and for new entries in 1988-89

Equity Stake at Entry	1980 population (at entry)		Entries in 1988-89	
	no.	%	no.	%
Minority	43	60.6	40	74.0
50	6	8.4	2	3.7
Majority	7	9.8	0	0.0
100	15	21.2	11	20.4
Unknown*	0	0.0	1	1.9
Total	71	100.0	54	100.0

Note: \* The one unknown entry in 1988-89 is Mitsubishi Freestate Class

are their investments in steel service centres and in steel mini-mills. In the 1970s Japanese trading companies helped Japanese steel manufacturers establish steel mini-mills in America and took a minority stake in these investments. Examples in our database are Auburn Steel in Maine (Sumitomo and Kyoei Steel) and Tamco in California (Mitsui and Tokyo Steel). Setting up mini-mills in the US was a clever way of avoiding trade barriers, as they made use of two inputs, electricity and scrap metal, that were cheaper in the United States than in Japan (Christelow 1995:95). Later, in the early to mid-1980s, Japanese trading companies, occasionally with minor participation by Japanese steel companies, set up in the United States a number of steel service centres to cut and blank steel imported from Japan or made in Japanese-owned plants in the US. These centres supply the trading companies' automotive customers, both Japanese transplants and the US Big Three (Kenney and Florida 1993:184-5).

A second reason for the stakes taken by Japanese trading companies in US manufacturing was to develop American exports to Japan. Japanese trading companies, well aware of Japanese needs and of US cost conditions, were in a position to link US firms with Japanese customers. To stimulate American exports, they have taken strategic stakes in US firms. Aluminium production is energy-intensive. Japanese firms have typically relied on oil-fired power plants, while US producers have used hydroelectricity. The 1974 oil shock hit domestic Japanese producers harder than their American counterparts. Consequently, Mitsui and Nippon Steel purchased half of the aluminium business of Amax, an American firm, and set up Alumax as a joint venture to supply their Japanese customers with primary aluminium and other aluminium products (Christelow 1995:95). Similarly, Japanese trading companies, such as Marubeni, set up in the 1970s fish canneries and freezing plants in Alaska (Wilkins 1994). These plants tap abundant stocks of previously unused fish, such as pollock and arrowtooth flounder, to produce *surimi* and other fish products for Japanese and other customers (Chojnaki 1997). More recently, Japanese trading companies have taken strategic stakes in American high-tech firms. Mitsui, for example, has set up a joint venture with a Massachusetts manufacturer of high-tech medical devices and secured approval of the Japanese Ministry of Health for imports of that firm's medical lasers into Japan (Carlson 1989).<sup>6</sup>

The pattern of Japanese trading company investment we observe in the US thus fits the logic described earlier. Japanese traders have taken minority equity stakes in US and/or Japanese concerns to protect their trading rights and to motivate suppliers and customers to invest in new value chains.

### Evolution of trading company manufacturing investments

As industries mature, suppliers gain confidence, clients deal directly with each other, and the trading company identifies new areas for investment, we would expect equity holdings by Japanese trading companies in US-based manufacturers to decrease. In contrast, conventional foreign direct investment theory would predict that Japanese non-trading investors would joint venture to tap the locals' knowledge of the host country and, eventually, would take full control of the venture (Stopford and Wells 1972). The general trend for traders should be to hold or divest their equity whereas non-trading investors should generally increase their stakes.

Table 12.3 shows the evolution of equity stakes of both trading and non-trading investors. We define decrease or increase in the level of the ownership stake as passage to a different ownership category with the categories defined as follows:

Zero	=	under 5 per cent
Minority	=	5 per cent and over, but less than 49.5 per cent

50	=	49.5–50.5 per cent
Majority	=	over 50.5 per cent and less than 95 per cent
100	=	95–100 per cent

For example, a stake that goes from 48 to 50 is coded as increasing, while one that jumps from 10 to 48 is coded as unchanged. This is consistent with the fact that the impact of ownership level on control is highly discontinuous across ownership levels (Hennart 1991).

Japanese trading companies did decrease their equity stakes.<sup>7</sup> The sharpest difference between the two categories is in the proportion of equity stakes that goes to zero, 41 per cent in the case of trading companies versus only 17 per cent in the case of non-trading investors.<sup>8</sup> Adding the number of decreases across categories that are shy of complete divestment to the number of complete exits, the results are 40.8 per cent for trading companies versus 18.4 per cent for non-trading investors. Inversely, the percentage of ownership links that increased was higher in the case of non-trading (10.0 per cent) than in the case of trading companies (8.5 per cent).<sup>9</sup>

What explains the large number of Japanese trading company stakes going down to zero? The simplest explanation is that the affiliate in which the trading company has a stake experiences difficulties, and must be liquidated. Trading companies may also end up selling their stake to their majority

*Table 12.3* Changes in Japanese equity stakes in US manufacturing affiliates, from entry to 1989

<i>Change in Equity, Entry-1989</i>	<i>Trading Company</i>		<i>Non-Trading Company</i>		<i>Total</i>	
	<i>no.</i>	<i>%</i>	<i>no.</i>	<i>%</i>	<i>no.</i>	<i>%</i>
To Zero	29	40.8	51	17.1	80	21.6
Decrease across categories	0	0.0	4	1.3	4	1.1
Subtotal, Decrease across categories	29	40.8	55	18.4	84	22.7
No change across categories	36	50.7	214	71.6	250	67.6
Subtotal, Decrease or No change across categories	65	91.5	269	90.0	334	90.3
Increase across categories	6	8.5	30	10.0	36	9.7
Total	71	100.0	299	100.0	370	100.0

partners. There are three possible scenarios here. Trading companies may be 'booted out' when their expertise is no longer needed (Hayashi and Robock 1982). Trading companies may also find that the investments they made to secure sources of supply are no longer needed, and that they can sell back their equity stake to their partner and still safeguard their trading rights. This divestment also liberates funds for investments in new ventures. Hence Mitsui sold its 45 per cent stake in Alumax back to Amax in 1986 and replaced it with a long-term supply contract (see Chapter 11, this volume). While a trader could sell its stake to a third party, we would expect that most trading companies will divest by selling their stake to their majority joint venture partner. This is because the majority partner probably has the right of first refusal on the trading company's shares and because the trader will seek to continue to handle the trade of its erstwhile partner. This would be more difficult if the stake were sold to a third party.

In contrast, and as was stated above, the non-trading Japanese investor is more likely to increase ownership in affiliates. Exit is more likely to result from adverse economic conditions or from errors made at entry. Hence, we expect a higher proportion of non-trading company exits to be due to liquidation/bankruptcy and a lower proportion to be due to sales than will be the case for trading companies.

Table 12.4 shows how minority equity stakes in our database were unwound by their parents. A higher percentage (87.1 per cent) of the minority stakes held by trading companies were sold to their majority partner than in the case of non-trading Japanese investors. Only one of the 21 stakes (4.3 per cent) sold by trading companies was sold to a known party external to the joint venture, compared with six out of 28 (19.4 per cent) in the case of non-trading investors. These statistics are therefore consistent with our story.

## **Conclusions**

Why and when will trading companies invest in manufacturing concerns? Trading companies, be they brokers or resellers, invest in manufacturing, at least initially, to support trade, not because they have special expertise in manufacturing. When they take equity stakes in their manufacturing suppliers and customers, it is for two main reasons. Trading companies take stakes in existing customers to prevent them from dealing directly with each other and doing without their services. Traders thrive on ignorance and chaos. As markets mature, buyers and sellers will forge direct links. Because the existing business of trading companies is continually threatened by extinction and its margins are so thin, traders are continually motivated to find new areas in which they can play their role of intermediary. These new value chains will require financing, which the trading company, because of its broad vision and superior intelligence, and because of its ability to configure the whole chain, is in a privileged position to provide.

Table 12.4 Divestment of Japanese minority stakes

1989 Status of Minority Stake at Entry	Trading Company		Non-Trading Company		Total	
	no.	%	no.	%	no.	%
Liquidated	1	4.3	1	3.2	2	3.6
Sold to joint venture partner	20	87.1	22	71.0	42	77.8
Sold to third party	1	4.3	6	19.4	7	13.0
Sold to unknown	1	4.3	2	6.4	3	5.6
Subtotal, Sales	22	95.7	30	96.8	52	96.4
Total	23	100.0	31	100.0	54	100.0

Trading companies will thus take strategic equity stakes in both mature and emerging value chains, but their stakes will be mostly minority ones. In mature businesses, these stakes will be just sufficient to assure them trading rights. In newly established value chains, the stakes will have to be large enough to reassure suppliers and customers and to make up for the lack of traditional bank financing.

As value chains mature, the manufacturing stakes of traders will go down, both because traders will lose their role of intermediators, and because they will be able to reduce the stakes they have taken to set up manufacturers in new value chains. By selling these stakes, traders will cash in on their foresight, and will obtain the resources necessary to start a new set of emerging value chains. Trading company stakes in manufacturing will therefore be, on average, short-lived. Divestment, an unintended consequence for non-traders, is part and parcel of trading company strategy.

A careful look at the 370 stakes taken by Japanese trading and non-trading parents in US manufacturing affiliates shows that Japanese trading companies exhibited a greater preference for minority stakes than their non-trading counterparts. These stakes were invariably taken to support their trading business. Over time, trading companies were also more likely than Japanese manufacturers to reduce their stakes, and when these were unwound, to do so by selling them to their former joint venture partners.

While our observations are limited by the specificities of time and place, they seem consistent with the findings of business historians who have studied the investment strategies of British and German traders (see Chapters 3, 4 and 6, this volume; Drabble 1973; van Helten and Jones 1989; Miller 1994)<sup>10</sup>. Why, and when traders invest in manufacturing, and whether these investments follow a general logic that is applicable to all trading firms will, however, continue to pose a challenge to business historians.

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## Notes

- 1 '[I]t's the classic problem of the small businessman. People are queuing at the door to take his product but he does not have the working capital to make the thing and commercial banks are very unsympathetic. They want assets, they want a balance sheet, which has no relation to the business a company can generate' (Carlson 1989).
- 2 This has been called 'loan and import'.
- 3 A fourth reason why a trading company may find itself owning equity in a supplier/customer is that the latter has gone bankrupt and the trading company has picked up the enterprise as collateral for its loans. We would expect this situation to be transitory and the trading company to eventually sell off all or part of the affiliate.
- 4 According to Arthur Clauser, adviser to the president of Mitsui USA: '[T]rading companies aren't so much interested in a high return on investment as they are on increasing trade flows. To the extent they can do this, they're quite content to get a return on investment of 1 to 2 per cent' (Carlson 1989). With the exception of Mitsubishi, that has made good returns on its investment in Brunei natural gas, most Japanese trading companies have earned very low rates of return on their equity investments (Kojima and Ozawa, 1984: 24).
- 5 The unit of analysis is the equity stake in a Japanese-owned US manufacturing affiliate. An affiliate that has two Japanese parents will generate two stakes. This census of manufacturing plants wholly or partially owned by Japanese firms in the US was compiled mainly from secondary data published by the Japan Economic Institute (JEI). Other sources such as the *JETRO Directory of Japanese Affiliates in the United States and Canada* were consulted. Mail, Fax and telephone inquiries were made of the subsidiaries or of their Japanese parents. We are confident that our database is very close to being a census of all Japanese equity stakes in US manufacturing at year-end 1980.
- 6 This investment, like many others made by trading companies in the US high-tech sector in the late 1980s, is not included in our database.
- 7 Information on the change in equity stakes was obtained from *Mergers and Acquisitions, Predicasts' F & S Index of Corporate Change*, the *Lexis-Nexis* database, and numerous phone and mail inquiries to the subsidiaries and their parents. In the case of discontinued affiliates, we confirmed this event with the City Hall, the Post Office, and/or the Chamber of Commerce of the last known location. Our results are robust to other definitions of ownership change. For example, if we look at changes across ownership deciles, 44 per cent of the stakes taken by trading companies declined, 46 per cent stayed within the same decile, and 10 per

- cent increased. The figures for non-trading companies were 19 per cent, 69 per cent and 12 per cent, respectively.
- 8 Our findings answer the question raised by Yasumoro (Chapter 10, this volume) as to whether the investments of trading companies have a higher mortality rate than those of traditional Japanese investors. In our case they do.
  - 9 Because our data form a census, no significant tests are necessary to establish the presence of statistically significant differences. One explanation for increases in trading company stakes is that our unit of observation is the affiliate, not the project. A given affiliate may be the institutional structure for more than one project. We would expect the trading company stake in the affiliate to remain stable or to increase if the trading company and its partners are using the subsidiary to undertake new projects. We are indebted to Tom Roehl for this suggestion.
  - 10 The number of equity stakes in our database, while large enough to allow us to generalise, is small enough to be influenced by specific events, such as Mitsui Trading and Nippon Steel's sale of 27 minority equity stakes to Amax in 1986.

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