

# Zaibatsu and Keiretsu: A Network Structure of Japanese Firms

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# The origin of Zaibatsu

- In the 18<sup>th</sup> century, most of **oldest Japanese merchant families** established their **economic role** and **social status**.
- Mitsui, Sumitomo, Kinokuniya, Yodaya (Konoike) strengthen their influence despite the authorities' restrictions.
- Since these families were from **landlord families** and **Tokugawa shoguns** were **supported** by **merchant capital**.
- Hachirobei Takatoshi Mitsui, was a **founder of Mitsui**. His first business was the **silk trading** established in the middle of 17<sup>th</sup> century.
- Then, Mitsui extended his trading to other commodities. He also established **rice trading**, **money exchange shop** and **local credit company**.
- In 1680, his son founded **Echigoya warehouse** company covering the areas of Edo, Kyoto and Osaka.
- This company later became the **chain of courier service**. Mitsui started to **acquire land** and extended the **business activity to agriculture**.

# The origin of Zaibatsu (cont'd)

- **Sumitomo** family originally conducted the medicaments and **iron-ware trade** in **Kyoto**.
- In the early years of Tokugawa period, Sumitomo operated the **copper mining** and conducted the copper trading in Osaka.
- After acquiring modern technique of copper smelting, Sumitomo has extended its production capability and eventually became the **largest copper producer in the world**.
- In 1783, Sumitomo was **the Shogun's representatives** in **Kansai** region.
- Later Sumitomo extended its industrial productions to **textiles, clothing, sugar** and **medicines**.
- Also Sumitomo established the **money exchange business**.

**Source:** Directly quoted from Grabowiecki, J. (2006). Keiretsu groups: Their roles in the Japanese economy and a reference point (or a paradigm) for other countries. IDE-JETRO Visiting Research Fellow Monograph Series NO. 413.

# The origin of Zaibatsu (cont'd)

- From the beginning of the period of Japanese economy and society modernization, **the lack of strong middle class** operating the **industrial-oriented finance** and business development was a **significant problem**.
- Leading merchant families experienced in banking and business activity in the Tokugawa period supported the economic changes of the Meiji, earning the name of the so-called '**political merchants**' (Seisho).
- The political merchants that developed into **major Zaibatsu** can be categorized into **three groups**:
  - (1) *Mitsui* and *Yasuda* were licensed to handle **national tax revenues**.
  - (2) *Okura* and *Fujita* were **trading companies** supplying goods and services.
  - (3) *Mitsubishi* operated the **shipping** and **logistics business** with government's subsidies.

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## Group-specific origins in 19<sup>th</sup> century Japan

	Origins	Growth and Relations with the Government
<i>Mitsui</i> *	Dates back to 1673; “ <i>political merchants</i> ” who provided financial services to the <i>Tokugawa</i> regime since the late 17 <sup>th</sup> century.	Historically close ties to various governments. Growth and diversification through acquisitions, in part through establishment of new business, in part through government privatization and contracts.
<i>Mitsubishi</i> *	Founded by a former Samurai after the <i>Meiji</i> Restoration.	Initially investment in shipping enjoyed government protection, subsidies, loans etc. Subsequent growth and diversification patterns broadly similar to Mitsui’s.
<i>Sumitomo</i> *	Dates back to the late 16 <sup>th</sup> century with ties to the <i>Tokugawa</i> regime.	Diversified from mining into trading, finance, and industry. Again, diversification and growth through both acquisitions and through the establishment a new business, with government support.
<i>Yasuda</i> *	“ <i>Political merchants</i> ” from the <i>Meiji</i> Restoration period. Mainly provided financial services (including the establishment of the third national bank in 1876).	Less diversified than the other large groups more focused on banking and finance. Again, both acquisitions and new business as mechanism of growth.
<i>Asano</i>	Around 1870, no previous political ties.	Initial fortune out of various investments. Growth through cooperation with separate financial institutions.
<i>Fujita</i>	Origins: supplier of good and engineering works to the new government (with contacts to major figures in the <i>Meiji</i> government).	An internal family feud led to the dissolution of this group and its reorganization as the <i>Kuhara zaibatsu</i> .
<i>Okura</i>	Merchant (groceries) before the <i>Meiji</i> restoration; converted into gun production in 1860s and then into overseas trading starting 1873.	Growth mainly through acquisitions. Despite substantial operations overseas, government contracts remained major sources of income.

\* denotes the “*big four*” *zaibatsu* groups  
Source: T. Khanna, Y. Yafeh (2005, p. 83)

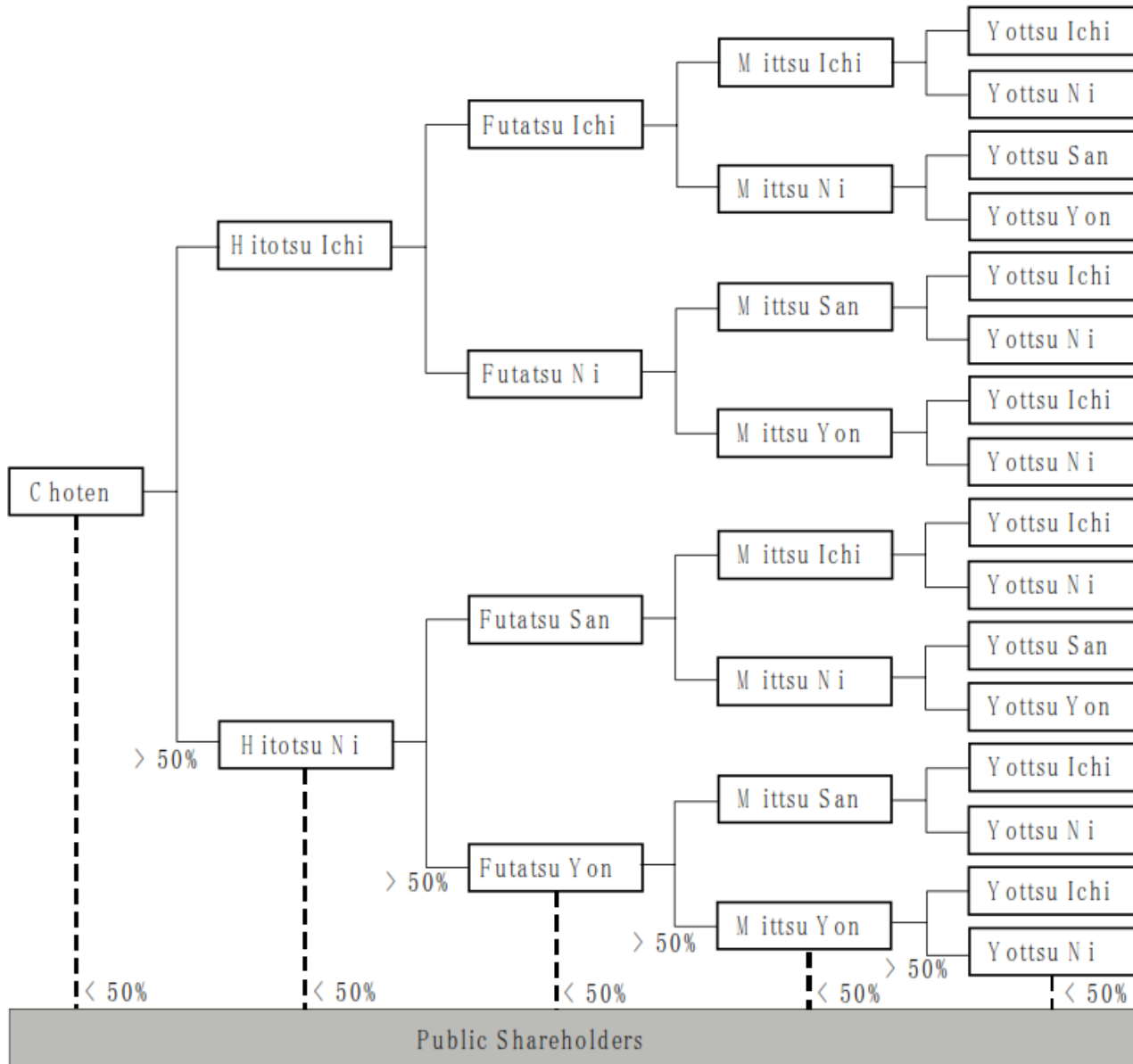
Source: Directly quoted from Grabowiecki, J. (2006). Keiretsu groups: Their roles in the Japanese economy and a reference point (or a paradigm) for other countries. IDE-JETRO Visiting Research Fellow Monograph Series NO. 413.

- **The House of Mitsui**, an **Asian business dynasty** that combined **Krupp industrialism** with **Rothschild financial skills**, taught the lessons of capitalism to a reluctant Japanese aristocracy. Now, with John G. Roberts's comprehensive and always fascinating study of the family and its businesses, we in the West learn of the tremendous power their private money wielded over the public affairs of that nation.
- . At the **height of their power, between the two world wars**, the personal fortune of the men who headed the 11 Mitsui families was **conservatively estimated at \$450-million** and their businesses **employed more than three million people**. The clan pulled it all off with an instinct for survival that won them the nickname “doubledealing Mitsui.”
- In 1616, Mitsui Sokubei Takatoshi, a samurai who found himself in the awkward position of living in peaceful era, rebelled against his noble caste and opened a **sake and soy-sauce shop**.
- Their youngest son, **Mitsui Hachirobei Takatoshi**, took after his mother and set the family on its dynastic course. Hachirobei became an amazingly successful seller of **brocades, silks and cotton** by **refusing to give credit, setting fixed prices** and by **relying on volume sales instead of high mark-ups**, innovations that so angered his feudal competitors that they threw him out of their guild and leaked sewage into his shop. He overcame these irritants and by **1683**, a **decade before the Bank of England was founded**, had **opened a bank** that still operates from the same location in the **Surugacho district of Tokyo**.

- Whenever **political ideologies clashed** in Japan and, later, throughout Asia, the **Mitsuis could be found steadfastly supporting all sides.**
- While acting as **a sort of national bank for the ancient Tokugawa military regime**, they gave **financial support to the Meiji revolutionaries** who eventually toppled it.
- They **supported the Manchu Dynasty** in China, once nearly **pulling off a deal to buy Manchuria**, and at the same time **channeled money and arms to the democratic movement of Sun Yat-Sen.**
- The Mitsuis went so far in their dedication to fairness that in 1932 they **subsidized an ultranationalist secret society** that soon after assassinated the business's “prime minister.”
- When Japan's isolationists fell from power in 1868, with the help of **Commodore Perry's rather pushy opening of Japanese ports** to American shipping, the **Mitsuis gratefully opened their doors** to the world of international business. Girded with capital, experienced in trade and with a **ready supply of cheap labor**, **Mitsui Bussan**, known outside Japan as Mitsui and Company, became the **prototype of the large family financial cliques**, or **zaibatsu**, that, like the great British traders before them, were to **convert an island nation limited in natural resources into leading industrial power.**

- The Mitsuis made **one fatal error**. While Tojo militarism never particularly appealed to them, they understood too well that **huge profits** were to be made **from Japanese imperialism**. As Japan's soldiers occupied Asia **the Mitsuis followed with opium under a deliberate “narcotization policy” for China**.
- Before and after Pearl Harbor the **Mitsui intelligence network ably provided strategic information** to the Japanese armed forces. Later in World War II the **Mitsuis imported slave laborers** to work in their home factories.
- One subsidiary, Mitsui Mining, had more than **16,000 Chinese and a larger number of Koreans** digging coal in Japanese mines, **“Mitsui in 1945,”** Roberts states, “was probably the **world's largest private business organization.**”
- When **the war ended**, the United States occupation authorities **divested the Mitsui family** of its holdings in an effort to **end zaibatsu domination** of Japanese economic affairs.
- But the **managers** who had **dedicated their careers** to the Mitsui family prosperity carried on, and when the Korean War presented the United States with the need for an integrated Japanese economy it was these competent men, and their like numbers from competing families, who **created the new conglomerates** in the image of the old zaibatsu.
- **One former Mitsui executive built Toyota**, a loom-making company, into the world's third largest auto maker, while **another made the Sony transistor radio** as much a symbol of Japan as the Rising Sun.

## A Stylized Representation of a Z Contral Pyramid



**Source:** Directly quoted from Grabowiecki, J. (2006). Keiretsu groups: Their roles in the Japanese economy and a reference point (or a paradigm) for other countries. IDE-JETRO Visiting Research Fellow Monograph Series NO. 413.

# A Structure of Zaibatsu

- This pyramid structure was described by Yoshisuke Ayukawa, the founder of Nissan.
- This tactics was applied by other **Japanese mercantile families** during the prewar period.
- During the period of **Meiji Restoration**, the **Big Four Zaibatsu** (*Mitsui, Sumitomo, Mitsubishi and Yasuda*) has been formally established.
- All of them applied the **pyramidal structures**. Also each Zaibatsu conducted both terminating the low-competitive firms and constantly establishing new holding companies.

**Source:** Directly quoted from Grabowiecki, J. (2006). Keiretsu groups: Their roles in the Japanese economy and a reference point (or a paradigm) for other countries. IDE-JETRO Visiting Research Fellow Monograph Series NO. 413.

# A Structure of Zaibatsu (cont'd)

- In 1876, **Mitsui Bank** was **the top** of Mitsui pyramidal network.
- Earlier, at the end of Edo period, the **clothing production** and **money exchange** were **the top** of its Zaibatsu structure.
- However, the **decline of textile industry** during 1870s triggered the restructuring process, assigning the **commercial bank on the top** of the pyramid while moving **all industrial firms to the lower levels**.

# A Structure of Zaibatsu (cont'd)

- **Sumitomo** *Zaibatsu* structure was **very similar** to that of Mitsui.
- Financial company (**Sumitomo Bank**) was **the top**, while **industrial corporates** were placed in **the lower level**.
- The Zaibatsu included the bank, the trading company (Sogo Shosha), an insurance company, a coal mine and department store.
- Also the Sumitomo's pyramidal structure included **Sumitomo Chemical (1934)**, **Sumitomo Metal Industries (1935)**, **Sumitomo Electric Wire and Cable Works (1937)**

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# A Structure of Zaibatsu (cont'd)

- Yasuda Zaibatsu was **different** from others.
- Yasuda bank was the **largest bank**, established from the **merger of 11 minor banks** in 1913.
- Yasuda managed the capital of **150 million yens**.
  - Mitsui Bank: 600,000 yens
  - Sumitomo Bank: 500,00 yens
  - Dai Ichi Bank: 430,000 yens
  - Mitsubishi: 300,000 yens

# A Structure of Zaibatsu (cont'd)

- Mitsubishi was the **industrial-oriented** Zaibatsu, focusing on the heavy industry and sea transport.
- In addition, Mitsubishi recruited high-skilled managers from outside the family.
- There were also other groups of industrial-oriented Zaibatsu. Most of them **concentrating on industrial productions** and were **lack of bank and financial institutions** as the member of Zaibatsu.
- *Asano, Kawasaki, Furukawa, Shibaura Manufacturing Work* (now *Toshiba*) and *Hitachi* were examples of **leading industrial-oriented Zaibatsu**.
- During the economic and financial expansion from 1917 to 1919, the **new industrial-oriented Zaibatsu were established**: *Nissan, Nichitsu, Mori, Nisso* and *Riken*.

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## Concentration of Fourteen Zaibatsu Subsidiaries in Heavy Industries (Paid-in Capital, 000's Yen)

	1937				1947			
	<i>14 zaibatsu*</i>		Total companies (within Japan)		<i>14 zaibatsu*</i>		Total companies (within Japan)	
Manufacturing and mining	2 039 348	25.3	8 056 601	100.0	10 440 200	100.0	22 089 231	100.0
Heavy industries	985 504	27.3	3 612 502	100.0	7 919 585	54.9	14 430 619	100.0
Metal	174 478	19.1	911 752	100.0	1 655 406	43.2	3 829 681	100.0
Machinery	385 312	29.4	1 311 471	100.0	4 302 777	56.4	7 632 409	100.0
Chemical	425 714	30.6	1 389 279	100.0	1 961 402	66.1	2 968 529	100.0

\* the fourteen zaibatsu are: *Mitsui, Mitsubishi, Sumitomo, Furukawa, Asano, Okura, Yasuda, Nomura, Ayukawa (Nissan), Nitchitsu, Nisso, Mori, Riken, Nakajima.*

Source: H. Morikawa (1992, p. 234)

**Source:** Directly quoted from Grabowiecki, J. (2006). Keiretsu groups: Their roles in the Japanese economy and a reference point (or a paradigm) for other countries. IDE-JETRO Visiting Research Fellow Monograph Series NO. 413.

# A Structure of Keiretsu

- Keiretsu was the **crucial factor** in influencing **the economic growth**, enhancing **productivity** and enabling **technological improvement**.
- This transformation **bridged the gap** between **Japan and other developed economies**.
- Keiretsu is a cluster of independently managed firms maintaining the **network of collaboration** via many mechanisms such as **cross-ownership** and **interlocking directorates**.
- The **horizontal keiretsu** is the structural connectivity of firms linked by **cross-shareholding, intra-group financing** and a central (often shadowy) body of directors.
- The **vertical keiretsu** is the cluster centralizing around one big company and comprised of a **multi-layer supply chain system** systematically serving the production of the core manufacturing firm.

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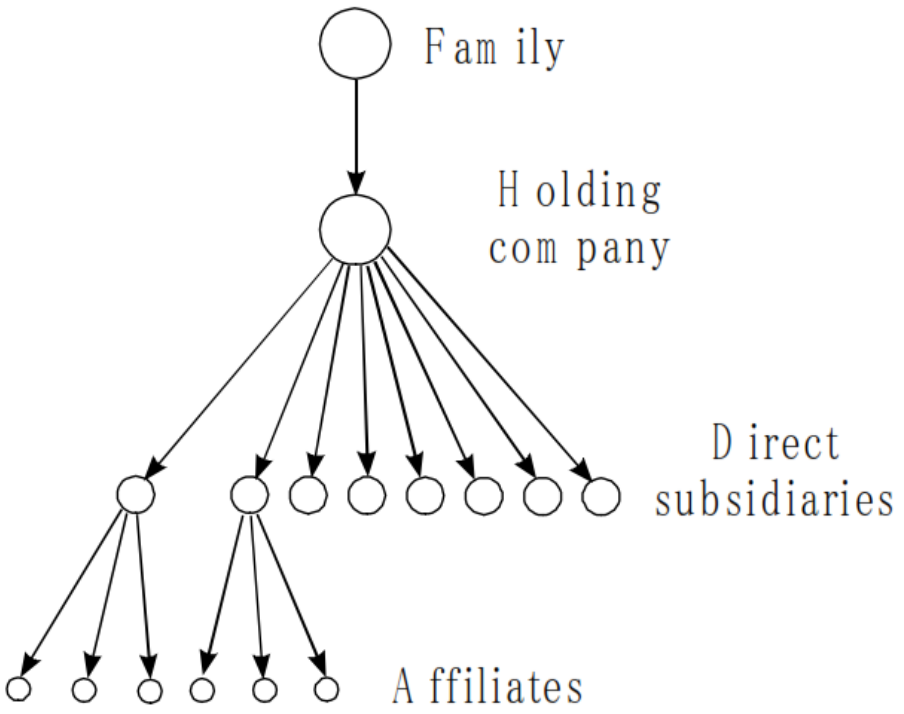
# A Structure of Keiretsu (cont'd)

- The essential feature of the Japanese companies **distinguishing them** from the **American and the European** ones is the long-term character of the **relations connecting** with the **banks within the Keiretsu groups**.
- The most important determinants of these relations include: the banks combining the function of a **lender and shareholder**, the key role of indirect finance, particularly loans provided by the main bank, in the company's capital structure, and the dominant role of banks in the process of the **companies' monitoring** in the situation when financial results get worse.
- The main bank provides the group companies with a **full range of banking services**, including: financing, deposits, foreign exchange transactions, payments, securities sub-issue and others.
- The main bank carries out **permanent monitoring** of the companies on behalf of other lenders as well.

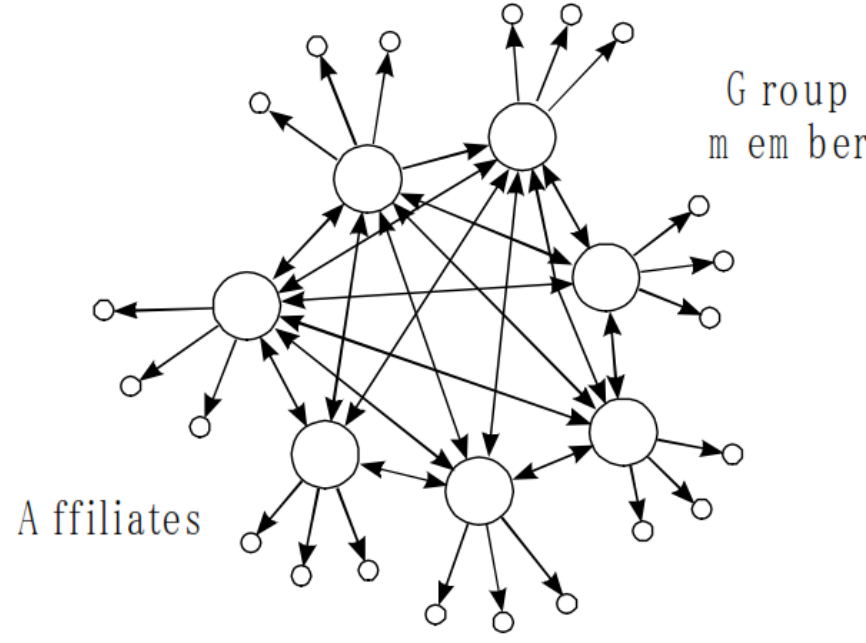
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# Structures of *Zaibatsu* and *Keiretsu*

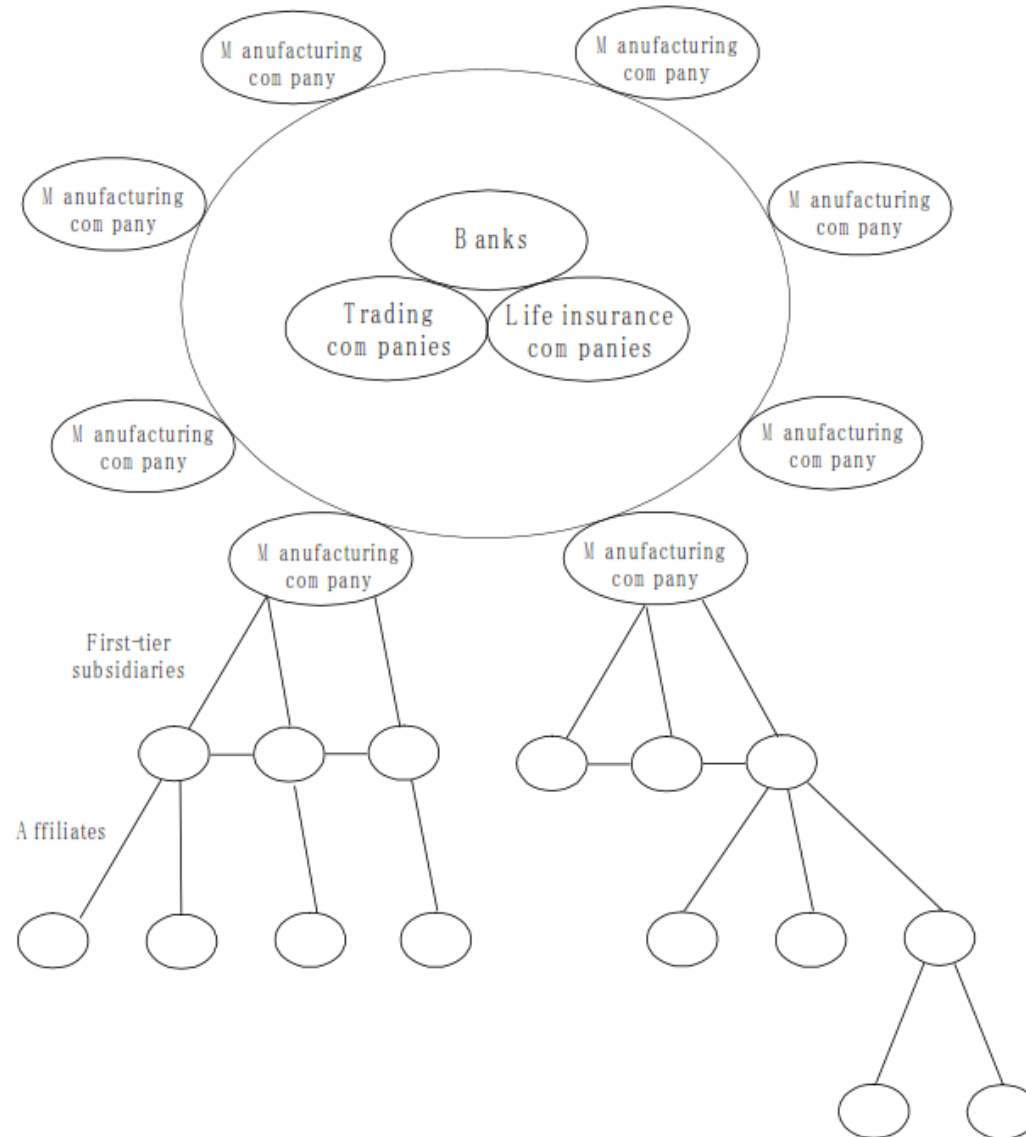
*Zaibatsu*



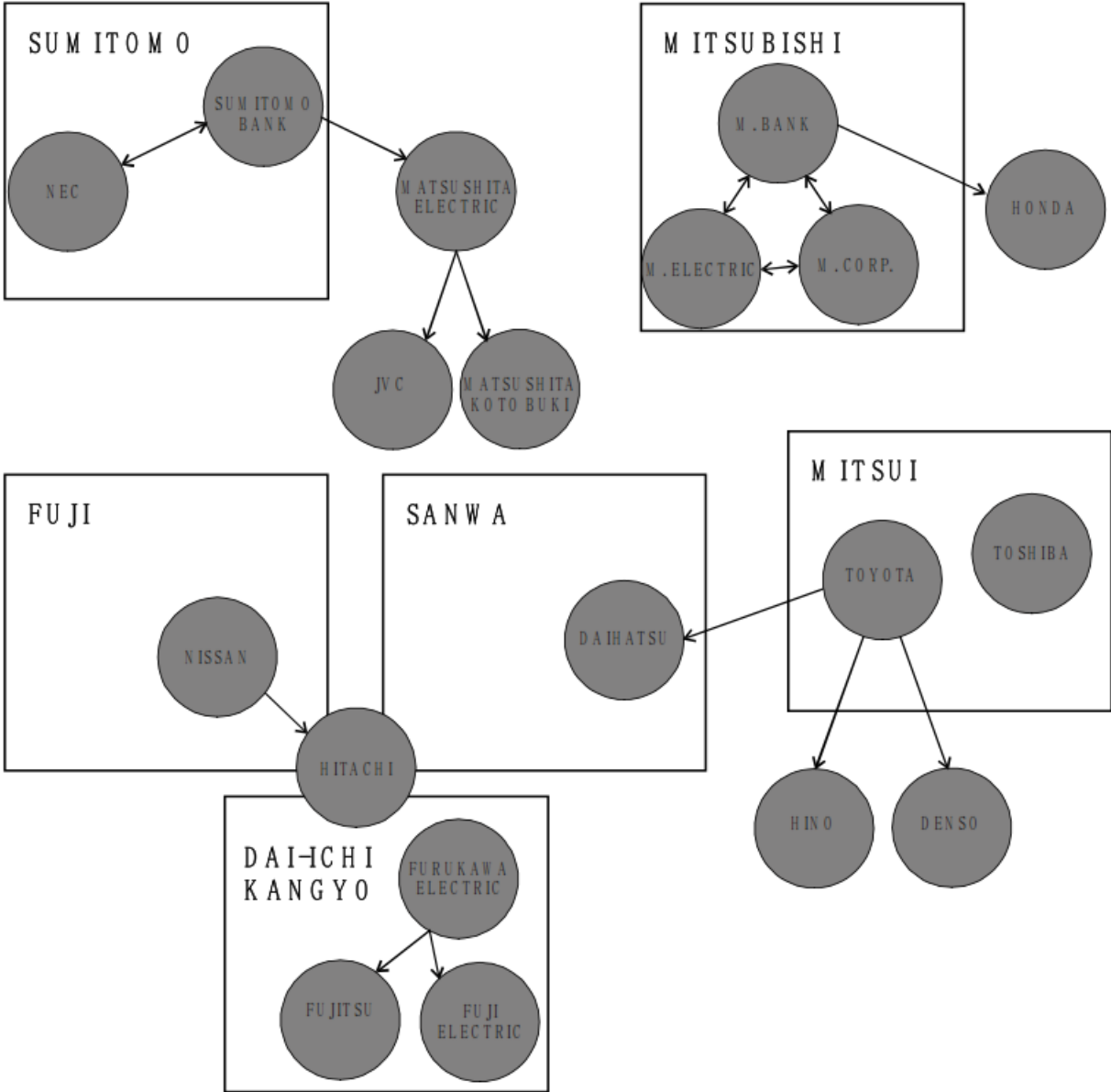
*Keiretsu*



# Structure of *Keiretsu*



# Integration of Horizontal and Vertical Keiretsu



## Cross-Shareholding of Major Horizontal Keiretsu (% of total share value)

Group <sup>a</sup>	1987	1999	2000	Change <sup>b</sup> 1987-2000
<i>Mitsubishi</i>	11.16	11.62	9.15	-18.01
<i>Mitsui</i>	6.35	6.95	4.78	-24.72
<i>Sumitomo</i>	10.95	9.43	8.46	-22.73
<i>Sanwa</i>	4.75	4.79	4.07	-14.31
<i>Fuji</i>	5.27	4.31	3.70	-29.79
<i>Dai-Ichi Kangyo</i>	6.99	6.32	5.87	-16.02
Cross-shareholding ratios of the six corporate groups (value basis)	28.01	20.36	16.71	-40.34
Cross-shareholding ratio of overall market (value basis)	18.4	10.6	10.2	-44.56
Intra-group cross-shareholding ratio (value basis)	12.10	9.39	7.47	-38.26

<sup>a</sup> Group firms as identified by Nippon Life Insurance

<sup>b</sup> Percentage change in cross-shareholding from 1987-2000

Source: NLI Research Institute (2001, pp. 30-1)