MARKETING THROUGH THE JAPANESE DISTRIBUTION SYSTEM

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INTRODUCTION

This study arose, initially, from the continuing debate over Japan's ongoing balance of payments surpluses by an international economic community which demands "balanced trade." Complicating this issue is the fact that the industrialized countries not only desire a balance in terms of dollar value but also in the "quality" of goods traded. The desire to trade manufactured goods or highly processed materials arises, of course, from the countries' desire to provide higher quality and better paying jobs at home and to gain greater value from their raw materials. This poses a particularly difficult complication for Japan since only roughly 20 per cent of its imports are manufactured goods, compared to 50 per cent for the U.S. and 40 per cent for the E.E.C.[1]

In the wide-ranging debate over the reasons for the above situation, the nature of the Japanese distribution system has increasingly been noted as a major problem area for the foreign producer seeking to penetrate the Japanese market. This study is an attempt to identify the nature of the problems faced by the foreign supplier in selecting the appropriate local representatives, gaining access to the relevant market segments, and in managing to compete successfully once entry to the market has been gained.

The results reported in this paper arise from structured interviews with the senior executives of thirty firms now operating in Japan as well as the commercial staffs in the Canadian and American embassies. These structured interviews were

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[1] Ministry of International Trade and Industry, Japanese Markets: The Myth and Reality (Tokyo: MITI, September 9, 1977), pp. 1-2.

designed to determine the issues involved in obtaining adequate representation from the members of the channels of distribution in various performance areas developed during a previous study.[2] The firms were chosen to represent a wide cross-section of industries and ownerships. In addition to supplier firms, interviews were also conducted with certain Japanese middlemen in order to ascertain the extent to which the views expressed by the foreign manufacturers met with agreement by the trade. For purposes of reporting, all firms will remain anonymous.

Since the results are based on a limited number of observations, they do not constitute an exhaustive treatment of the problem. Also, the wide collection base means that many of the problems noted may well characterize one industry but would not present a major difficulty to firms in another sector -- e.g. consumer versus industrial markets. I have, however, tried to keep the report centered as much as possible on those issues which were generally recognized as being of common concern.

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[2] See R. Ross, "Selection of the Overseas Distributor: An Empirical Framework," International Journal of Physical Distribution (Autumn, 1972), pp. 83-90. These performance areas are outlined, by topic, in the "Operational Issues" section of this paper.

OVERVIEW

For purposes of introduction, a general overview of the existing Japanese distribution system would seem in order. While the Japanese distribution systems vary by commodity, industry, and company, there is one generalization that seems to hold throughout -- the channels have many layers of middlemen and thus are extremely long. Historically, the multi-layered wholesale system arose because of the difficulty of communicating and transporting goods over long distances, and because of the large number and small size of most retail outlets, which could be best supplied by small tertiary wholesalers in the immediate vicinity.

The fact that the system has proven highly resistant to change in the past undoubtedly results from a number of factors. In the past, the middlemen's basic philosophy appears to have slowed change,

> -- the monopoly status and alliance with the political elite began to dull the initiative and ingenuity of the merchant class. Their mentality became characterized by a strong conservative orientation and well-entrenched tradition.[3]

Japan's relative isolation also meant that many trends in western business practices did not appear until fairly recently. However, many businessmen today feel that the isolation of the past has produced a situation where the Japanese group together as an identity and the foreigners are taken together as a separate identity. This, in turn, continues to insulate the system from forces of change from abroad. Finally, as we shall see shortly, the distribution system has been used to a great extent to create jobs for the potentially unemployed and thus

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[3] M. Y. Yoshino, The Japanese Marketing System: Adaptations and Innovations (Cambridge, Mass.: The MIT Press, 1971), p. 6.

receives support from many sectors of the society because of this job-creating function.

Description of the Japanese Distribution:

The first characteristic that must be noted is that the system consists of a very large number of small enterprises as the following table indicates.

Table 1: Commercial Activity

	Number of shops (A)	Number of regular employees (B)	Annual sales ¥ million (C)	Employees/ Shop	Sales/ Employee ¥ million
Wholesale	259,863	2,988,351	105,835,461	11.5	35.4
Retail	1,494,643	5,123,802	28,095,238	3.4	5.5
Total	1,754,506	8,112,153	133,930,699		

Note: Eating and drinking establishments are not included.

Data: MITI, Census of Commerce, 1972.

As of July 1972, Japan had 259,863 shops engaged in wholesale trade, compared with 310,000 in the United States (U.S.), 110,000 in West Germany and 90,000 in France. Retail stores numbered 1,494,643 versus 1,763,000 in the U.S. The average number of employees per store was 3.4 persons in Japan compared to 5.3 in the U.S., 5.1 in Britain and 5.4 in West Germany. The small size of these stores is apparent in the ratio of retail stores to population which is 71 people per store, compared with 143 in the U.S., 109 in Britain and 141 in West Germany. These figures certainly arise out of the 'neighbourhood, family-owned and operated nature' of Japanese retailing.[4] Also worth noting is the fact that roughly half of the Japanese retailers are engaged in the selling of food and beverages, which can be seen as being indicative of the "local neighbourhood shop" type of

[4] Fuji Bank Bulletin, Japan's Distribution System (April, 1975), p. 65.

business in question.[5] As a final point of comparison, the reader may get the "flavour" of the situation by noting that a U.S. equivalent of the Japanese system would emerge if 85 per cent of all U.S. wholesalers and retailers were located in the state of California!

Although small enterprises dominate the distribution system in numbers, the wholesale trade is also characterized by the dominant position occupied by the large general trading companies. For example, the six largest trading companies (Mitsubishi, Mitsui, Marubini, C. Itoh, Sumitomo, Shoji Kaisha, and Nissho Twai) account for 17 per cent of all wholesale sales. Particularly strong is their position in foreign trade; they account for 40 per cent of all exports and 50% of all imports.[6] This raises serious issues relative to channel access and control which we will see later.

The impact of the various levels in the channel can also be seen in Table 1 where the value of yearly sales of wholesalers is 3.8 times higher than that of retail stores. Since retailers normally deal solely in consumer goods rather than the whole range of products as do wholesalers, some difference is to be expected. But the sales of wholesale establishments in the U.S. is only 1.5 times higher than those of retail stores. The reason for the higher wholesale sales level is the complex structure of the Japanese distribution system in which the same commodity passes through a number of wholesale stages before reaching the ultimate buyer.

Table 2 gives an analysis of the wholesale sector.

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[5] Yoshino, The Japanese Marketing System, p. 74.

[6] Fuji Bank Bulletin, Japan's Distribution System, p. 66.

Table 2: Sales Breakdown of the Japanese Wholesale Sector

	Supply Sources	Sales by Customers	Number of establishments	Annual sales ¥ billion	Share in sales total A or B	A+B	A+B+C
Primary Wholesalers	Manufacturers & imports	Total (A)	69,302	32,957.3	100.0	67.6	53.0
		Wholesalers	19,975	14,330.9	43.5	29.4	
		Industrial users	16,277	9,748.4	29.6	20.0	
		Exports	1,376	778.0	2.4	1.6	
		Retailers	31,476	8,100.0	24.6	16.6	
Secondary Wholesalers	Wholesalers	Total (B)	84,854	15,789.7	100.0	32.5	25.4
		Wholesalers	19,471	5,746.2	36.4	11.8	
		Industrial users	24,461	3,635.7	23.0	7.5	
		Exports	357	170.7	1.1	0.4	
		Retailers	40,565	6,237.1	39.5	12.8	
Other Wholesalers		Total (C)	22,590	13,470.2			21.6
Grand Total (A+B+C)			176,746	62,217.2			100.0

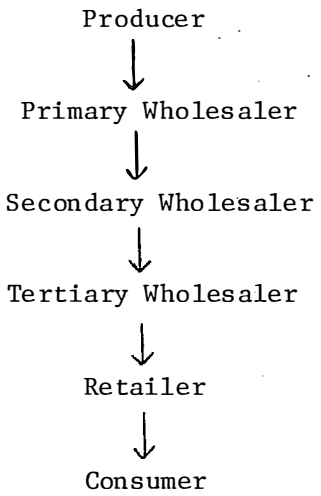
Source of data: MITI, Census of Commerce, 1972.

In the composition of the sales of primary wholesalers, sales to industrial users account for about 30 per cent of the total, sales to retail shops make up about 25 per cent, and sales to secondary wholesalers account for another 44 per cent. But in the structure of the sales of secondary wholesalers, those to other wholesalers again constitute 36 per cent of sales which means that there are many commodities which go through at least three wholesale stages. Compared with the 44 per cent for which intermediate wholesaler sales account in Japan, their share is only 15 per cent in the U.S., so that the Japanese system certainly implies longer and given the additional margins being levied by each level, more costly distribution channels.

Flow of Goods:

The above statistical description of the Japanese distribution system has outlined the extent of the problem of a multi-layered channel. The issues which are created as a result of this type of organization will be the subject of the balance of this paper.

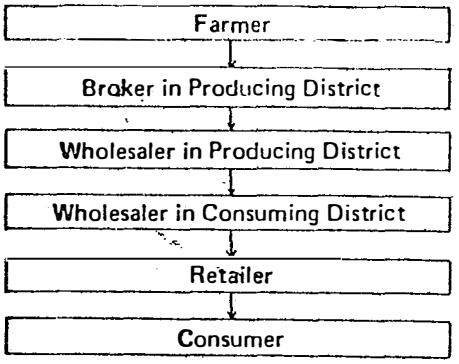
A typical Japanese distribution pattern for a consumer good may be represented as follows:



Typically the large primary wholesalers are those of the central or national variety located in the main cities like Tokyo or Osaka, and they frequently act as producers' sales representatives for specified commodities. The secondary wholesalers may be regarded as local primary merchants and are located in the large and medium-sized provincial cities, stock goods from the national wholesalers, and resell them mainly to the small wholesalers. The tertiary wholesalers are provincial secondary merchants who sell and deliver to the local retailers. Thus the "typical" flow for an agricultural product would look as follows:

Exhibit 1:

Pattern of Distribution of Agricultural Products

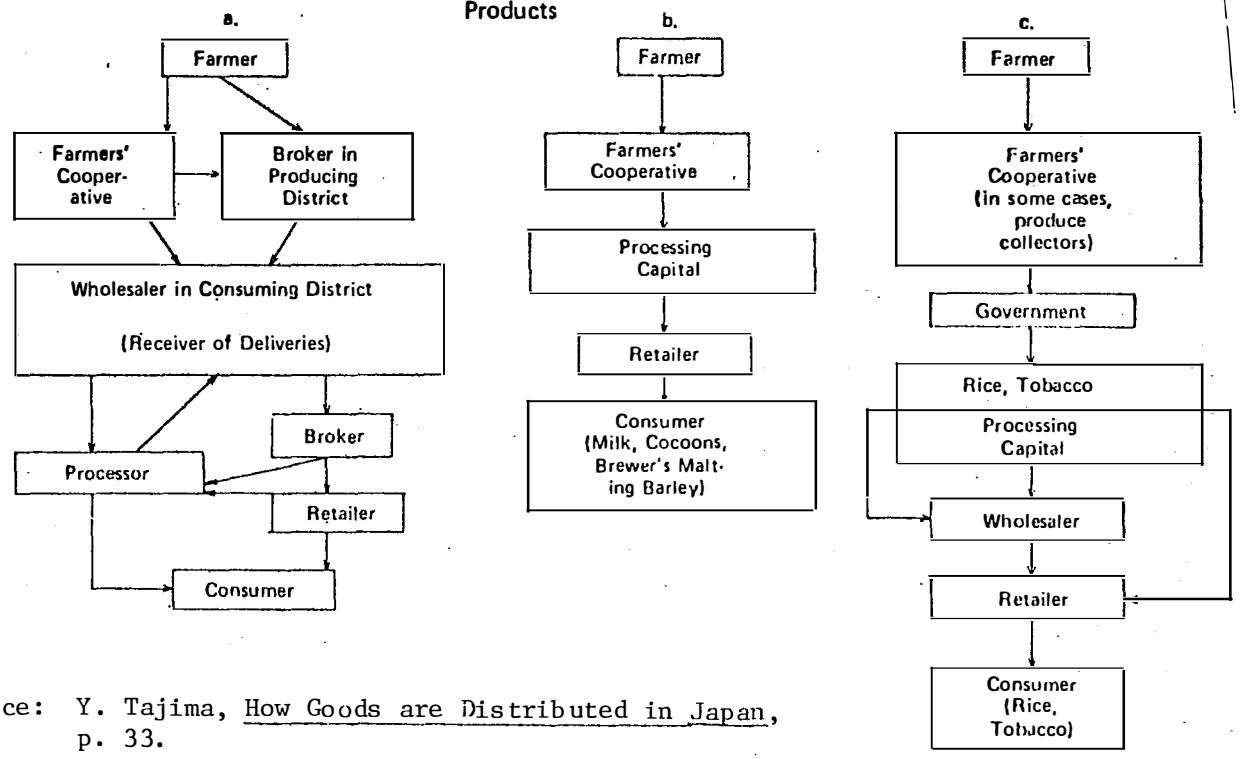


Source: Nosambutsu Kakaku no Genjo Bunseki (Analysis of Present Prices of Agricultural Products) Agricultural Statistics Association, Reprinted in: Y. Tajima, How Goods are Distributed in Japan (Tokyo: Walton-Rideway & Co., 1971), p. 31.

However, the above is really an oversimplification. The following exhibit gives an illustration:

Exhibit 2:

Three Distribution Patterns for Agricultural Products



Source: Y. Tajima, How Goods are Distributed in Japan, p. 33.

In the case of some products like rice and tobacco, the government intervenes directly as the sole buyer; with others like milk, cocoons (silk), and brewer's malting barley, the processing firms (i.e. dairies, textile mills, and breweries) handle the cargo booking directly; while in the case of fruits and meats, the agricultural producers' cooperatives are highly developed and act as the primary wholesaler.

Yet another dimension of the problem is the number of possible alternative flows even within an established system. The next exhibit points out the possibilities of these flows for a relatively simple product such as lumber.

Exhibit 3: Lumber Flow Chart

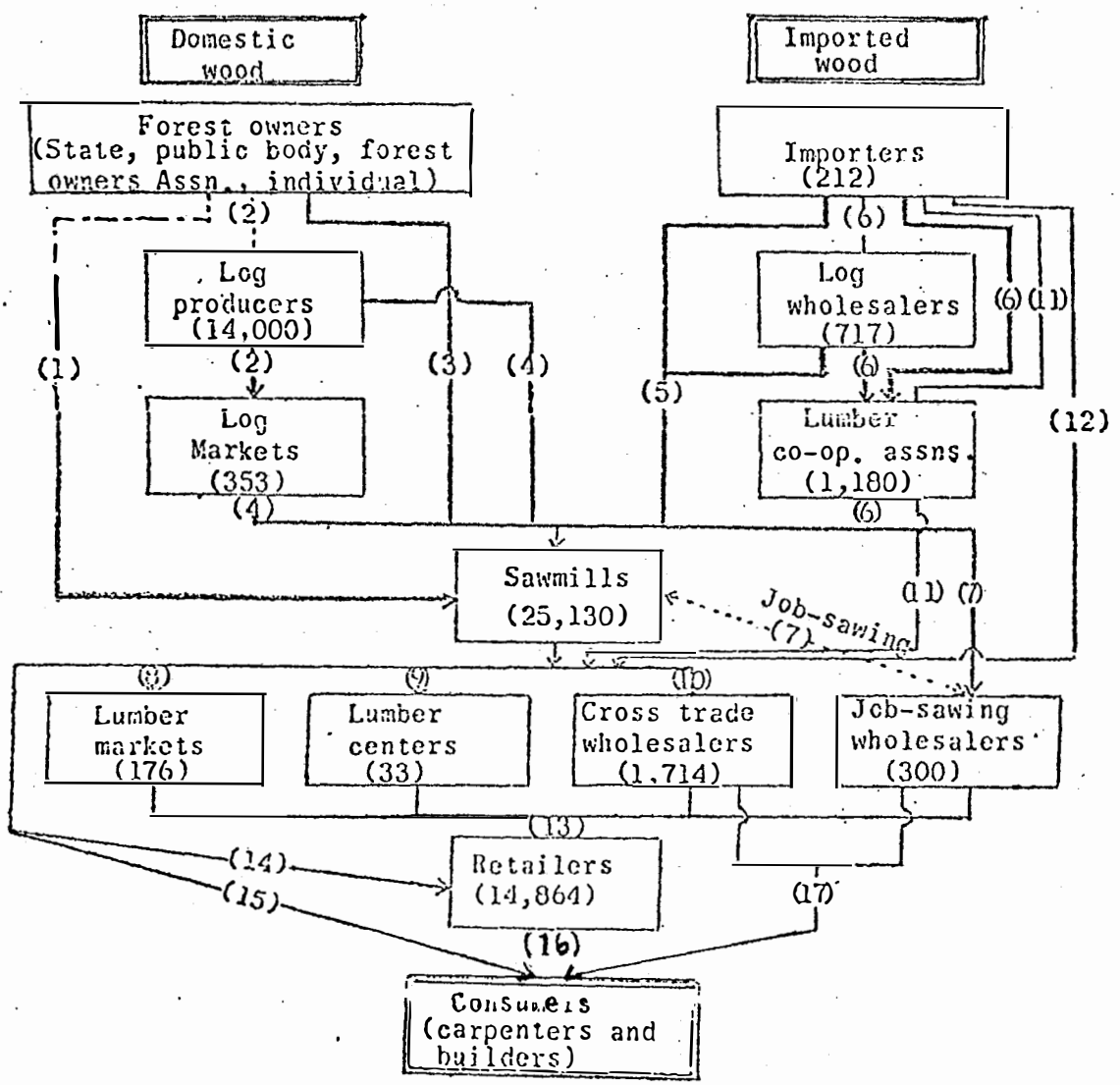


Exhibit 3 (cont'd)

Legend

_._._._ Dotted thick line indicates distribution of standing tree (uncut).

Thick line indicates distribution of logs

Thin line indicates distribution of lumber

------- Thin intermittent line indicates job sawing

[152] Figures indicates the number of dealers or places

(1) Sawmillers purchase standing trees from forest owners and undertake log production and carry them into the mill.
(2) Log producers purchase standing trees from the forest owner and sell logs produced at the log market.
(3) Sawmillers purchase logs which the forest owners produced.
(4) Sawmillers purchase logs from log producers or log market.
(5) Sawmillers purchase imported timber from importers or log wholesalers.
(6) Timber Cooperative Association purchases imported timber from importers or log wholesalers and sell them to sawmillers
(7) Job sawing wholesaler makes the sawmill to do job sawing of logs purchased.
(8) - (13) Timber market, timber center and cross trade wholesaler purchase lumber from sawmills, lumber cooperative association and importers and sell them to retailer. Most lumber markets are doing their business under consignment.
(14) Sawmillers often sell lumber directly to retailer.
(15) - (17) Consumers often purchase lumber which they need from retailer but sometimes they purchase from sawmillers, cross trade wholesalers or job-sawing wholesalers. In most cases, large consumers purchase lumber from wholesaler directly.

Source: Internal Document from one of the sample firms.

Another example of this crossing-over of distribution lines would be the presence of concessionaires in most department stores. Some 10 per cent of department stores' total sales are accounted for by these independent operations leasing space in the parent store.

> Typically, the concessionaires handle widely known specialty products, such as foods, which have high sales potential. As specialty stores in Japan are not generally efficient and modern operations, they benefit from the attractive surroundings and large numbers of customers coming to the department stores; conversely, the department stores feel that the well-known names of the specialty products attract customers to

the department stores who then shop for other items as well.[7]

In short, the problem facing the foreign manufacturer is not only the number of layers within the channel, but also trying to ascertain how his particular product will, and should flow through the various permutations and combinations. In this quest the Japanese middlemen are typically not very helpful since they understand, like their counterparts in many other countries, that your ignorance is their power.

Cost Efficiency of the Distribution Structure:

There appears to be considerable concern about the costs of moving goods through the Japanese distribution system. Consumer groups deplore the alleged inefficiencies of the system as the source of high and rising prices. Japanese businessmen defend their companies from "dumping" charges abroad by explaining that domestic prices for their goods are higher than prices in foreign markets because of the high cost of distribution, and not because of policies directed towards expanding foreign markets. Foreign businessmen and, in turn, their governments charge that the system acts as another obstacle to doing business in Japan. As a result, successive Japanese governments have voiced concern and intentions for action. Yet, as the following chart indicates, the problem of the consumer price spiral continues.

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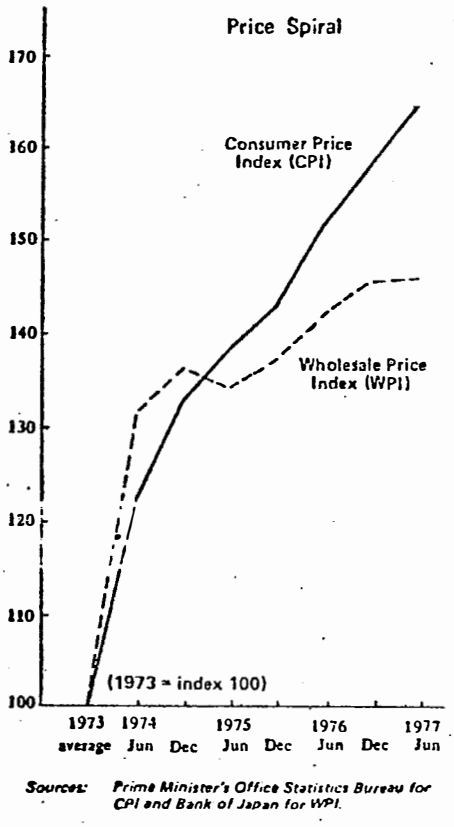
[7] U.S. Department of State, The Japanese Distribution System (Tokyo: American Embassy, Airgram -- No. A-1065, Nov. 7, 1972), p. 9.

Exhibit 4:



To understand why the problem is difficult to overcome one needs to look at the causes of the inefficiency. Professor Tajima has classified the problem in terms of three "lags" within the system.[8]

Lag on the part of the distributors themselves. Manifestations of this include: "non-professional" qualities more closely identifiable with a family trade or an individual vocation, lack of foresight, and a conservative attitude toward innovation.

Lag in the constitution of distribution. Specifically, the distribution structure is composed of wholesalers and retailers too small in scale and too large in number, and at the wholesale level in particular, several classes of wholesalers exist and complicate the distribution channel.

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[8] Y. Tajima, How Goods Are Distributed in Japan, pp. 25-40.

Lag in the manner in which distribution activities are carried out. Here three characteristics need to be mentioned. The use of labour intense procedures. Reasons for this would include: the excess of labour in the past and in particular the fact that surplus labour flowed into the commercial segment of the economy. Wages have traditionally been lower than in manufacturing and the distribution sector has been a refuge for the unemployed during recessions, thus encouraging labour intensive techniques. The lack of standardization in such areas as packaging, lot sizes and so on. Finally, the lack of systems within the channel. That is, systems of established procedures and functions to be performed by each member of the channel.

In addition to these lags, the organizational structure of the channel may add even greater costs than would be necessary. A prime example of this issue is the question of imported beef. Exhibit 5 illustrates the flow and costs involved.

First, all imported beef must pass through the Livestock Industry Promotion Corporation (LIPC) whose job it is to stabilize beef prices. Thus,in early 1978, the LIPC adds on ¥600 per kilogram to bring the wholesale price of the imported beef up to roughly the same level as the domestic beef. The LIPC then sells to only 18 designated brokers (national federations). However, in practice, it seems that most of the quotas go to only six brokers.[9] These brokers then sell the beef to provincial and local meat wholesalers, some of whom may be part of the original brokers' own organization -- a point of certain scandal.[10] In short, the system is structured and supported in such a way as to allow price inflation in what is known as 'niku-korogashi' or meat rolling.

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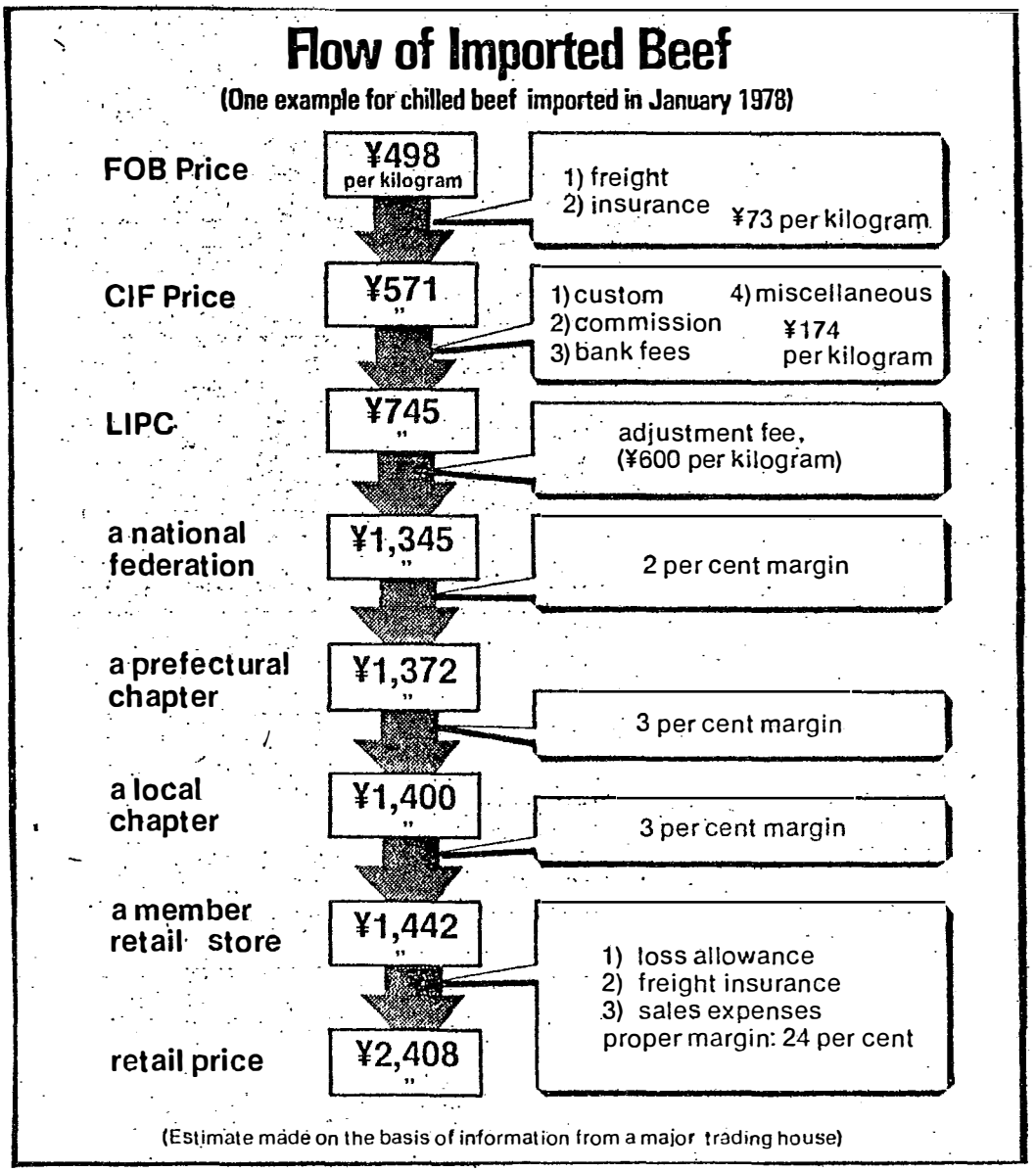
[9] The Japan Times, "Beef Maze Hides Profiteering," March 19, 1978.

[10] The Japan Times, "Beef Baron's Empire Exposed in Diet," Feb. 2, 1978.

Exhibit 5:



Source: The Japan Times, March 19, 1978, p. 3.

While beef is certainly a unique problem, the issue remains. Too many levels are allowed to charge full margins with very little provided in return. This will be dealt with again later in the paper under the question of functions performed.

The major problem to arise out of this issue is its impact on the price of foreign imports. In a study conducted by the Japanese government it was clearly established that the Japanese distribution system produces higher prices on imported products than do other countries' distribution systems.[11] For example: the price of a certain West German auto is double the import price as compared to 1.38 fold in the U.S., 1.51 in Britain and 1.81 in France, chocolate is 3.17 fold the import price, and the import price of whiskey constitutes 12 per cent of the retailers price. And, with the low profits of many of the middleman, this situation has not changed dramatically with the rising value of the yen as the system absorbs through higher margins a great deal of the differential.

Finally, it is sometimes argued that the high costs drive up the final price for all sellers, Japanese and foreign, and thus does not represent a unique barrier to the off-shore manufacturer. However, the foreign manufacturer often has to gear up specifically for the Japanese market and thus needs high minimum sales to justify the set-up costs; yet at the high prices these sales may not occur. The Japanese firms, on the other hand, are already geared to their home market.

Control over Channel Members:

The issue of control was previously touched upon relative to the significant role played by the trading houses. The importance of this issue for the foreign manufacturer involves not only gaining access to the market in general, but also in selecting the "right" middleman he needs to know "who owns whom."

First of all it is difficult, if not impossible, to know the complete list of subsidiaries and affiliates of any major company. While the relationship between a parent firm and its direct subsidiaries is fairly clear, relationships

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[11] The Japan Economical Journal, "Complex Marketing Set-up Prevents Drop in Prices of Imported Goods."

where minority equity by the parent, with minority equity by one or several subsidiaries, combines to give control over still another firm, is much less clear. To carry this further, where the subsidiaries of the parents' subsidiaries, and their subsidiaries down the line are all taken into consideration, relationships with the starting point become almost impossible to trace. Some examples of subsidiaries of major firms are shown in Exhibit 6, but it should be noted that parent firms only list major subsidiaries, leaving the whole area of affiliates unclear.

Exhibit 6[12]

1965 Study - 22 of Top 100 Firms

	PARENT COMPANY EQUITY						
	10-29%		30-49%		50% & Over		Total
Taiyo Fisheries	10	companies	15	companies	43	companies	68
Hokkaido Colliery & Steamship	5	"	7	"	42	"	54
Nippon Oil	6	"	3	"	13	"	22
Nippon Mining	5	"	10	"	26	"	41
Furukawa Electric*	11	"	6	"	22	"	39
Yawata Steel	19	"	18	"	18	"	55
Ishikawajima-Harima	7	"	6	"	14	"	27
Hitachi Mfg.	10	"	7	"	59	"	76
Mitsubishi Chemical	7	"	8	"	12	"	27
Bridgestone Tire	2	"	12	"	115	"	129
Asahi Glass	3	"	2	"	16	"	21
Kajima Construction	5	"	3	"	11	"	19
Kirin Beer	0	"	0	"	15	"	15
Toyo Rayon	5	"	2	"	14	"	21
Mitsui & Co.	48	"	38	"	48	"	134
Mitsukoshi Department Store	0	"	0	"	13	"	13
Nippon Express	27	"	24	"	92	"	143
OSK Mitsui Shipping	15	"	12	"	18	"	45
Tokyo Electric Power	0	"	1	"	10	"	11
Matsushita	11	"	37	"	237	"	285
C. Itoh & Son	37	"	33	"	49	"	119

[12] U.S. Department of State, Industrial, or Vertical Keiretsu (group of companies) in Japan (Tokyo: American Embassy, Airgram - No. A-447, May 17, 1973), p. 2 of enclosure No. 4.

In the case of the large general trading houses the problem is confounded by the breadth of its holdings in various industries. The following exhibit seeks to point out the nature of this problem.

Exhibit 7:[13]

EXAMPLE OF A TRADING COMPANY'S AFFILIATES

Industry	Capitalization Under ¥100 Million	Capitalization Over ¥100 Million	Companies Total
Fishing	3	0	3
Mining	4	2	6
Construction	1	2	3
Food Products	20	7	27
Animal Husbandry	12	0	12
Textile	22	8	30
Paper/pulp	0	3	3
Chemical	11	18	29
Glass/Stone	24	6	30
Steel	23	20	43
Non-Ferrous	12	8	20
Machinery	16	15	31
Other Manufacturers	12	9	21
Commercial	81	19	100
Real Estate	0	4	4
Shipping	13	17	30
Services	5	11	16
Other	2	3	5
TOTAL	261	152	413

Source: GOJ Study, 1972

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[13]U.S. Department of State, The Large Japanese Trading Firms-Soga Shosha (Tokyo: American Embassy, Airgram- No. A453, May 18, 1973), Enclosure 2.

Associated with the issue of direct holdings is the question of the control over the flow of goods down through any particular channel. In this context two important phenomena should be noted. First, when there are many small producers, then the wholesale sector will tend to be more powerful. In Japan, roughly one-third of businesses have nine or less employees (for example: out of 3582 sake brewers, 3,564 were classified as small by the government, there are 3,500 soft-drink bottlers, and so on). Second, in industries where competition among the manufacturers is keen, they will seek to affiliate themselves with selected wholesalers in the hope of building an exclusive distribution channel handling only their own products. To date, such manufacturer-dominated vertically integrated channels can be seen in autos, electric home appliance and consumer electronics, pharmaceutical and cosmetic industries. The methods of affiliation normally include the manufacturer taking a controlling financial position in the wholesalers, sending in its own management personnel, the use of differential rebate systems, and often combining this with its own parallel sales organization and heavy consumer promotion.

Such control allows the manufacturer to limit the access of new competitors to the market and to manage the resale of his products. For example:

> A camera salesman sums up the distribution situation for cameras: "Manufacturers have become strong in recent years and have aligned wholesalers so that they no longer have the power to distribute cameras to retailers at low prices." Thus, for sources of merchandise, discount store chains must resort to ailing wholesalers who need quick cash, small manufacturers and parallel import channels.[14]

It should be noted in summary to this issue that there are forces seeking to resist this trend. For example, many agricultural producers try to gain some power by forming cooperatives for joint shipment, sorting and grading, and brand identification. Also, the growth of large-scale mass merchandising firms and

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[14] Focus Japan, October 1977, p. 18.

cooperative or voluntary chains amongst smaller retailers is presenting a countervailing power to the manufacturers. However, in industries such as electrical appliance the channel control makes full entry by a foreign manufacturer extremely difficult and/or would require the substantial investment needed to develop its own channel organization.

Change in the Distribution System:

Before leaving this general discussion of the nature of the Japanese distribution system, the question of potential change should be considered. A number of observers have commented on the possibilities and I shall summarize their various views in the interest of brevity. We will begin with what appears to be some positive forces for change.

Overall:

- An increasing labour shortage, combined with a rapidly rising wage level are now forcing some members of the distribution sector to reassess their traditional labour-intensive techniques.
- The younger people are not joining certain areas of the wholesale trade since they prefer less hard work, more certain earnings, and the greater prestige in other occupations.
- In some industries (e.g., lumber) the small wholesalers are going out of business because they are in the center of the cities on expensive land which can yield higher returns in alternative uses.
- Some trading houses have realized the limitations placed upon their own operations by the existing system and have taken steps to modernize and rationalize the system; by investing in and financing a range of storage facilities; by establishing specialized frozen food storage and distribution facilities; and by constructing shopping centers.
- The Japanese housewife, because of the growth of the nuclear family and the use of time-saving appliances, has much more time for shopping than was the case in

the past and thus is not so tied to the local neighbourhood trading sphere. One must, of course, realize that these local relationships are very strong and will change slowly.

- The population in areas such as Tokyo, Osaka, Nagoya grew until 1965 but have declined since. The move to the suburbs and satellite cities may provide an opportunity for the growth of larger and more efficient forms of retail structure.
- The paper-thin profits and recent rash of bankruptcies in the channels has shaken the banks and they are now less willing to extend credit than in the past. They are now looking for sound buyers, for wholesalers in trouble including recommending foreign firms, and this may, in certain cases, allow for more channel integration.

Wholesale Sector:

- The rise of supermarkets and large chains, serving wide geographic areas which most wholesalers do not, and their need for more product and promotion information than wholesalers can provide means that more direct distribution is likely.
- The above demand for service by chains is leading to the development of "family groups" of primary wholesalers which may well, in turn, lead to the cutting of the second and third levels in the traditional channels at least for the chains.
- The lack of warehouse space and modern loading equipment has meant that while volumes grow, wholesalers' ability to cope does not. Thus many manufacturers now plan for new warehousing and distribution facilities as they plan for output expansion. This vertical expansion should lessen the importance of the wholesalers and allow for some shortening of the channel.
- The demand for service capability over a wider area has led to the establishment of more delivery and distributional processing centers by the more influential

primary wholesalers and thus has reduced their dependence on the lower levels of the channel.

Retail Sector:

- Wholesalers are organizing small shops into voluntary chains, with some 12-15 per cent of all retail sales going through such organizations. While operational practices have changed little, this form could provide for future efficencies through larger scale central buying and more direct shipping.
- Self service stores, including supermarkets, continue to grow and now represent some 8-10 per cent of total retail sales. An official of the Japan Self-Service Association estimated that tertiary wholesalers had been almost completely eliminated from their channel; the role of secondary wholesalers has been reduced by 50 per cent; and in some cases, such as clothing, self-service stores now buy their goods directly from manufacturers.
- Department stores have reacted to competition from the self-service stores by establishing branches in suburban areas, by effecting tie-ups with affiliated stores, and, in some cases, by establishing their own self-service stores.

However, working against these changes are a number of forces which will undoubtedly counteract these trends. First let us look at actual change in the retail sector:

Table 3:[15] Share of Department Stores and Supermarkets in Retail Sales

	1964		1968		1972		1972/1964
	¥ billion	Share %	¥ billion	Share %	¥ billion	Share %	times
Retail sales, total	8,362	100.0	13,615	100.0	28,095	100.0	3.4
Department stores	926	11.1	2,286	9.4	2,382	8.5	2.6
Supermarkets	392	4.7	1,029	7.6	2,449	8.7	6.2

Notes: 1. Supermarkets are stores with a floor space of at least 100 m^2 in which self-service accounts for at least 50% of the sales.

2. The classification is subject to slight variations in the different years.

Data: MITI, Census of Commerce, 1972.

As one can see, the actual percentage share of the market accounted for by department stores and supermarkets (including self-service) has changed very little. The only noticeable change is the growth of self-service noted above. The reasons for this basic fact of Japanese market life are undoubtedly complex but certainly would include the following:

- Lack of space. Chains in North America and Europe had space to build and thus got economies of scale. In Japan, as one executive put it, "if there is a space something is growing on it or someone is living on it."
- The chains have not been able to bring down the price level as much as hoped for since they have to absorb the high fixed costs of starting-up today whereas the small shops tend to have been family-owned for a long time and thus do not have to carry the overheads of the new stores.
- The Japanese government has a Department Store Law (now includes supermarkets) which restricts the growth of these organizations in order to protect the small shops.

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[15] Fuji Bank Bulletin, p. 70.

- The inability of the retailers to get higher lines of credit continues to tie them to the traditional channels.
- The Japanese shopper continues to show a preference for shopping in his immediate neighborhood. Even if the shopper has a car the traffic and lack of parking still present a serious problem. This is especially true for those goods which are purchased frequently.
- Supermarkets have yet to launch full-scale promotion campaigns for their private brands -- one way used in North America to cut distribution costs. Private brand-name products account for less than 20 per cent of their sales.
- As we will see later, the professional quality of the chain management has not developed as one would have hoped.

In sum, the area of retailing, where change was most expected, has failed to develop in any real major way. Yet, as the operational section will point-out, for many foreign manufacturers of consumer products the new chains represent the only real hope for efficient market access.

In addition to the above, there are at least two major factors which will work against any rapid change in the distribution system in general:

- Given that the system does indeed maximize employment there will be great resistance to any major "trimming," particularly under the present economic conditions of slow growth. This can be seen in the situations where the primary wholesalers have virtually integrated their channel by purchasing lower level firms and yet all the people and functions continue to remain.
- The extremely high value placed on established business and personal relationships within Japan also acts as a very serious barrier to any shortening and rationalization of the system.

In conclusion, I would like to point out that while major and rapid change is probably out of the question, the reader should keep in mind that the

development of the North American and European distribution systems took place over a very long time. To expect Japan to significantly alter its system "overnight" may not only be unrealistic but also somewhat unreasonable. For the foreign manufacturer, then, the main issue is not the introduction of change. Rather, learning how to work within the operational parameters which the system has established constitutes the problem at hand.

OPERATIONAL ISSUES

With the foregoing brief discussion of the Japanese distribution system as a background, the specific issues which the firms now operating in Japan seem to be facing will be looked at. The point of reference for the following is, as was previously noted, what particular factors should a foreign manufacturer entering Japan be aware of in selecting the middlemen who will represent him in the market. In what follows areas will be identified which appear to be of common concern amongst those firms which participated in the study. It is hoped that the reader will, as a result, become familiar with at least some of the major dimensions of the problem of obtaining particular levels of market participation. For purposes of presentation the issues will be discussed under the various attributes which may characterize a distributor's operations and relationship with his supplier.

Nationality:

The nationality factor bears upon the problem of adequate representation in a number of ways; the attitude of the distributor towards the manufacturer, the attitude of the trade towards the distributor, the degree to which local nationality governs access to certain markets, and the degree to which contacts or relationships govern trade access. For Japan, the main issue is to judge the results of the complex web of horizontal and vertical relationships which govern access to certain markets, loyalties, and the true desire to sell the imported product in question.

It is probably a truism that in Japanese business activity the question of whom one is dealing with is just as important, if not more important, than the nature of the transaction itself. This has, in turn, produced a web of relationships and obligations which the foreign manufacturer must understand if he is

ever to be succcessful in marketing his product in Japan. Japanese businessmen often respond to our criticisms of their system by emphasizing this aspect of feudal loyalty and note that foreign businessmen want to operate solely on the basis of money. This feudal loyalty is held together, at least in part, by the concept of "wa"[16] or harmony. That is, the maintenance of good relations and stability above all else.

The foreign businessman is always well-advised to determine what any distributor candidate's "contacts" or "connections" are in evaluating his potential worth. Yet this may be extremely difficult since "contacts" is not solely the issue, one must interpret his relations and who they involve in order to judge their true value. In addition, this endeavour to ascertain who really has access to whom will be made rather difficult by the lack of sound information since the trade will always work for its own survival, and thus will block any information which may allow the manufacturer to do without them.

Japanese businessmen also like to point out that it has taken years for them to develop their channels and earn the loyalties of those in the chain and the foreign manufacturer should be prepared to do likewise. This ignores, however, all the incentives used to maintain the system.

> For example, the manufacturer offers his products to the wholesaler on consignment, and the wholesaler consigns products to the retailers. They provide financing for the lower levels; e.g., for store remodeling or a new delivery truck. A rebate system exists throughout. The manufacturer tells the retailer what wholesaler he can buy from and even sets the wholesaler's price to the retailer. To insure price maintenance at every level, the manufacturer holds a certain amount of money from the wholesaler and retailers 'in trust' for a period of a few months after delivery is made.[17]

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[16] "Japanese Managers Tell How Their System Works," Fortune, pp. 127-28.

[17] U.S. Department of State, Marketing Consumer Products in Japan: Background Information (Tokyo: American Embassy, Airgram -- No. A-141, April 20, 1976), p. 17.

The foreign manufacturer, therefore, must be prepared to provide these incentives if he wishes to develop his own chain of loyalties. However, it should be noted that for some of the activities, he would be violating his home competition laws and thus would be liable to prosecution!

This "loyalty" is also involved in the question of vertical integration which the preceding section on control noted. In some industries the Japanese manufacturers hold substantial financial and management positions in the wholesalers and, in turn, the wholesalers will also be stockholders and thus board members of the manufacturers. A foreigner is therefore, faced with a tight "family" system which may bar his entry. This is particularly true in certain industries where sales are heavily concentrated in the hands of a relatively few distributors -- e.g., liquor, machine tools, furniture, and so on. Unless the exporter is prepared to spend the money and accept the risks of setting up a parallel system he will have to try to align himself with a domestic manufacturer to gain access. In so doing, he is forced to select only those items from his total product line which are non-competitive with his Japanese partner, and he thus may greatly reduce his potential in the market.

The sense of dependency or control, not only flows from the top to the bottom but also in the reverse. The primary wholesaler also knows that he is sustained by the loyalty of the people below. For example, use of the "2 x 4" system in house construction, for a number of reasons, is a threat to the traditional Japanese carpenters who, in turn, are placing pressure back up the system to resist its adoption. While other factors are slowing the adoption of the technique this force cannot be ignored.

A final point in this general area of market access by foreign manufacturers is that this tradition of loyalty seems to mean in certain industries, such as chemicals, that the successes seem to come in specific product markets which are growing sufficiently to allow the foreign manufacturer in without damaging the

position of the domestic manufacturers. One individual pointed out as an example of this phenomenon the fact that the trade was not purchasing the increasingly cheaper imported chemicals (with the fall of the dollar), but rather, was moving within their group to stockpile inventories of raw materials for the domestic producers.

The operational implications of this web of relationships are, as one can appreciate, numerous. Some of these are noted below for purposes of illustration:

-- A firm's strength may be product(s) specific. An example is Ajinomoto, which has the major market share for mono-sodium glutamate which can be found in almost every food retail shop, but has only placed its new mayonnaise in the largest supermarkets and department stores.

-- The interrelationships in a particular industry, e.g. liquor, may be so great that to get any reasonable coverage a foreign manufacturer would have to go through a large number of different "key" firms and, in reality, end up doing business with everyone. This can create management and control problems as well as increasing the amount of investment required.

-- Since many of the channels are controlled by very large wholesalers, an exporter may only be able to gain "key" access <u>after</u> he has shown that his product has significant sales volume potential. The obvious question, of course, is how he proves that without initial access? The established domestic manufacturer can often overcome this problem by "piggy-backing" his new products along with his established sellers.

-- Some of the large trading houses cannot give the exporter total coverage since they are bound by their relations only to sell within their specific network. Similarly other members of the group are bound only to buy within their own system.

-- This problem is compounded in traditional markets such as lumber where the system identifies certain exporters with certain local houses and cross-overs are avoided by the general trade to maintain stability. Thus an exporter can become locked into the particular sub-system which his original house deals through. This may be overcome if the product is in wide demand and the firm therefore has the power to appoint additional houses or distributors.

-- The large trading houses must protect the group as well. For example, if a firm was selling pig iron it may have to use a large house because of its ties with the steel industry. But, they also have strong relations with domestic producers of pig iron which must be protected. Or, the trading houses have a responsibility to sell logs over cut-lumber since logs yield greater total profits for the group and thus the exporter essentially must take a "supply on request" position.

-- The basic inability of the exporter and the smaller wholesalers to communicate in each other's language prevents the foreign manufacturer from going below the major trading houses in an attempt to expand his market coverage. In addition, these smaller wholesalers typically do not have the financial strength to create the necessary "loyalties" and, in many cases, exporters are reluctant to put in the required funds.

-- Because of the importance of the relationships the exporter may have to appoint a representative and pay him full margins just in order to gain access to an account or particular segment while many, if not most, of the actual business transactions will have to be carried out by the manufacturer himself.

-- The role of "connections" also includes the distributor's position within the various product-denominated associations. This is particularly true in those product areas where there are quotas and/or other various forms of "window guidance" by the various ministries and where the exporter needs to be well represented.

The strong personal ties also means that it is exceedingly difficult for the foreign firm to institute any change process. For example:

-- If the manufacturer wishes to ship directly to the retail chains or large industrial users he may be able to do so, however, the billing and associated margins will still have to go through the traditional middlemen. While these margins are negotiated down, both by the manufacturer and the buyer, they must be paid in order to continue to have access to the specific outlets. Thus while the channel is being "shortened," the costs continue to be high. In turn, the importance of established business/personal relationships means that the buyer is also unwilling to eliminate middlemen, even though doing so would save him money.

-- To protect their position, wholesalers will bar manufacturers from calling directly without their prior approval and negotiation of what will be offered. Thus many manufacturers do not know what the retailers or industrial buyers are prepared to accept in the way of change and under what conditions this would take place.

-- The banks, while becoming more concerned, still continue to carry middlemen within their "group" which anywhere else would be allowed to go under.

The degree to which these relationships are difficult to identify depends on the number of levels in the particular channel and on the degree of specialization of the final sellers. For example:[18]

-- Approximately 60 per cent of all fresh fish sold in Japan passes through three levels before it reaches the retailer; but 90 per cent of shoes and 88 per cent of all furniture sold passes through only one wholesaler before reaching the retail outlet.

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[18] See: U.S. Department of State, Marketing Consumer Products in Japan; Background Information, pp. 14-15.

-- Most Japanese make major clothing purchases at department stores and specialty shops, thereby making the neighbourhood store unimportant for this type of product. In contrast, there are 120,000 stores in Japan which sell beer and alcoholic beverages, and in 1970 approximately 90 per cent of all liquor and beer was sold in stores which sold less than $8,000 a year.

-- Allowances must also be made for those types of outlets in which foreign products are sold. For example, there are 100,000 stationery outlets in Japan but most of these sell Japanese family name seals, rice paper and calligraphy brushes. Quality imported stationery products are only sold in department stores and high quality specialty shops.

-- The leading Japanese manufacturers and primary wholesalers tend to have greater market shares outside of the urban areas; this is a reflection that their distribution channels into these outlying areas are stronger and more developed and have not been challenged by newer companies. This can also mean that the major urban areas represent prime targets for the foreign firm.

In short, the "web" may not be as widespread, complex, and tight as it first appears for certain imported products. Consequently, those firms with highly diversified lines must be prepared to engage in various forms of entry relationships; e.g., one firm uses a primary distributor for men's toiletries and medical equipment, a joint-venture in pharmaceuticals, and their own system for confectionary and pet food products. The cost and control issues of such "flexibility" need, of course, to be understood and traded off.

Since the chains are trying to shorten the channels and lower costs, some foreign consumer goods manufacturers are seeking to make more direct contact with the retail chains and placing their major emphasis in this area in order to by-pass the problems and constraints of the traditional channel. They realize, of course, that this will reduce their total market potential but they are banking on a future with a dominant position in the sales of their particular goods being

played by the chains. Or, what we may see in the future is a mixed system with direct dealings to the chains and the use of the older system for the balance when the firm needs total market coverage in order to be viable.

Finally, while one hears the suggestion that the foreign manufacturer should simply by-pass the system to overcome these problems, the fact is that few who have tried have succeeded. It would appear that those who have been successful, in addition to being able to make the required investment, have done so from the beginning, have been able to concentrate on a limited number of major accounts, and have had a product which was unique enough in some way that domestic manufacturers could not meet the competition.

Contractual Relationship:

The formal legal relationship between the foreign manufacturer and his local representative(s) raises the following types of issues: the local Japanese laws which are significant in their content and application, the general role which contracts play in the relationship between the manufacturer and his representative, the elements which should be included in the contract, to what extent the legal form can be used as a method of control, and the extent to which termination of a contract can create difficulties.

Given what has been previously noted about the strong role that personal relationships play in Japanese business life, the contract clearly plays a very minor role if one means a long-term document. To quote one executive, "you can have a contract, but, if you ever have to refer to it the 'feeling' of the partnership is over." While more formal long-term agreements appear possible with the large trading houses, since they are more accustomed to Western practices, they still remain very general in nature.

At issue here as well is the Japanese businessman's concept of any "agreement." Arrangements that are concluded are done so relative to the con-

ditions which are prevailing at that point in time. Should the conditions change then, "of course," the original agreement also needs to be changed. In this regard it should also be noted that there appears to be some support to this flexible interpretation by the Japanese courts. Thus, for any firm which feels that it needs a written statement relative to performance standards such as expected sales levels, inventory to be carried etc., these will normally be negotiated on a six-month or one year basis but not longer.

This means that the firm needs to have its people in Japan constantly negotiating these agreements or it will have no real contract. That is, the firm needs to be there to exercise control on a face-to-face basis. But executives interviewed felt that a foreign national cannot really monitor the Japanese unless he speaks the language and knows their customs. Since very few Westerners speak the language well enough to conduct business in it, one must constantly follow-up discussions with letters, written confirmation and so on. The danger of not making this investment is, of course, that misunderstandings will breed mistrust. In addition, various Japanese business customs, such as the fact that those who are important in the "evening decision making" may not appear so on the official organization chart. Consequently, the men responsible for the negotiations must be very familiar with both Japan and the individual firms being dealt with.

In addition to this constant negotiation, control can be gained via other avenues. Some firms feel that financial relations rather than contractual relations provide the best approach for the Japanese system -- e.g., get the middlemen deeply in debt to the firm. For others, the use of their own salesforce to call not only on the wholesalers but also to go out into the field with the wholesalers' salesmen is the best method. Firms who can finance heavy direct promotion have been able to use this as leverage to gain certain concessions from the trade such as a uniform price to the final consumer. All of these, however, require substantial investment by the foreign firm.

Finally, while formal contracts are seen as being very "loose," the relationship which they reflect are seen as being very "tight." While this does not mean that the exporter cannot change or terminate the relationship, it does mean that any changes must be carefully planned and executed. Any change will become common knowledge within the business community and, given the significant role played by the need for "harmony" in Japan, one must constantly be aware of the potential impact of any changes on the real or assumed obligations of all the parties involved otherwise the firm will end up being labelled as insincere and unreliable in the context of Japanese business practices. To this must also be added the fact that to sever a relationship totally would be very expensive since Japan has its own set of indemnity-type laws which would require the exporter to pay the distributor's associated costs of losing the account.

Assignment of Exclusive Rights:

At issue in relation to the contract form is the question of exclusive rights. The questions raised include: is it necessary to offer exclusive rights? on what basis are any rights given? and how are these rights viewed in Japanese law?

The formal written assignment of exclusive rights is illegal under Japanese competition law. However, the granting of "so-dairitin" or sole agency is permitted and tends to serve essentially the same purpose.

At a general level, the Japanese wholesaler, like his counterparts all over the world, wants exclusive rights given to him for all the obvious reasons. This is particularly true if the foreign firm has a good product since there appears to be a tendency for Japanese wholesalers to use the availability of a volume/profit product as a condition for their "loading-in" other slower moving items. Additionally, the role of "wa" in Japan adds new pressures on the manufacturer to grant those rights. Usually the clear assigning of territories is necessary in order to ensure controlled competition. When the large wholesalers overlap they

tend to reach their own agreements. However, if one wholesaler gets overly aggressive and crosses over the lines the trade will look to the supplier to bring him back under control in the fashion of Japanese manufacturers. This desire for harmony or stability also stretches down, in the eyes of some, to the customers themselves. For example, one distributor of industrial products stated that if his sub-wholesalers started to cross-over and cut prices to gain others' accounts, he would end up losing the respect of his customers and sales would suffer.

For products sold through department stores the pressure may even be greater. It is apparently a common practice for the large department stores to flex their economic muscle and tell the smaller wholesalers and agents that they will buy the foreign product offered only on the condition that the wholesaler does not sell it to any of their competitors. Many importers go along with this, although it is a violation of the Japanese business practice code for someone to use his economic position to force someone either to sell or not to sell to another party. After all, the middleman realizes that this is the way actual business is often done in Japan, and, he is not about to go running to the Japanese Fair Trade Commission when he is happy with his 30% margin!

Given the above, the question arises of how these rights are assigned. Generally territory assignment tends to be prominent since for many products true 'national' coverage does not exist. That is, the primary wholesaler/importers' have to rely on relationships with other wholesalers to gain coverage and many firms at that point prefer to deal with these other houses directly in order to maintain some control.

This raises the issue of using the large trading houses since they gain their coverage through a multitude of contacts. Many of the executives felt that such an approach is a major mistake by exporters and that they should deal directly with the series of primary wholesalers beneath the trading company if they really

want to ensure proper coverage and effort. Also, the major trading companies often really only have sound access within their "group" and thus the exporter is really only getting access to a certain sub-set of the total number of customers. Here the exporter needs to do his homework and work back from the customer or outlets he wishes to sell to, to the middlemen stream that has access to these accounts. That is, there is a growing feeling that assignment of rights by customer list may be the most appropriate approach for many classes of goods. As previously noted, however, it is often difficult to find out who really has access to whom. Thus until experience allows the foreign firm to understand the system it should only assign any rights for a short term upon original entry.

Finally, some of the general problems of the use of sole agents should be mentioned. First of all, these "arrangements" within the system bother some foreign firms since they feel that they do not have any independent benchmarks as a result.

Secondly,

> Any product sold to an importer who is a 'sole agent' will be penalized with additional import tax which may add up to 3% of the landed costs. The Japanese customs and excise assume that on a 'sole agent' basis, the importer is receiving either advertising allowance, commissions or other benefits over and above his trading profit.[19]

Thirdly, for certain products such as liquor the sole agents are at a pricing disadvantage because they have to operate through a complicated web of middlemen who mark up the price, whereas non-sole agent importers can ship directly to retailers and department stores. It should be noted in passing that fear over such parallel importing is so pronounced among major Japanese importers for select foreign product groups that they will not accept any products for which the foreign manufacturer will not guarantee exclusive availability.

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[19] Brian Glynn, "A Supplement to the Briefing of Exhibitors at The Canadian Government Sponsored Stand," Tokyo Motor Show 1977 (October 28, 1977), p. 8.

Purchasing Characteristics:

In the general area of how the trade buys there are at least two main issues of interest: The manner in which purchases are made -- ordering characteristics, the terms, and the payments; and the role that credit plays in sales to channel members and the final customer, including its impact on market access.

For those firms exporting directly all purchases must be made on a letter of credit basis.[20] In addition, due to the well-developed banking and commercial paper system in Japan, importers can obtain foreign currency financing for imports on a routine basis from their banker. Should the exporter wish to maintain such a "distant" stance the payments problems are rather few. These include: the terms may begin after the goods arrive in Japan and this can easily add an additional 90-120 days from the time of order processing. Purchasers of goods often require that invoices be submitted on their forms, and this means extra work for the seller. The documents must proceed the goods through the banking system rather than with the shipment as is customary elsewhere. Japanese purchasers often do not consider a good to be "bought" until it has been inspected and payment terms are computed from the date of inspection. So, the seller must devise a follow-up system to insure reasonably prompt inspection and customs clearance.

But, for the foreign manufacturer who really wishes to develop the market the question of terms and the role of credit is considerably more complex. As was noted in the first part of this paper, an important role of the primary wholesaler is in financing the trade. Goods in Japan are normally sold within the distribution channel on the basis of the "Tegata" system; these are notes, often interest-free, which mature in from 30 to 120 days or longer. The main

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[20] The plans announced by the Japanese government in December 1977 to liberalize certain controls on the length of import usance facilities should facilitate the extension of credit by foreign suppliers without the need to establish a local branch operation.

distributor generally provides some or often all of the financial resources for this line of credit. If a firm wishes to sell on shorter terms than, say, its Japanese competitors, it creates tremendous problems for its wholesaler since he has to push his secondary wholesalers for faster payments than he has to make on other brands. In the Japanese system this will create problems even if the particular product is a market leader and is, in fact, turning over within the credit term.

Part of the issue of terms is the degree of flexibility which may have to be built in. For example: Japanese manufacturers' prices are often not fixed, in fact many do not publish price lists. Rather, prices are set on a case by case basis depending on the situation. Factors such as: competition, plant capacity utilization, desired market share, the customer's budget allowance for the type of product, extent to which lower margins can be shifted back onto sub-contractors, degree of "giri" (mutual interdependence) which exists between the two firms, and so on. If the representatives of overseas producers face a fixed price and margin situation they are limited in their ability to sell.

This problem of terms has created certain problems for the foreign firms operating in the market. Some of these are worth noting. The amount of money outstanding produces a high entry fee and the need for greater cash-to-sales levels than in many other markets. Firms who feel that they cannot afford to make the investment are forced to align themselves with the major houses which may not give them the desired representation. The credit extension acts as a barrier to manufacturers who would like to shorten the distribution system since they feel that they could not assume the credit risk and the simple physical collection of the money. The system is all working on credit and therefore the trade has to keep the goods and debt moving -- a "bicycle" operation. If the goods do not sell within the time period they will be sent back (see distribution section) or someone has to extend the terms. Thus the supplier's cash management must be tight -- e.g., if he gets caught with average receivables of 120

days and the same inventory in stock in the channel it could be a disaster (especially if the products were perishable or seasonal in nature). Most firms add this credit cost to the price at the top, which is, of course, multiplied down through the system as the margins are added on. While this may be viewed as a "non-problem" by some, it does have long-run implications for potential volumes, profits, inflation, and the ability of channel members to remain solvent which cannot be overlooked. And, since many Japanese manufacturers have followed the credit extension down through the trade to a position of ownership, the foreign firm must either pay to set up his own parallel system or piggy-back on a domestic manufacturer's system with those items in his line which are non-competitive.

Some observers have expressed the hope that the large department store and chain organizations would help overcome these problems but this does not seem to be the case. The chains, first of all, are over-extended with property purchases and are not in a position to buy direct, and thus depend on the large wholesalers for their financing as well. Also, the chains want larger discounts and therefore need to deal with the primary wholesalers because the secondary levels cannot afford to sell at the rate demanded. But the primary wholesalers, at times, cannot sell at the margin left and continue to finance the chain and so they come back to the manufacturer looking for greater margins. Possibly even more distressing is the fact that the chains take most of the increased savings themselves and do not pass them on to the customer. In fact, one large food wholesaler makes this a condition of sale since, in their own words, major price differentials "would confuse the consumer!" Of course, these primary wholesalers need to protect their more traditional network to the small retailers. Even in the nature of the ordering process itself, the chains have added little. While some are establishing "central buying offices" they seldom function for the entire chain and sellers must deal with regional buying offices or individual

stores -- including separate labelling for each store.

In the matter of change some other observations should be made. Since the "oil shock" and recession, with the accompanying increase in bankruptcies, the banks have become less willing to carry the secondary levels. Thus they are becoming more dependent on the primary wholesalers for their financing and, in some cases, creating mergers between the two levels. However, all the functions, and costs, remain while the power of the primary wholesalers is increased considerably. Even those foreign firms wishing, in spite of the risks, to shorten the channel and gain more control through taking on the credit role find it difficult since the banks are reluctant to open large long-term financing of this sort with non-Japanese companies. In short, little change can be expected in the present system.

The question of order quantities raises yet another set of issues. Generally the quantitites ordered are small and with a high degree of assortment -- in the world of one executive, "I haven't seen a minimum order quantity met yet." Reasons offered for this include: the retailers' lack of financial strength, the lack of storage space, and the fact that Japan is, to a tremendous extent, a "buyer's market." Because of these factors it would probably be fair to say that the basic principle is not to order anything until it is already sold. Two immediate results of this principle are: Inventories are pushed back up the channel onto the primary wholesalers and manufacturers. And, "out-of-stock" situations can easily occur during a time when the manufacturer is running a special promotional program.

Because of the reluctance to order large quantities, the provision of rebates, commissions, and discounts are extended by primary wholesalers to secondary wholesalers and/or outlets and customers to encourage larger orders. These may be in the form of a straight percentage commission or discount based on sales or purchase volume, a progressive commission or discount based on various sales or

purchase levels, or special commissions or discounts for purchases of new products, or cash payment. As a result, normal or "open" sales tend to disappear into a series of "deals" and manufacturers consequently end up losing control over the resale of their products on their own terms since these deals are negotiated on a daily basis by the trade with no feedback to, or approval by, the supplier.

The above has led to a "purchase on special" syndrome throughout the Japanese system for almost all products. Thus the manufacturer must work out the timing of these 'specials' whether they be by season, area, account-type, or product item in order to hold down his inventories and try to maintain steady manufacturing and shipping schedules. Even then programmed special deals can run flat if the manufacturer does not exercise constant channel control. For example, a special deal price may not be different from the norm, or, the wholesaler may have moved one product item by offering discounts on other, better selling items, and then when the manufacturer runs a special on these better selling items nothing happens because the system is already loaded-up. Also, these discounts have, for many firms, been included in their promotional budgets. But, over time, they have lost their effectiveness as a promotional tool to the trade, and yet there is less money available for other promotional efforts and supplier promotions are absorbed by the trade rather than being passed through to the customer.

Physical Distribution:

An issue associated with the purchasing system is the actual physical movement and storage of the goods. That is, to what extent does the trade carry the required size of inventory stocks, at the desired locations, provide efficient transport, perform the necessary break-bulk and re-packaging necessary, and so on.

At the top of the channel, many of the houses and primary wholesalers have "trading" as their basic viewpoint and thus do not want to increase their investment any more than necessary. Thus the exporter often has to begin by accepting

that he is going to carry the safety stocks, that he may have to share in the carrying costs of the wholesaler's "normal" inventories, and that the levels will be negotiated on a product by product basis in relation to proven sales. Yet, it is here that the foreign firm can usually reach some reasonable agreement on the required stocks; further down the system the problem becomes more severe. As one executive put it, "you have to cram as much as possible into one case since he is only going to buy one of anything." In addition to the problem of space, secondary wholesalers and retailers are living off credit extensions and they therefore tend to look upon inventories as cash rather than stock to supply sales. Some firms in the industrial market have found that their distributors are really commission agents with the manufacturer shipping directly to the customer from its own stock. Even major customers of raw materials appear imbued with the same philosophy. For example; many firms have been working with customer consignment on inventories in North America and Europe but Japanese industry is very resistant to this practice. As a consequence, inventory carrying costs cannot be reduced (and profits shared) and the supplier adds these costs onto the list price to the trade and these get multiplied up by the successive margins. In short, the system generally attempts to avoid or at least minimize stocks at all levels even though the practice leads to higher individual product costs.

This "back pressure" in the system has created certain problems for the foreign firms. For some products, such as chemicals, the margins have not been good enough to pay for keeping the manufacturer's inventories in Japan themselves. Once the inventory moves off-shore, however, many problems are encountered with delays in shipping, border clearance etc. Also, firms must plan their external production to Japanese sales movements and shipping dates. That requires a major corporate commitment to the market and a sales level sufficient to make this "integration" a viable proposition.

In addition to the need for small lot delivery to many outlets, the lower levels of the channel usually want a great deal of assortment within the "one case" they are prepared to take. This means that the trade must perform time consuming and expensive break-bulk and repackaging operations. Another reason for this individual handling is the fact that the Japanese consumer to a great extent buys on the basis of the appearance of the product and package which, therefore, must arrive in perfect condition. Certainly, in many fields this is a prime reason why manufacturers will not attempt to go direct since they could not afford to reach all the market with the individual shipment requirements of the various retailers.

Not only must the system move the goods down, but also, because of the lack of space at the bottom of the channel, it must be prepared to take the return of the goods as well if they do not sell within a fairly limited period of time. Even though free return policies are a time-honoured tradition, some suppliers have sought to institute a no-return policy to control the flow of goods through their middlemen. In such cases, however, the stock may be sold-off at below cost to "cash wholesalers" to free-up space and then these wholesalers will dump the goods back into the market threatening the stability of the pricing structure.

The need for constant contact with the retail trade by the manufacturer is strengthened by the fact that it appears that one can often get initial distribution -- many seem to buy because it is new -- but once it sells, the system is slow to re-order and the firm and its representatives must constantly follow-up if stock-outs are to be prevented. The reasons for this undoubtedly reside in the issue of management quality within the trade referred to in the first part of this paper.

The following would seem to indicate that the practice of multiple handling also takes place within the transportation function:

> Physical distribution outside of Tokyo is difficult and expensive. An American firm may contract with a single transportation company to get the product to the end user. Often, however, a different transportation company will carry the product between each middleman. Sometimes transportation companies operate only within given geographical areas, and to ship goods for great distances means that several transportation companies will be involved, each within its own area, even though no middlemen are involved.[21]

It should be noted, however, that most firms feel that this creates a cost problem more than one of delays in delivery.

The lack of inventory space in the system means that if sales drop then orders are cut back quickly causing rapid inventory build-up at the top of the channel or, if sale pick up the orders come in faster than home-based production can respond. For products such as lumber this can create a serious problem. For example lumber is shipped in large quantities by ship and is placed in holding yards. But if the yard becomes full then the old stock must go or pay very heavy fines. To avoid these fines and be prepared to meet sales increases would either require that inventories of Japanese-cut stock to be held offshore or that the foreign sawmills be prepared for rapid production switch-overs for what today is a small proportion of their business.

On balance it would seem that the issue of physical distribution in Japan is not so much one of efficient delivery as it is one of considerable cost. For foreign products there must, therefore, be sufficient margins, given minimum possible volumes, to absorb these costs. And the firms involved must be sufficiently committed to the market to carry the necessary inventories and/or program their production to the market.

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[21] U.S. Dept. of State, The Japanese Distribution System, p. 22.

Border Arrangements:

In any review of the issues behind proper market representation the question of what the distributor can and should be able to perform in moving the goods and payments across his border needs to be dealt with. Of particular concern is his role in obtaining the necessary import licenses, arranging for customs clearance, obtaining the most preferential goods classification for duties and insuring that the payment for the goods can be made out of the country.

Probably the first fact that needs to be emphasized is that Japanese custom officials have a world-wide reputation for being sticklers for detail and the slightest error in the documents etc. will stop the clearance process. While the port of entry can apparently play a role -- Yokohama has a tough reputation compared with, say Kobe -- the exporter will undoubtedly need a distributor who has had sound importing experience or is well connected with one of the handful of brokers who can bring goods into Japan.

Beyond this there is also the question of the need for "connections" with the various authorities in order to get desired treatment. It appears that connections with customs people does play a role in duty assignment or speed of clearance -- probably a result of both the size of the distributor and his experience in dealing with the various individuals. The size of the importer raises the issue of the role which the large trading houses can play. The lists of prohibited goods in Japan is a positive one in comparison to the negative lists one normally finds. If the customs officials have never come across a particular product it will not be on their positive list and thus will not be allowed in. In such cases having a large trading house as the exporter's representative has many advantages if the trading house is prepared to use its power on the foreign manufacturer's behalf -- the Japanese government is not swayed easily. When licenses from various ministries are required the potential role the importer can play is not clear. There is general agreement that these

ministries are very difficult to influence but it is also true that the large Japanese trading houses appear to have far less trouble and can certainly get licenses much faster than small Japanese importers or foreign manufacturers. Finally, quotas for some goods under quota restriction are given only to trading companies and therefore one has no alternative but to export through the quota holders.

On a broader plane, the need to deal with various government offices is a fact of Japanese business life. Careful adherence to form and procedure is important, and the exporter's Japanese representative should spend considerable effort in cultivating good relations with the offices with which he must deal. For goods which are under quotas the role of the various industry associations must also be taken into account. That is, the distributor should have a well established position in order to be able to use this traditional channel to the government to secure a desired portion or position in whatever allotments are being made.

In the area of payments, since most imports move on a letter of credit there are few problems once the bureaucratic process is understood. For example, the documents must travel through the banks and arrive before the goods or they will not be cleared. For terms other than the standard letter of credit, the March, 1978 revisions which substantially liberalized the "Standard Method of Settlement" system have helped to improve the often time consuming and complicated document process although the procedure remains a discouragement to the exporter and requires a reasonably sophisticated distributor.

Except when there are special license, quota, or clearance problems it is generally felt that while this dimension of representation is a headache it is not a major problem area and probably should not be considered a key distributor selection criterion.

Selling of Other Goods:

In judging how well a potential distributor may be able to represent the exporter the question of what goods he is now selling always requires attention. Specifically, the exporter should know: (1) to what extent available distributors' lines are competing and compatible; (2) the extent to which he can exercise control over the number and types of lines carried; (3) what factors appear to govern which particular lines are given a push.

In discussing the issue of access to the market one must first draw attention to the highly concentrated nature of Japanese business. For purposes of illustration, the following table points out the market shares which the leading companies in several consumer product areas held in 1971:

Table 4:

Product	Company	Market Share
Color TV	Matsushita (Panasonic)	31.5%
Passenger Cars	Toyota	40.3%
Color Film	Fuji	70.0%
Cosmetics	Shiseido	32.0%
Toothpaste	Lion	70.0%
Laundry Detergent	Kao Soap	32.5%
Beer	Kirin	62.5%
Whiskey	Suntory	70.0%
Cheese	Snow Brand	63.0%
Carbonated Beverages	Coca-Cola Japan	68.0%
Pianos	Nippon Gakki (Yamaha)	64.4%

Source: U.S. Department of State, Marketing Consumer Products in Japan: Background Information, p. 6.

There are also indications that the market concentrations of these Japanese companies are increasing rather than decreasing. As a result, in the relevant channels of distribution for these products almost everyone owes their livelihood to the leading Japanese companies. Thus the foreign manufacturer is often faced with the options of either attempting to build a parallel system, aligning himself with a domestic manufacturer and offering his non-competing items, or limiting him-

self to a selected number of outlets or corporate accounts which are prepared to accept his offering.

When licenses are required, the goods classification can also create a problem of the trade carrying direcly competitive products. For example, band-aids are called pharmaceutical products and thus must go through those wholesalers who can get a license from the Ministry of Health. Given a limited number of licenses most wholesalers may also represent competing products.

There is also a tendency for the trade to go primarily after the short-term margin rather than think about long-term market shares and product positioning. In the department stores, for example, the great gulf between the buying and merchandizing departments means that goods are bought on the basis of margins and not on the basis of volume. That is, the space given to individual brands in a department store may have nothing to do with market share. Thus the trade will push whichever brand is giving the best deal at the time. In passing it should be noted that some firms, such as a successful pharmaceutical company, feel that this margin fixation actually works in the foreign firm's favour since its products are typically the highest priced and thus carry the greatest margins.

Another point relative to the question of competitive products is the issue of the financing role played by the primary wholesalers. To obtain the desired market coverage the exporter will normally have to align himself with one of the larger wholesalers who can finance the channel and therefore is often faced with the competitive products problem.

Finally, to many observers there appears to be clear proof that, for any number of reasons, the trade will sell domestic equivalents over imports in many cases. This situation is, of course, not unique to the Japanese market but does mean that extra effort is required to sell imported products.

Given the above, the issue that presents itself is how does a firm seek to get the trade to push its brand of a product. One group of foreign firms which

appear to have succeeded in dealing with this situation are concentrating on selling a limited number of unique items in their lines or are in a growing market where sales of imports will not hurt domestic producers. Those firms who have aligned themselves with domestic manufacturers appear to have partially overcome this problem as well.

Another group of firms is attempting to resolve the situation by developing the demand for their products themselves on the belief that the trade, as one person put it, "loves to take orders." This pull strategy will be dealt with further in the next section so suffice it so say here that while the approach is both expensive and risky, a limited number of foreign manufacturers have been successful with this approach.

Those firms who have tried to generate a push through an internal program of special deals, salesman spifs etc. have generally found that a large part of their promotional budget is consumed in these efforts since the wholesaler is playing all the firms off against each other, with rather marginal market impact.

Since the trade, as we saw previously, often sells on the basis of a calendar of promotional packages, the carrying of competing lines can become more awkward. For example, wholesalers will attempt to load in three months of, say, proprietory drugs in one week with a special deal to the retailer. The next month a special on a competitive brand will be offered in order to load that brand in. This can create a great deal of dead stock and the infamous return goods problem noted under the inventory section. In short, attempting to get brand emphasis through the use of special deals to the trade can be the source of many headaches and failures.

Sales Effort:

Of primary concern to the exporter is the question of whether or not his representatives will provide the type of sales effort required for market success. In this regard he needs to judge the ability of the trade to deliver a total and consistent selling effort down through to the final buyer to cover the entire relevant market on a geographical or account basis, and to field a sales force which is adequate in size and quality.

It is widely agreed that the wholesale trade in Japan is essentially one of order takers. This is particularly true at the secondary levels where the typical "wholesaler" is really a van driver who goes around asking people what they want today. This order taking mentality has meant, for many firms, that they cannot control the selling effort the way they want. It is difficult, as a result to concentrate on products and segments desired with the required level of manpower to build a future position.

To overcome this, firms constantly try to negotiate certain targets with their wholesalers. Others use competitive pricing techniques such as the provision of differential margins to give the desired direction. All agree, however, that if the job is to get done, the manufacturer will have to do it himself.

As an example of this problem consider a firm selling a consumer product to the chain organizations. The supplier's salesmen will first go to their wholesaler and negotiate what they are going to offer a chain in this area. They cannot call directly on the chain since this would be a threat to the wholesaler's position. Once the offer is agreed to then both sets of salesmen go on a double call ("doco hombi") and sell it to the retailer. At this point the wholesaler generally loses interest since he has made his money and he has no merchandizing expertise. However, since the standards of management in the chains is quite low (poor merchandise display, poor traffic flow, non use of brand leaders for store positioning etc.) the supplier must use his own salesforce to follow through.

The issue of being a foreign firm appears to be involved here as well. Many Japanese distributors, because of past experience, are very skeptical of foreigners because they feel that they do not follow-up. Thus the firm needs to go down the channel with his goods if, for no other reason, but to show that he is serious about the market. The foreign firm also confronts a problem as it seeks to attract the quality of Japanese personnel required for its sales effort since working for a foreign firm has traditionally carried very little prestige or security for the Japanese.

This need to "do it yourself," combined with limited resources, has meant that some firms have had to limit their prime market targets to a small number of outlets in the consumer area or to a certain select group of accounts in the industrial field. In other words, the foreign firm must follow a selective market segmentation approach on entering the Japanese market.

Japanese pricing practices also have a direct influence on the nature of the sales effort. The first issue is the previously noted "margin fixation" of the trade. One writer described this process as follows:

> Profit in Japan from selling imported goods has traditionally come from selling small quantities with large profit margins. This attitude towards foreign products and profit margins continues throughout the Japanese distribution system -- importer, distributor, wholesaler and retailer are all committed to handling limited quantities of the product because this is how they keep their profit margins high. Everyone profits in this type of pricing system except the foreign manufacturer.[22]

As a consequence, any major increase in selling effort runs headlong into the constraint of the limited market potential created by the exceptionally high final prices.

The second area of concern is the issue of "flexible pricing" in Japan. We previously saw that the price set by a Japanese manufacturer depends on a number

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[22]U.S. Department of State, Marketing Consumer Products in Japan: Background Information, p. 9.

of factors, one of which is the desire to maintain the traditional spread between domestic and imported products regardless of changes in production costs, exchange rates and the like. Thus if the trade due to the margin orientation, is using pricing techniques as its major selling effort, the exporter may find it difficult to build an initial market position without heavy price discounting.

Also, the use of rebates as a prime selling method can lead to a loss of control over the final price and thus loss of control over market positioning. For example, if the seller can increase the size of his rebate by cutting the price to obtain some minimum volume level, he may be able to generate more profit through the higher rebate than would otherwise be the case. Adding to this problem is the fact that the trade jealously guards its freedom to utilize flexible pricing and it may be very difficult even to find out what they are doing not to mention the difficulties of controlling it.

The constant use of a pulsating calendar of promotions means that it is difficult to maintain a constant and systematic sales push. It appears that the trade feels that if it can load-in inventory at the next lower level the goods will somehow move. This "supply creates demand" philosophy may well be a result of Japan's traditional production orientation during the rebuilding after the war. Such a system, with its resulting total orientation to price, will ensure that eventually the firm's branded goodwill turn into a commodity. Thus, again, the exporter needs his people constantly in the field to control the process.

In the industrial market "selling" may really be the development of personal friendships. Most firms buy from a vendors list and the manufacturer's representative must either get on that list or develop ties with a firm that is. Consequently, while the manufacturer's own salesforce may be doing the actual product selling, he will continue to pay the middlemen to keep himself on the list. Thus the market really requires two levels of sales effort.

The lengthy personal negotiations which characterize the Japanese industrial market means that the number of calls and time spent per order is often much higher than elsewhere. Thus the firm must take this into account relative to the size of the required salesforce, call frequencies and cost-per-order considerations when selecting the middlemen, building its own force, or in choosing market targets.

In the industrial field a number of firms felt that for highly technical products the traditional wholesalers were often not capable of providing the qualified sales personnel necessary and that they required constant back-up from the manufacturer. This appears to be particularly true for the large trading houses who appear unwilling to make the necessary investment. This does not, however, keep these companies from insisting that they act as the middleman for the product in question based on their value in "contacts."

Finally, a word should be said about the problems encountered with the sales efforts of the large trading houses. On the basis of the interviews conducted the difficulties appear to fall into three areas. First, they prefer to sell only to large accounts. Secondly, they are really only effective in promoting to their own group. And thirdly, they will trim their sales efforts if by so doing they can help other domestic manufacturers with whom they have various relationships.

If a conclusion can be drawn from the above it is that the appointing of a distributor to do the selling is seldom enough. The exporter must be prepared to make the necessary investment to place himself in the market on a regular basis.

Advertising and Promotion

In addition to the personal selling effort the foreign manufacturer also needs to know what role advertising and promotion can play in achieving his desired sales levels. Within the context of channel management, he also must determine who should be responsible for the development and management of promotional programs and who will have to pay for them.

For the purpose of general introduction, the following table indicates the relative percentage of advertising expenditures in various media by representative manufacturers' groups as well as the percentage of total national advertising expenditures accounted for by each industry.

PRODUCTS	NEWSPAPER	MAGAZINE	RADIO	TV	PERCENT TOTAL ADVERTISING
Foods & Beverages	13	21	19	47	14.8
Raw Materials	11	19	54	16	1.1
General Machinery	25	25	22	28	.9
Precision, Office* Machinery	18	48	14	20	3.0
Electrical Machinery*	23	26	33	18	6.4
Transportation Equipment*	20	19	50	11	5.4
Housing, Construction Materials	62	17	5	16	6.6

* By definition includes some consumer items.

Source: U.S. Department of State, Capital Goods Marketing in Japan (Tokyo: American Embassy, March, 1978), p. 24.

Advertising in the industrial field in Japan appears to have at least two characteristics. In a number of industries the Japanese appear to do a great deal of institutional promotion but very little individual brand work. This may well be a result of the "group" orientation discussed earlier. The trade also

tends to advertise in spurts, either because of the fact that seasonal buying tends to characterize the general field or to coincide with trade exhibitions which play a major role in promoting industrial products in Japan. Consequently, there is very little promotion aimed at long-term brand build-up.

Generally, given the role of personal contacts the influence of advertising is felt to be minor in generating industrial sales. Yet, the executives interviewed agreed that foreign manufacturers need to advertise in order to maintain the "foreign and new" image which does definitely help sales.

In the consumer field, one of the major issues is the allocation of the promotional budget because of the question of market access. For some products, such as liquor, access to the market is so tightly controlled that the major portion of the budget must go to the trade to gain access. For example, 50 per cent of Tokyo's on-premise market is controlled through 54 "retailers" (out of 8,000) who set up individuals in their bars and supply them with all of their goods.[23] To sell to a bar, all of which are basically brand exclusive, a manufacturer must give the new bar free liquor, glasses, cash, silverware and the like. Also, since retail outlets are really controlled by the levels above them through credit extensions, promotion may get the manufacturer awareness but not necessarily sales if he has not obtained floor space. Thus, unless the firm has a lot of money it is felt that he is "better-off spending it where you can touch the customer." In short, because of the way the system operates the "push" element must be present if "pull" is to have any value.

There also appears to be some resistance by the trade to heavy promotional efforts by manufacturers since it may well lessen its control and some of the financing will, in all probability, come out of reduced trade margins. This resistance is further strengthened if the trade feels that programs transplanted

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[23] Figures provided during an interview.

from abroad may run counter to established practices and competitive norms. Given the trade's control over the flow of the goods, this means that it can and often does play a restricting role.

Compounding the promotional problem is the fact that, like everything else, advertising in Japan is very expensive when compared to, say, North America. (The executives felt that overall costs were approximately 50 per cent higher.) In addition to the higher production costs, the fact that the media do not seem as well segmented also adds greatly to the expense. This also hinders the firm's ability to isolate and test various alternative programs which, again, may add to the ultimate cost.

This raises the issue of who pays for the promotion. Because of space and financial limitations inherent in the system, the trade cannot afford to carry a product for very long and thus tends to be very conservative when it comes to long-term market development. Consequently, while there does appear to be some short-term co-operative advertising, the majority of the suppliers have found that they need to place and pay for any major advertising themselves. Yet, because of the costs and the feeling that the Japanese market is still "uncertain," many of the local managers have found it very difficult to get their head-offices to agree to spend the necessary amount.

Finally, in practice the use of advertising to build a "customer franchise" in order to pull the product through the channel faces a number of operational problems. First, because of the difficulty in protecting product designs or even brand names -- since English brand names often become generic terms to the Japanese -- the foreign manufacturer has to protect himself in the store with frequent sales calls or his advertising can be wasted. Thus the market share of a number of firms is considerably less than their share of advertising because of the substitution effect. Second, to make advertising pay the firm must send out a detail force to try and control the retail outlets. Specifically, they

must promote "space management" concepts given the traditional orientation of buying departments to purchase primarily on the basis of margins. This is made more difficult in many product groups by the fact that no one product has a large enough share of the market to force any change at the retail level. Thirdly, there appears to be a limited number of direct pull-creating mechanisms in Japan. There are advertising and consumer contests -- with specific limits -- but no coupons, sampling can be extremely expensive, self-liquidators do not seem to work well, and deep-cut feature pricing does not really exist. Consequently, the firm cannot build a full North-American type of promotional package and as a result looses some of the total impact from its normal marketing program.

Post-Sale Servicing

For some products the provision of adequate servicing is a critical element in the total sales effort. In such cases the firm must determine the extent to which the trade can provide the required levels of service, the availability of outside groups who can perform the function, the costs involved, and the role the manufacturer must play himself.

The real role that service plays in Japan was difficult for this writer to fully determine. On the one hand the following can be heard:

> ...assuring the Japanese customer of the reliability of the foreign supplier's long-term commitment to the Japanese market is critical, because he is accustomed to a full range of responsive follow-up service by Japanese domestic suppliers. A major criticism levied against foreign suppliers, and in particular U.S. firms, is lack of attention to technical services both before and after sales, and Japanese manufacturers are quick to exploit these attitudes. Many Japanese buyers are inclined to opt for the purchase of less expensive domestically produced equipment with lower performance characteristics and product life, because of the assurance that even with breakdowns, down time will be minimized by the rapid service response of the domestic supplier.[24]

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[24]U.S. Department of State, Capital Goods Marketing in Japan, pp. 25-26.

Certainly the firms interviewed in this study did agree with the essence of this quote. That is, service has to be available locally; buyers will not depend on service personnel being called in from abroad as needed.

On the other hand, some firms have found that the Japanese do not look on products in as long a term point-of-view and if the manufacturer wants to maintain its quality image he has to maintain his own post-sale groups to perform the up-keep. In fact, one major industrial distributor noted that his firm typically has not charged for its service since the customer would not maintain the equipment if he had to pay and then the supplier would not be able to keep up its quality image. Possibly the issue can be summarized by saying that local service is a necessary, but not critical, condition to sales.

Most of the firms felt that the average Japanese distributor, like elsewhere, wants to sell the product but not get involved in the after-service. In addition, some noted that the distributors have not been able to keep up with the new technology, particularly since the competition and customers have become very technically astute. However, there are distributors who do provide the service although one will often find that they are carrying competing products, a condition the supplier may have to live with, <u>if</u> he will take the new firm on.

In other cases the supplier firms have found that there are usually good independent service organizations around. The problem is that they are very expensive and thus one can see manufacturers performing the warranty servicing themselves and only turning the post-warranty work (for which the buyer pays) over to these service groups. If service is critical, and the exporter cannot afford his own staff, then he may try to select a Japanese manufacturer of related products as his distributor to gain access to the qualified personnel. This may, again, limit the number of lines which he can sell in the market.

Market Information

The final trade function to be dealt with here is the question of the market feedback which the distributor will provide to the supplier. Such issues as the type of information which is made available, its reliability and timeliness, and the trade's view towards its use need to be considered.

First of all, Japanese distributors, like others around the world, will generally guard their market knowledge in order to protect their position. One must add to this the fact, that, the way in which the wholesalers guard access to their customers -- the manufacturer cannot call on them directly -- also means that it is difficult to get the kind of information the firm may want.

In the consumer goods area, the trade generally lacks a "consumer orientation" in a North American sense. It is felt that this probably results from the fact that until recently Japanese manufacturers simply said they will make "x" amount and they could always sell it. Thus "research" usually means the analysis of past sales figures to estimate future volumes but always extrapolating the past. This orientation also means that even when the manufacturer does the study himself there is still a problem in getting the trade to understand it.

In the industrial market most firms felt that a truly "buyer's market" exists and thus all the trade does is feed back the comments of purchasing agents who, of course, are trying to get a better deal. For example, foreign produced products, in any field, are "never right for the Japanese market." One case involved American tools which were supposed to be too large and heavy for Japanese workers -- until the supplier went out and purchased all of the competitors' products and found that the American tools were the smallest and lightest on the market!

Consequently, most firms feel that they have to get their own information. This is a rather recent development which has come about with the opening up of a number of branches by the major international consulting firms since, as one

executive put it, "they are the only ones who understand what I'm talking about." Again, however, the costs are high -- one major American consulting firm said that its fees run about 50 per cent higher than in the U.S.

The importance of the firm doing its own research and analysis is heightened by the fact that Japanese distributors work almost totally to agreed targets and thus the supplier had better have its own set of data in order to negotiate these targets properly. In fact, some firms noted that this lack of knowledge could be their greatest weakness in the market. They have been flying blind in total dependence on their Japanese wholesalers.

SUMMARY

At this point it is appropriate to give a brief and general summary of some of the more important issues and problems which have been touched upon.

Overview

-- The channels of distribution tend to be long with many layers involved in moving the goods.

-- The system is characterized by many small firms.

-- The complex and lengthy channels add greatly to the final price with a particularly negative impact on foreign-produced goods.

-- The large trading houses play a dominant role in foreign trade.

-- A great deal of control over the lower levels of the channel is exercised by large manufacturers, trading houses, and major wholesalers.

-- Within the lengthy channels the actual flow of a particular good can be highly product specific.

-- Some positive forces for change appear to be: increasing labour shortage in the trade; rising wage rates; middlemen closing down because of poor returns; some investment being made in infrastructure by trading houses, manufacturers

and government; suburban and satellite-city growth; banks becoming more concerned about low returns and bankruptcies; rise of supermarkets and chains; and increase in large voluntary groups of wholesalers and retailers.

-- Resistance to these forces appear to arise from: conservative philosophy; isolation from foreign change agents; high use of labour-intensive techniques which serve to create jobs; generally poor management; too many small firms to develop any real economies of scale; lack of standardization of functions and processes; lack of space for chains to grow efficiently; high cost of buying-in today; laws and regulations to protect the small firm; need for financing by retailers; shoppers still prefer local stores; and importance of personal relationships in dealings.

-- Actual change has been very slow coming to-date.

Operational Issues

Nationality:

-- Personal relationships and obligation, combined with a strong desire for stability, play a critical role in gaining access to the market.

-- These relationships are held together by a series of financial incentives and control procedures.

-- The importance of personal relations means that the foreign manufacturer must use a Japanese middleman even if they provide little in functional performance.

-- The tight grouping also acts as a barrier to any change being introduced by the foreign supplier.

-- The strength of the group may force an exporter to align himself with a domestic manufacturer and sell only non-competing lines; or sell goods which will not hurt domestic manufacturers.

-- A representative will have strength only within his group of relations and this will determine the market which he can cover.

-- The difficulty a supplier may have in identifying the nature of the relationships will vary by product, account type, and geographic area of concern.

-- There has been little success in trying to by-pass this system.

Contract:

-- The legal form of contract plays a minor role in establishing and controlling the supplier's relationship with his local representative.

-- To be of any value the contract should be viewed as being short term, flexible, and constantly under negotiation.

-- Control is normally achieved through face-to-face contact, financing of the trade, and the use of overlapping salesforces.

-- The desire for harmony and stability means that any changes in existing relationships must be dealt with carefully.

Exclusive Rights:

-- While exclusive rights are not allowed under Japanese law, the sole agency form is and tends to serve the same purpose.

-- Given the desire for stability and harmony, some form of exclusivity by area, product, or account list normally is given.

-- The supplier must be prepared to control the degree of competition among the middlemen.

-- The problem of limited access arising from the role of groups means that the supplier must work back from the market segments to ensure proper assignment.

Purchasing Characteristics

-- While some change is now taking place, most goods must move to Japan on a letter of credit basis -- with certain unique procedures being involved.

-- Goods are sold on an extensive credit basis internally which must be matched either by the manufacturer's representative or himself.

-- To be competitive the trade needs great flexibility in the prices charged for any one sale.

-- In addition to adding to costs and raising final prices, the credit system also means that tight on-site cash management is required.

-- Credit often serves to limit market access for the foreign supplier.

-- Goods are typically ordered in small amounts and in wide assortments.

-- The nature of ordering forces inventory backup the channel and has created a "dealing syndrome" which makes control extremely difficult.

-- Dealing has also served to reduce the effectiveness of promotional programs.

-- Little change in the present system can be anticipated.

Physical Distribution:

-- A strong "trading" orientation by channel members serves to reduce investment in stocks.

-- Trading also tends to create wide fluctuations in order patterns and thus in stocks.

-- This has created many inventory, shipping, and production scheduling problems for the foreign suppliers.

-- The ordering characteristics have created a great deal of handling and re-packaging which carries a very high cost.

-- The role of credit and the "loading-in" of stocks creates a returned-goods problem and/or the need for greater credit extension.

Border Arrangements:

-- Japanese customs have a reputation for being tough and the exporter's local representative must either be experienced or have good relations with a broker.

-- The large trading houses appear to be able to get better treatment.

-- The foreign manufacturer's representative's position in the relevant industry association is important in dealing with the government.

Selling Other Goods:

-- Market shares are highly concentrated among Japanese manufacturers and they therefore exercise strong control over the trade.

-- When licenses are needed, the foreign supplier usually must go with a representative who is carrying competing products.

-- The trade tends to buy and sell on immediate margins rather than long-term profits and the foreign supplier must therefore use margins to get emphasis for his product.

-- The foreign producer often must concentrate on non-competing items so as not to hurt domestic manufacturers and consequently get a push for his products.

-- The use of in-trade "deals" to get emphasis appears to be less than rewarding as a long term strategy.

Sales Effort:

-- Japanese middlemen are seen as being basically order-takers.

-- It is felt that because of this it is difficult to control the selling effort and the supplier really needs his own overlapping salesforce.

-- Being a foreign firm also means that an extra sales effort by its own people is required to show commitment to the market.

-- The resources required to mount the sales effort often means that only certain segments of the market can be targeted.

-- The high final prices also limit the total market potential even when the firm's own salesforce is employed.

-- The flexible pricing by Japanese manufacturers can blunt major sales efforts because of the margin fixation of the trade.

-- The practice of loading-in of inventories makes a constant sales effort for any individual brand difficult to obtain.

-- Even when the supplier is doing all of the selling he needs to appoint local

representatives in order to gain access to the accounts.

-- Sales efforts by the large trading houses appear to be limited by the desire to serve only the large volume accounts, the concentration within their group, and the willingness to help domestic manufacturers.

Advertising and Promotion:

-- In the industrial field advertising tends to be institutional and short-term.

-- Because of the difficulty in gaining market access, a great deal of the promotional budget must go to the trade.

-- The trade tends to resist a heavy pull approach because of fears about loss of control and maintaining competitive harmony.

-- Production costs, lack of media segmentation, and a limited number of promotional mechanisms make advertising very expensive.

-- Any long-term program must be paid for by the manufacturer himself.

-- A heavy follow-through of personal sales efforts is needed in order to protect any gains achieved through advertising.

Post-sale Servicing:

-- Must be available locally.

-- The buyers want service but are reluctant to pay for it.

-- Those representative houses which do provide service are usually carrying competing products.

-- Independent service groups are available but expensive.

-- To gain the service element some foreign suppliers choose to sell non-competing lines through domestic manufacturers.

Market Information:

-- The trade will guard its knowledge.

-- There is a lack of a "consumer orientation" in a North American sense.

-- A "Buyer's market" tends to colour the information fed back by the trade.

-- Most foreign firms get their own information, often through the international consulting firms now coming into the market.

CONCLUSION

A successful entry into a national market is always a difficult process for any off-shore producer. Yet, the rather limited success of foreign firms in Japan[25] would seem to indicate that this particular market is more troublesome than most. Based on the results of this study, we believe that the manner in which the Japanese channels of distribution are structured and managed presents one of the major reasons for the apparent failure of foreign firms to establish major market participation in Japan. In particular, when compared to alternate markets, the entry costs appear to be exceedingly high given the "real" sales potential for many foreign produced goods.

While the paper has concentrated on some of the problems which foreign firms have experienced in the Japanese market, there are successful marketing ventures and those should not be ignored. If we were to characterize these firms a number of the following attributes are often present:

(1) They have been in Japan for a long time and have put substantial sums of money into the market with low initial returns.

(2) They have placed their own management in the market.[26]

(3) They have defined their target markets not only on the basis of customer groups but also on the basis of the most desirable channel structure. That is, market segmentation must take place not only relative to the ultimate buyer but must also take into account the particular group of middlemen

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[25] See for example: Ministry of International Trade and Industry, Trends in Foreign-Affiliated Enterprises in Japan (Tokyo: News from MITI, NR-165, April 20, 1978).

[26] The yearly cost of placing a man in Tokyo has been estimated to be around $150,000 exclusive of salary and fringe benefits. See: U.S. Department of State, Capital Goods Marketing in Japan, p. 45.

which the firm feels is the most appropriate to align itself with.

(4) They have attempted to place themselves as close to the ultimate user as possible from the beginning. In some cases this has meant the development of their own distribution structure.

(5) They have aligned themselves with Japanese manufacturers of complimentary products yet still maintained constant involvement in the selling effort.

(6) They have concentrated their selling efforts to those product items which are unique in some way -- e.g., have patentable features, a well established image, or have control over some critical material input to the production process which Japanese firms can not obtain.

(7) They have adjusted their personnel policies (and management style) to meet Japanese standards in order to develop a sound local marketing group.

(8) They have constantly shown the trade that their world-wide organization is committed to the market for the long term.

In sum, entry into the Japanese market is difficult but not impossible for the firm with the resources, the products, and the commitment. In addition, the new firm must be prepared to spend far more time developing a working knowledge of the market for his products than is often the case elsewhere. Initial blunders last far longer in Japan than what many Westerners are used to.

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