3 Sōgō Shōsha Quo Vadis?

The Strategies of the Japanese General Trading Houses in the Chinese Market

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Introduction

The existence of general trading houses with huge transaction volumes, acting as traders, investors and project organizers in domestic and foreign markets is one of the remarkable features of the Japanese economy. However, shaken by the current changing domestic and international environment and by the aftermath of the bursting of the financial bubble, their future as a unique type of firm lies in doubt. Since foreign trading activity is the well-known special feature of these so-called sōgō shōsha,[1] their performance as international traders and as actors in foreign markets will most probably determine their future existence. As China is probably the strategically most important foreign market for Japanese business at present, Chinese performance and Chinese expertise are of crucial importance for them. Indeed, the sōgō shōsha have been playing a prominent role in the Sino-Japanese trade and economic relationship. Their eminent status is demonstrated by some illuminating facts:[2]

- They handled about ten per cent of all Sino-Japanese trade in 1999;
- They own minority shares in about every fifth Japanese manufacturing investment in China;
- They initiated, promoted and sometimes co-financed virtually all large Japanese infrastructure projects in China;

[1] As members of the Japan Foreign Trade Council (JFTC), the 17 trading companies are officially called sōgō shōsha. However, the focus of economic and business research as well as of the Japanese public is limited to the eight largest trading companies among them, namely Mitsui & Co., Ltd. (*Mitsui Bussan*), Mitsubishi Corporation (*Mitsubishi Shōji),* Itōchu Corporation (*Itōchū*), Sumitomo Corporation (*Sumitomo Shōji*), Marubeni Corporation (*Marubeni*), Nisshō Iwai Corporation (*Nisshō Iwai*), Tomen Corporation (*Tomen*) and Nichimen Corporation (*Nichimen*).

[2] The following figures are rough estimates based on official statistics, private business information sources (Kaigai Shinshutsu Kigyō Sōran) and direct information from the sōgō shōsha.

- They have subsidiaries and offices all over China;[3]
- The leading sōgō shōsha have intimate contacts to the very top ranks of Chinese politics (metropolitan, provincial) and business, including leading political figures like Jiang Zemin and Zhu Rongji.

The sōgō shōsha are evidently well connected to the domestic Chinese networks. In the Chinese market they are influential, effective and successful agents for Japanese, and at times non-Japanese companies. As a result, the activities and strategies of the sōgō shōsha in China are not only interesting per se, their performance in the difficult Chinese market environment is also relevant for the theoretical analysis of the sōgō shōsha. Their achievements in China may shed some light on their future as an international trading company. Thus this paper is basically on two levels. In the first general part – drawing from the rich sōgō shōsha literature – the rationale of the sōgō shōsha type firm will be considered in a rapidly changing business environment. The second special part will deal with particular questions related to China. The main questions of the paper are: What is a sōgō shōsha per se? What are its main functions? What are its core competencies? With special reference to China it will be asked: What are the main economic activities of the sōgō shōsha in China? Which role do they play in the Sino-Japanese trade and investment relationship? What are the recent activities and strategies of the sōgō shōsha in China?

Methodologically the following contribution is based on the ample sōgō shōsha literature, on the current information from newspapers, journals, business information directories, and above all on empirical fact finding at the sōgō shōsha firm level. For the latter purpose open-structured interviews have been carried out by the author with representatives of the sōgō shōsha in Tōkyō and Beijing from May to July 2000.

THE SŌGŌ SHŌSHA IN THE FACE OF STRUCTURAL CHANGE

WHAT IS A SŌGŌ SHŌSHA?

The advantage of inter-firm partition of labour provides in general terms the reason for the existence of profit-seeking trading companies which balance supply and demand spatially, inter-temporally, quantitatively and qualitatively. International trading companies specialize in trading in for-

[3] To be more precise: There are sōgō shōsha offices in Beijing, Changchun, Chengdu, Chongqing, Dalian, Fuzhou, Guangzhou, Haikou, Harbin, Hong Kong, Kunming, Nanjing, Nantong, Ningbo, Qingdao, Shanghai, Shenyang, Shenzen, Tianjin, Wuhan and Xiamen.

eign markets and in assuming the specific risks of foreign trade. They are a common phenomenon in all capitalist economies. But what is the difference between the sōgō shōsha and the international trading companies in other countries? In comparison the sōgō shōsha have three main characteristics:[4]

First of all the sheer size is evident (for a statistical overview see Table 3.1). In the annual Forbes lists of the world largest companies (i.e. the years 1999 and 2000) the three leading sōgō shōsha (Mitsui Bussan, Mitsubishi Shōji, Itōchū) can be found in the top ten ranking (by turnover) together with Wal-Mart, the bigger automotive manufacturers and the big international oil companies. The next three big sōgō shōsha (Marubeni, Sumitomo Shōji, Nisshō Iwai) follow close behind, being listed among the top twenty.

Table 3.1: **Key corporate data of the sōgō shōsha (31.3.2000)**

Sōgō Shōsha	Trading transactions in million USD	Net income in million USD	Number of employees (Japan/overseas)	Number of offices (Japan/overseas)
Mitsui Bussan	128 162	346	7 159/ 3 543	34/ 89
Mitsubishi Shōji	127 309	253	7 556/ 3 437	45/ 117
Itōchū	114 408	-1302	5 254/ 2 200	19/ 150
Sumitomo Shōji	103 457	-340	5 436/ 2 756	34/ 158
Marubeni	96 438	154	5 344/ 2 398	27/ 154
Nisshō Iwai	68 692	-96	2 964/ 1 754	32/ 136
Tomen	27 008	-890	1 702/ 1 072	17/ 42
Nichimen	26 961	-28	1 418/ n.a.	15/ 94

Source: Annual Reports 2000.

Apart from the simple fact that they are traders, the other particular feature of the sōgō shōsha is their low degree of specialization. Usually foreign trading companies are specialized in certain products, markets or services. However, this is not the case with the Japanese *general* trading companies:[5] Their range of trading products includes raw materials, energy, food, textiles and apparel, chemicals, plants and machinery, vehicles and various consumer products, or as Marubeni has put it 'everything from mineral water to satellites' (http://www.marubeni.co.jp). Beyond trade the sōgō shōsha are active in many other service sectors like trade finance and insurance, transport and logistics, and the organization and coordination of investment projects. Moreover, they have invested in mining, in the energy

[4] For a detailed description of the sōgō shōsha business: Eli 1977; for a more recent overview: Nakatani 1998.

[5] See the English meaning of the Japanese term '*sōgō*' = synthetic, comprehensive and '*shōsha*' = trading company.

sector, in telecommunications, in the media, in financial services, in wholesale and retail trade as well as in overseas manufacturing plants on their own right. According to the claims of the sōgō shōsha, the virtue of the wide scope of business activities and functions is the increase of profitable business opportunities and the diversification of risks.

Another striking feature of the sōgō shōsha is their presence not only in the major business centres worldwide but also in the more important emergent markets. In economies that are just about to open up to the international economy, e.g. Indochina, Central Asia and the Russian Far East, they conduct market research, they venture into resource exploration projects and they pioneer virtually any (potentially) profitable business. The sōgō shōsha's business operations are characterized by economies of scale, a global reach, switch trading, a handling of products repeatedly along the value-added-chain, and synergy effects through an integrated organizational structure. Usually the sōgō shōsha trade in their core business activities with standardized or bulk products, they handle large transaction volumes or recurrent lots, so that transactions costs can be held low and their famous 'razor-thin margins' can be offered. There are other business transactions, however, such as the Japanese import of luxury items, of highly sophisticated machinery, or the overseas infrastructure business, where the sōgō shōsha show a remarkable preference for high value-added and high margins. In any case due to the global network and the wide range of products and functions, the business structure and organization of the sōgō shōsha are very complex (Gödeke 1991, Roehl 1983).

The third characteristic feature of the sōgō shōsha company type is their unique existence in Japan. The business activities and functions as well as the organizational structures of the sōgō shōsha are closely connected (and related) to the particular features of the business system and the cultural setting of Japan. The sōgō shōsha are integrated into the manufacturing supply networks and the distribution system of Japan, they play an essential role in the horizontal business groups (*keiretsu*), and they are an integral part of the so-called iron triangle of politics, ministerial bureaucracy and business. Historically their emergence is closely related to severe market failures during Japan's early industrialization period. Their success is connected to the catching up and industrialisation process. Since the early stages of Japan's industrialization the sōgō shōsha were able to secure the sourcing of raw materials and energy as well as the supply of technological strategic inputs, and they successfully developed export markets overseas for their Japanese industrial customers, so that the latter could specialize solely on manufacturing.[6]

[6] That is probably why Kojima and Ozawa named their 1984 published work on

Theoretical explanation

The well-known special features of Japanese economic history and of Japanese culture, e.g. Japan's late-comer status, Japan's business practices and cultural values – the uniqueness of these being widely accepted in the economic and business literature – provide a plausible theoretical explanation for the sōgō shōsha phenomenon in Japan and their commercial success (Yoshihara 1982). However, a historic and cultural approach of this kind fails to identify and analyse the relevant determinants explaining the rationale of the sōgō shōsha in a common theoretical framework. Such a common theoretical framework is the necessary prerequisite for a comparison between the sōgō shōsha and trading companies from other countries. Mainstream neoclassical theory still cannot provide such a general framework. Closest to the required common logical and comparative analysis of the sōgō shōsha is the theory of institutional economics. Central to the institutional analysis of the sōgō shōsha is the notion of transaction costs.[7] The existence of transaction costs in foreign trade can be put down to information asymmetries, the specific risks of foreign trade, protectionism and other 'structural' foreign trade impediments. High and scale-intensive transaction costs in foreign trade are generally a constitutive feature of foreign trade (Schmidt-Trenz 1990, p. 74). Whereas in the West foreign trading institutions were gradually built up and trading knowledge was accumulated step by step, historically Japan had to face high foreign trade transaction costs in an abrupt way. At the beginning of industrialisation the high transaction costs of foreign trade were a prohibitive barrier for Japanese manufacturing companies acting far away from the world market. Major parts of the Japanese manufacturing industry could only get access to world supply and sales markets with the active help of the sōgō shōsha, which had accumulated a significant expertise in foreign trade ranging from the mere trade operating know-how to the intimate knowledge of foreign markets.

Furthermore, by centralizing the industrial demand from Japan, the general trading houses were able to gain considerable purchasing power

the sōgō shōsha: Japan's General Trading Companies – Merchants of Economic Development.

7 The analysis of transaction costs goes back to Ronald Coase and his early work on the theory of the firm (Coase 1937, pp. 386–405). Based on Coase's analysis Oliver E. Williamson has developed a refined and complex model of transaction cost economics (Williamson 1985: chapters 1–3). Furthermore it is notable, that Roehl and Gödeke argue explicitly that the sōgō shōsha have the specific capacity to save transaction costs in the Japanese economic and cultural setting. See Roehl 1983, pp. 388–414; Gödeke 1991, pp. 33, 43.

in world markets. With growing export and import volumes, the mutual business relations (between the sōgō shōsha and their Japanese customers) grew increasingly close and intensive, and the complexity of the executed transactions also increased. This is one reason why the sōgō shōsha, not the Japanese banks, supplied the manufacturing industry with trade financing facilities to export to and to invest in overseas markets. In later stages the sōgō shōsha advanced even to organizers and promoters of raw material exploration and infrastructure development overseas (Kojima and Ozawa 1984, pp. 11–32). The sōgō shōsha played another important role in export and trade insurance, since only the sōgō shōsha in their function as an insider of the trade transactions could guarantee explicitly and implicitly the payment of the delivery (Sheard 1992, pp. 238–47). In summary, the sōgō shōsha were able to offer virtually all services needed in international business in an integrated manner and by doing so were able to attain considerable economies of scope.

Under the theoretical assumption of bounded rationality and opportunistic behaviour, the business relations of the sōgō shōsha to their Japanese suppliers and customers can be situated somewhere between the antipodes of market transaction and corporate hierarchy. From the institutional analysis standpoint they constitute an intermediate, often relational form of a contractual relationship characterized by the existence of long-term (implicit or explicit) contracts between the firms involved and a low degree of vertical integration within the firms. Such contracts do not take into account all future contingencies of business relationships, they are informal, implicit, not legally binding and imbedded in social and personal relations (Williamson 1985, p. 123). By virtue of the close ties of the sōgō shōsha to their business partners they ideally combine the advantage of low transaction costs with the advantages of market exchange, namely low internalization costs. Not surprisingly the sōgō shōsha are especially capable of realizing low transaction costs in business activities that deal with standardized products, with products handled in large lots or repetitively and with products moving through the production cycle (Roehl 1983, pp. 388–98). The notion of relational contracts is not unique to Japan, but the spread and the sophistication of closed networks in the industrial supply chain and in the distribution sector is not matched by economic systems outside of Japan. The widespread Japanese business culture of group orientation, consensual behaviour and the importance of personal relationships permanently secures the stability of once-established (confidential and reciprocally based) business relations. Within such well-established business relations the tendency to opportunistic behaviour is remarkably lower than elsewhere. Instead, confidence, loyalty and cooperativeness are more widespread

(Aoki 1984, pp. 3–43; Gödeke 1991, pp. 126, 131, 158–63). Being insiders in trade transactions and having established an intimate relationship with their (Japanese) customers, it comes as no surprise that the sōgō shōsha perform many more business functions than just trade and trade finance. They provide and process market information, they handle transport, logistics and storage, they are active in wholesale and retail operations in Japan and abroad, and they even organize and participate in various investment projects abroad.

Structural challenges

The above description of the sōgō shōsha as the universal foreign trader for Japanese business may have been correct until the mid-1980s. Since then, however, the sōgō shōsha have been facing increasing structural challenges and are struggling for survival. The three main challenges the sōgō shōsha have to cope with, are (1) the fading away of the traditional Japan-centred trading business, (2) the current industrial shift away from sunset industries, and (3) the pressing need for an internal restructuring.

(1) Most important from a theoretical point of view, the relational contract relationship between the sōgō shōsha and the Japanese manufacturing industry has come under increasing stress. Along with the appreciation of the yen in the second half of the 1980s, the Japanese manufacturing industry invested heavily in North America, in Europe and in Asia, and internationalized their purchasing, production and sales functions. Former export firms turned into multinational companies. When manufacturing firms reorganized their international activities in a way that minimized their transaction and internalization costs, the former relationship with the sōgō shōsha was increasingly substituted by the vertical integration of the formerly external manufacturing and distribution capacities into the existing firm hierarchy. By doing so the manufacturing companies were able to save substantial transaction costs. The sōgō shōsha, however, were losing significant shares of their former core business and were compelled to seek new business opportunities. This decline of core business increased even more in the 1990s when globalization trends intensified the competitive pressure on the manufacturing sector, the domestic economy of Japan stagnated, and technological innovations (the internet) made it easier to by-pass the middlemen (Nakatani 1998; Söderberg 2000).

(2) A fundamental industrial change in the Japanese economy, which started already in the early 1980s, put additional pressure on the sōgō shōsha to restructure. The relative weight of the product groups that were

the traditional focus of the sōgō shōsha trading activities, namely raw materials, energy, iron and steel, industrial machinery, chemicals, declined in Japan's foreign trade as well as in world trade. The sōgō shōsha's foreign trade in high-technology-goods, however, remained markedly small. Along with its systemic decline of business transactions with the Japanese manufacturing industry, this sectoral shift explains why the sōgō shōsha's share in Japan's total trade declined substantially over the 1990s. This decline was especially pronounced on the import side (Nakatani 1998; Söderberg 2000).

(3) In retrospect, it may have been an unfortunate coincidence that the economic Heisei boom from 1986 till 1991 concealed the structural problems of the sōgō shōsha. The sōgō shōsha invested heavily in the Japanese stock exchanges and real estate markets by means of special investment funds. At the height of the asset bubble some sōgō shōsha raised about a third of their profits from financial and real estate activities. When the bubble burst, the turnover of all sōgō shōsha virtually collapsed. Compared to the base year of 1990 the total turnover fell to 65 per cent, on average, in 1995 and to 58 per cent, on average, in 1999 (see also Table 3.2). The long stagnation of the Japanese economy in the 1990s and the 1997 Asian crisis aggravated the financial situation of the sōgō shōsha even more. At the end of the decade the sōgō shōsha were trapped in a spiral of contracting operating income (with coincidently fixed overheads), increasing depreciation volumes as a consequence of financial losses, and an deteriorating credit rating.

Table 3.2: **Key financial characteristics of the sōgō shōsha (FY 2000)**

Sōgō Shōsha	Return on equity on 31 March 2000 in %	Debt earning ratio on 31 March 2000 in % (net)	2000 sales transactions share of 1990 Sales transactions	Risk positions on 31 March 2000 in billion JPY*
Mitsui Bussan	5,38	400	72,4	262,4
Mitsui Bussan	5,38	400	72.4	262.4
Mitsubishi Shōji	0,60	410	75.3	366.2
Itōchū	n.a.	1200	59	451.8
Sumitomo Shōji	5,80	390	55.5	424.4
Marubeni	0,61	1030	53.8	581.5
Nisshō Iwai	5,90	1420	54.6	455
Tomen	n.a.	n.a.	42.4	n.a.
Nichimen	n.a.	n.a.	46.3	n.a.

Note: Risk positions consist of investments in Indonesia, Korea, Russia, Thailand, PR China, in real estate, and in venture capital in the information industry.

Source: Company information for Bōeki Kishakai (May 2000) and in annual reports.

Restructuring and re-inventing

Thus the restructuring and consolidation process, which was overdue since the mid-1980s, got off to an effective start only towards the end of the 1990s at a time when the whole Japanese business system was experiencing a period of comprehensive regulatory and institutional change and the Japanese economy faced a sustaining state of stagnation.

Two general trading houses, namely Kanematsu and Tomen, had to ask their creditors for debt forgiveness and eventually were forced to carry out severe restructuring. Kanematsu more than halved the number of their employees, eventually lost the status of sōgō shōsha and was downgraded to that of a senmon shōsha (i.e. specialized trading company). At Tomen the new major shareholder, Toyota Tsushō, the trading company of the Toyota Group, acquired a domineering influence. But also the larger sōgō shōsha were not able to circumvent their own restructuring. In the post-bubble era no company was immune to financial breakdown. Financial analysis makes clear that all sōgō shōsha show a low return on equity and a high debt earning ratio (see Table 3.2). Compared to former highs, share prices are very low.

This triple challenge of the fading away of the traditional Japan-centred trading business, the current industrial shift away from sunset industries, and the pressing need for an internal restructuring made the need for a new strategic focus of the sōgō shōsha all the more urgent. To be sure some restructuring had already started in the 1980s, though unfortunately consisting mainly of a much too hasty drive for diversification at that stage. The strategic decisions taken at the end of the 1990s were not homogeneous, so that in the current process of change and restructuring the former uniform notion of the sōgō shōsha is becoming more and more blurred and diverse. Nevertheless there is a parallel pattern of restructuring, namely diversification, vertical integration into the wholesale and retail sector, a streamlining of the domestic and the international activities, and an internal reorganization.

All sōgō shōsha have entered into new business fields. Generally it is claimed that the focus is on the information industry and on telecommunications. The bigger companies ventured already in the 1980s into satellite communication, in the 1990s they expanded into mobile communication and information services. In the new century they are establishing internet portals for e-commerce and they are pioneering the internet business throughout Japan. However, in spite of this new strategic orientation and some first bold moves, the new economy still plays a subordinate role in the sōgō shōsha's total business activities. Another major focus, at least for the larger companies, is the field of financial services –

in spite of the heavy losses incurred as a consequence of the burst bubble. There is significant activity in the trading of money, securities, futures and commodities, the project finance of large construction and infrastructure ventures overseas, the issuing of venture capital funds and in the leasing of airplanes, vehicles and machinery. Another important field of diversification is the media sector, most notably in the case of Itōchū, Mitsui Bussan and Sumitomo Shōji.

Trading is the true core competence of the sōgō shōsha. Being an integrated (*'sōgō'*) trading company, the sōgō shōsha have always been both foreign and domestic traders. In the 1990s, by means of further vertical integration into the domestic trade, they were in the process of strengthening their market position in Japan even more. In the current consolidation of the Japanese distribution sector they are actively expanding market shares and are becoming a more and more dominant actor. Itōchū, Mitsubishi Shōji and Sumitomo Shōji ventured into the retail sector by taking capital shares in convenience store chains, specialty stores or even department stores. In that way they aim to control the whole distribution chain, an effort that seems to have been quite successful already in the area of food imports to Japan. The sōgō shōsha owe their recent success in the Japanese wholesale and retail sector partly to their innovative logistical expertise. Beyond mere trading they are capable of providing sophisticated supply chain management functions. Thus customers from the retail sector and from the manufacturing industry can outsource these functions, cut purchasing expenses – saving transaction costs – and concentrate on their core business.

The diversification process is being checked by the pressing need to restructure. Under the scrutiny of financial markets it is neither advisable nor feasible to be engaged in the whole scope of industry any longer. Orientation to profit making, concentration on core competencies and specialization are the key words mentioned in the corporate mission statements of virtually all general trading houses. Mid-term business plans with strategies aimed at improving profitability have been set up. The plans include both defensive moves, such as curbing of personnel expenses including staff reductions, general cost cutting, amalgamations and liquidation of assets as well as more offensive decisions to expand into the fields of the chosen core competence. For example Mitsubishi Shōji and Nisshō Iwai are merging their steel divisions. Nisshō Iwai acquired or merged with Nichimen's profitable IT subsidiaries, its building material and pulp and paper divisions. Itōchū aims to concentrate primarily on information and multimedia industries, consumer and retail related industries, financial services and natural resource development. Thus Itōchū is still handling quite an extensive menu of activities, while actively pulling out of former established business fields. As a consequence Itōchū no longer claims to be a sōgō shōsha that trades universally in any type of product.

Although the current process of financial and organizational restructuring is certainly driven by the financial markets' demand for increased profitability, this course could ultimately change the appearance of the sōgō shōsha in a more fundamental way. By losing their integrated ('*sōgō*') function, the sōgō shōsha no longer seem to be general trading houses. They are becoming more and more specialized and are more and more active in non-trading areas. But if the sōgō shōsha are no longer *general* and *trading* companies, what are they? What will be the outcome of the current transition? It is certain that in a competitive market environment companies must concentrate on their core strengths and rid themselves of the burdensome rest. But even though the sōgō shōsha have developed into multi-functional and multi-divisional companies, notably in their structural composition and profitability, they still have to do considerable re-inventing and streamlining. Judging from the past, the sōgō shōsha's chances of survival are not so poor. They have a proven capability of adapting to changing situations and of moving into hitherto uncharted waters. Being active in world markets they know what it is like to be exposed to competitive pressure. Thus, they are less vulnerable to deregulation in Japan than other Japanese industries. It can be expected that the sōgō shōsha will continue their current struggle to restructure, redefine relationships and re-invent. Of course, the likely outcome of this process is difficult to foresee. A change is highly probable in the organizational realm. In future the sōgō shōsha may become an investment holding company, and in fact some companies have already officially stated this objective of organizational change. Investment holding companies have been allowed since a legal change in the 1990s, but a transformation of this kind does not make much sense for the sōgō shōsha because taxes cannot be paid on the basis of consolidated accounts in Japan.

Why is China so important?

If organizational change into holding companies is feasible, it is evident that in the current transitional process the sōgō shōsha are drawing nearer to a type of firm that has been a well-established form in the Western business world for some time. But getting closer is not the same as being the same. It is hard to imagine that the sōgō shōsha will not continue to be a unique type of firm. Above all the sōgō shōsha will always depend on its universal presence and its international trading activity. The central role the sōgō shōsha play in the Japanese economy depends crucially on its linkages to the outside world. Domestic trade and international trade (consisting of export, import and offshore trade) support each other and the interaction of both is synergetic. In fact the share of domestic trade in the sōgō shōsha's total operations has hardly changed over the last 20 years. It amounted to 45.7 per cent in 1980, 40.8 per cent in 1990 and 46.3 per cent in 1999.[8]

In this respect it is obvious why China is so important for the Japanese trading houses. The Sino-Japanese trade relationship has become the most important one in East Asia in quantitative terms and has even grown to be the most dynamic of the region. For the Japanese economy China is, next to the US, the second most important import source and, after the US and Taiwan, the third export destination. For China, Japan is the most important trading partner. Furthermore, China has become the most important location worldwide for direct investment of Japan's manufacturing industry and is the major pull factor of the much-lamented hollowing-out of Japanese industry. Attracted by the cheap labour and the promise of a big market, Japan's small and medium-sized enterprises are flocking to the China coast. But China is also a difficult and risky location to do business, and Japan's smaller manufacturing companies suffer generally from a lack of knowledge and a lack of human and financial resources for success in overseas markets. It is well known that the China investment environment is characterized by high risks as well as political and legal uncertainty (Hilpert and Haak 2002, pp. 5–8).

To put it in theoretical terms, more than anywhere else China seems to be a place where high and scale-intensive transaction costs impede a successful market entry (of a Japanese enterprise). The sōgō shōsha can be a natural partner for Japanese business to overcome these hurdles. Thus, mindful of the potential high future proceeds as traders and middlemen in China, the general trading houses have invested heavily into China so as to acquire their own specific China expertise. By building up a substantial amount of transaction specific capital they may eventually gain a fair share of the future China business. On the other hand, the sōgō shōsha's clients, Japanese small and medium-sized enterprises, may enjoy specific competitive advantages due to the presence and the activities of the sōgō shōsha in China.

[8] However, the composition of international trade changed within this period. Most notably the share of offshore trade increased considerably in the 1980s, but fell somehow over the 1990s (1980: 11.7 per cent; 1990: 28.2 per cent; 1999: 23.0 per cent). The 1980 and 1990 shares are taken from Abaco 1993: p. 75; the 1999 shares are calculated from the figures stated in the sōgō shōsha's 2000 annual reports.

Further to the transaction cost based arguments, there is also a supreme strategic reason for the importance of China. If China can sustain its high economic growth rates, the world's highest concentration of production and income will be located on the Chinese coast, which is situated just next door to Japan. To deal properly with this sea change in the Asian and the global economy will be a matter of survival both for individual companies and for Japan as a whole. If in this changing environment, a sōgō shōsha does not have expertise on China, how can it hold up its cherished integrated function?

Sōgō shōsha business activities and strategies in the China market[9]

Historically the sōgō shōsha trading activities with China reach back to the end of the nineteenth century, a period when the expanding Japanese textile and apparel industry's needed secure cotton supplies from abroad. In the first half of the twentieth century the sōgō shōsha's trade with China expanded in the course of Japan's economical, political and military advance in Asia. After the end of the Second World War the sōgō shōsha's business with China fell to a minimum along with the general collapse of Sino-Japanese trade. During the Cold War only Nichimen kept trading with Mainland China under its own name and had maintained a representative office in Beijing since 1959. All the other sōgō shōsha, being compelled to decide whether to trade with the People's Republic of China or with Taiwan (Republic of China), chose the latter as their more important trading and business partner. In March 1972 six months before Japan and the People's Republic of China resumed diplomatic relations, Itōchū was the first sōgō shōsha to establish formal trade relations with the mainland. Soon afterwards the other sōgō shōsha followed suit. Over the next years one after the other attained the official status of a 'Friendly Trading Company'. The trade with China expanded rapidly and so did at a later stage the direct investments and the physical presence in China. An overview of the sōgō shōsha's activities in quantitative terms at the start of fiscal year 1999/2000 is shown in Table 3.3 and their financial commitments in China in Table 3.4. Currently, China is the sōgō shōsha's second most important foreign market, next only to the US. For some trading companies China is already more important than the rest of Asia. Generally the representatives of the sōgō shōsha expect that the impor-

9 This section draws mainly on interviews conducted by the author with representatives of the sōgō shōsha in Tōkyō and in Beijing.

tance of China for their total business will increase even more in future. As a consequence all sōgō shōsha have made considerable efforts to establish themselves in the Chinese market. The general optimistic assessment of China and the strategic aim of localization notwithstanding, the sōgō shōsha's strategic focus has decisively turned away from volume growth to an increase in profitability.

Table 3.3: **Key data on the China business of the sōgō shōsha (as of 1.4.1999)**

Company	Number of employees	Trading by type of transaction in million USD	Trading by industries (Mio. USD)	Manufacturing investments (million USD and numbers)
Mitsui Bussan	Japanese: 73 Chinese: 336	Exports to Japan: 1 500 Imports from Japan 500 Offshore trade: 1 900 Total trading volume: 3 200	Machinery: 900 Chemicals: 700 Iron & Steel: 600	Total amount: 220 Number of investment projects: 106
Mitsubishi Shōji	Japanese: 64 Chinese: 410	Exports to Japan 1580 Imports from Japan 680 Offshore trade: 660 Total trading volume: 2 920	Machinery: 1070 Textiles: 610 Metals: 350	Total amount: 190 Number of investment projects: 117
Itōchū	Japanese: 57 Chinese: 283	Exports to Japan: 1 100 Imports from Japan: 1 800 Offshore trade: 1 900 Total trading volume: 4 800	Machinery: 1600 Textiles: 1200 Energy and Chemicals: 900	Total amount: 400 Number of investment projects: 240
Sumitomo Shōji	Japanese: 47 Chinese: 322	Exports to Japan: 1 170 Imports from Japan: 590 Offshore trade: 370 Total trading volume: 2 130	Electronic machinery: 770 Iron & Steel: 390 Chemicals: 290	Total amount: 150 Number of investment projects: 125
Marubeni	Japanese: 45 Chinese: 375	Exports to Japan: 900 Imports from Japan: 1 350 Offshore trade: 750 Total trading volume: 3 000	Machinery: 900 Plants: 400 Metals: 400	Total amount: 350 Number of investment projects: 130
Nisshō Iwai	Japanese: 48 Chinese: 218	Exports to Japan: 670 Imports from Japan: 350 Offshore trade: 970 Total trading volume: 1 990	Raw Materials: 680 Machinery: 640 Energy: 160	Total amount: 100 Number of investment projects: 83
Tomen	Japanese: 25 Chinese: 144	Exports to Japan: 220 Imports from Japan: 270 Offshore trade: 80 Total trading volume: 600	Chemicals: 200 Textiles: 180 Food: 110	Total amount: 50 Number of investment projects: 37
Nichimen	Japanese: 27 Chinese: 166	Exports to Japan: 320 Imports from Japan: 500 Offshore trade: 360 Total trading volume: 1 180	Machinery: 490 Textiles: 200 Chemicals: 170	Total amount: 97 Number of investment projects: 54

Source: *Bureenzu* of 11.9.1999.

Table 3.4: **The financial commitment of the sōgō shōsha in China by item – in billion JPY –**

Company	Investments	Credit lendings	Guarantees	Open positions (net)*
Mitsui Bussan	24.30	4,5	9,30	32.4
Mitsubishi Shōji	34.20	7,4	2,5	57.7
Itōchū	48.30	35.90	22,9	83.3
Sumitomo Shōji	24.30	0.80	11,7	26,9
Marubeni	32.50	47.0	94,4	146.4
Nisshō Iwai	24.0	55.40	5,6	44.4

Note: * Total of all investments, credit lendings, guarantees minus insured items.

Source: Company information on Bōeki Kishaka (May 2000).

Organization

In the beginning of the first decade of the twenty-fist century, prior to China's accession to the WTO, foreign and domestic trade are still belong among the non-liberalized business sectors in China. Consequently, the main part of the sōgō shōsha's Chinese exports and imports is still officially handled by headquarters in Tōkyō or Ōsaka. Still it is primarily the Japanese headquarters that are responsible for business investments in China. The sōgō shōsha's representative offices in Beijing and in various other cities are not yet officially allowed to trade on their own account; they may only negotiate on behalf of the company, i.e. the Japanese headquarters. However, there are fully owned subsidiaries in the bonded areas of Shenzen, Guangzhou, Shanghai, Dalian, Tianjin and Qingdao that are allowed to do business with other foreign subsidiaries within these special trading zones. Beyond this restriction the subsidiaries are also quite active outside of the bonded areas doing business with local companies. Such actions, though prohibited in the strict legal sense, are tolerated by the Chinese authorities. From 1993 till 1998 all sōgō shōsha set up China investment holding companies in China (*Touzi Xing Gongsi*), most of which are located in Beijing. In principle the investment holdings should take over the responsibility for all investments in China, at least for all newly established investments. However, under the current regulations these investment holding companies are obliged to hold at least a ten per cent share of each of its Chinese investments (so-called 'ten per cent rule'). This regulation has been set up with special regard to manufacturing companies. For a sōgō shōsha, however, whose investment strategy is usually only a minority share, the ten per cent rule is difficult to comply with. Therefore only a part of the sōgō shōsha's China investments are administrated by the new holdings. The actual role of these holding companies includes administration, information gathering, market research, business creation and, occasionally, payment and debt collection. In accordance with their strategic aim of localisation and in compliance with administrative deregulation in China, the sōgō shōsha will grant to the investment holding companies more and more responsibility in the operation of the China business.

FOREIGN TRADE

The development of the sōgō shōsha's Chinese foreign trade activities illustrate vividly the rapid volume growth and the change of industrial structure in the Sino-Japanese trade. In the 1970s and the 1980s the general trading houses mainly exported plant, machinery and chemicals from Japan to China and imported back raw materials such as oil, iron ore and food grains. This bilateral trade received its official blessing and some sort of state guarantee by the Sino-Japanese Long Term Trade Agreement in 1978. However, since the mid-1980s China has been increasingly exporting manufactured goods to Japan. Whereas the absolute value of China's energy, raw material and agricultural exports to Japan has remained at high levels, the more important export items are now labour and resource intensive manufactured products, amounting to a share of roughly 90 per cent of the total. The sōgō shōsha's exports to China mainly consist of iron and steel (plates, pipes), industrial plants and equipment, chemicals, industrial electronics (semiconductors, parts, machinery), telecommunication components, paper, vehicles and automotive parts. The main import items are food (rice, corn, fish and shellfish, various processed foodstuffs), textile and apparel, and raw materials (e.g. coal, coke, zinc, tin). Except for exporting and importing to and from Japan, the sōgō shōsha are also conducting China offshore trade. Most important are LPG (Liquefied Petroleum Gas) imported from Southeast Asia and apparel exported to the US and other third countries.

Beside the content change in China's export structure to Japan, equally impressive is the rapid volume growth of the Sino-Japanese trade over the last 30 years, originally instigated by the opening up of China. However, in the 1990s the sōgō shōsha's trade with China could not keep pace with the much more rapid increase of total Sino-Japanese trade. Apart from a strong position in China's textile, apparel and food exports to Japan the sōgō shōsha could not really gain a foothold in China's export of manufactured goods. Eventually their share of Sino-Japanese trade, which amounted to as much as 90 per cent in the 1970s and to about 50 per cent in 1995, fell to ten per cent in 1999 (Bureenzu 1999). The sōgō shōsha's weak trade performance in the import of manufactured goods from China should come at no surprise, because the consumer sector for the most part does not show the essential product characteristics that enable the general trading houses to handle transactions at low costs. Furthermore, at the end of the last decade both Chinese and Japanese import demand collapsed as a result of a cyclical economic downturn. In China the long phase of infrastructure and corporate investment ended in an abrupt way so that the Japanese export of plants, machinery and chemicals to China virtually broke down. On the other hand, the economic slump in Japan occurred amidst higher imports from China (as well as from other countries).

There is no doubt that the sōgō shōsha will continue to participate actively in China's foreign trade in energy, raw materials, agricultural products as well as in manufactured goods sector such as machinery, chemicals, textile and apparel. However, the profit margins in Sino-Japanese trade are generally thin, and the sōgō shōsha's relative importance in the Sino-Japanese (manufactured goods) trade will certainly not recover to its former highs. In order to attain an overall higher profitability, the sōgō shōsha will have to search for new sources of trade by expanding their trading business both upstream and downstream.

Manufacturing investment

The first sōgō shōsha manufacturing investment into China occurred already in the late 1970s. However, until the early 1990s most Japanese investment in China had more symbolic than true business value. Nevertheless, the early investors were able to gather local market information and gain valuable experience. When after 1991 the Japanese investment boom eventually took off and China advanced to become the preferred investment location for Japan's manufacturing industry, the sōgō shōsha were very well positioned. The general trading houses already looked back on nearly 20 years of business experience in China. They ran offices in many locations and were well connected to political leaders. For a foreign investor they could be useful as an information provider, consultant, mediator, relationship broker, negotiator, trade-financier and even co-investor. By virtue of their specific China know-how they could offer various investment related services, such as:

- identifying an appropriate Chinese business partner, who (ideally) has basic technical expertise, access to Chinese distribution channels, the necessary political contacts at the local level, and who is above all trustworthy;

- personal networking with business and political partners at the metropolis and at the provincial level;
- securing access to raw materials, plant equipment and machinery, to spare parts from China, Japan or third countries;
- carrying out market research in China, developing distribution channels in China and/or re-exporting to Japan;
- securing trade credit and coordinating investment finance.

By virtue of their activities a sōgō shōsha is potentially able to help the foreign investor gain swift access to Chinese resources and get a first foothold in the Chinese market. Through a liaison with a sōgō shōsha the Japanese investor can be safeguarded at least against some of the many risks investment in China usually incurs. In their Chinese investment activities Japanese manufacturing companies still tend to choose the trading house of their own industrial grouping as their preferential cooperation partner, but this relationship is certainly not the determining factor in the selection process. Manufacturing cooperation outside the existing horizontal keiretsu group does occur in particular in cases of severe competition (Jaussaud 1999, pp. 102–9).

The competitive edge of the sōgō shōsha in their function as middleman for a potential Japanese investor may now be understandable, but what is the principal merit for the trading company to be involved in a direct investment? First of all, sōgō shōsha avoid losing a valuable customer if they act as co-investor. If a manufacturing company chooses to supply the Chinese market by manufacturing locally instead of importing the goods from Japan, the trading company is cut out of its former business. If the sōgō shōsha participates in the investment, however, it will attain the full information of all the trading activities of the newly established joint venture firm. Eventually it might be able to control the supply chain and the distribution activities and might earn a slim trading margin on both trading sides. Moreover when raw materials, machinery equipment or components are provided by a connected source, a sort of triangular business may become possible. A concrete example illustrates this point: Itōchū is processing and packaging Chinese-grown peaches in a joint venture with a Chinese partner and with Dole Food Co. from the US. In this joint venture Itōchū does not only earn a share of the profitable export of canned fruits to Japan but also imports Japanese steel plates, which are needed to manufacture the cans for the packaging. In that sense co-investing may be a strategy for promoting trade.

Secondly the sōgō shōsha invest in China out of strategic motives. The profit margins in trade are usually thin, and in the 1990s it was generally assumed that the expected investment income would raise profitability in the long term. Related to the increased profit orientation was the particular consideration for localization in China. The enlargement and strengthening of the Chinese business base should help in gathering crucial local knowledge and serve as a vehicle to overcome the legal restrictions foreign trading companies face in China. It was hoped that new business opportunities could be created and that in the end the China offshore income would grow. In fact the sōgō shōsha expanded their manufacturing investments in China considerably in the mid-1990s. By far the most aggressive investor among them turned out to be Itōchū followed by Marubeni. Itōchū have invested in China up to now more than USD 400 million and held 240 investments in the year 2000, mostly in the textile and apparel and the food industry sector.

To be sure the sōgō shōsha's manufacturing investments in China did not fare any better than Western investment in China, on average. A lot of money has been wasted and the dreams of the large Chinese market proved in most cases to be an illusion. As most interview partners pointed out, there were many investments that should have been avoided in the first place, either because the project did not make sense economically or because it was struck by the severe market environment in China. Other reasons cited were selecting the wrong local partner, strong price fluctuations, the general bad paying morale and frequent breaches of contracts.

In the past the sōgō shōsha could have sustained such short-time losses at almost any cost, as their business strategy was aimed at increasing their market share. Apart from the traditional Japanese orientation to long-term profit making, there are also good local 'Chinese' reasons to hold on to an unprofitable investment. Pulling out of an investment in China may be quite an expensive affair. It not only costs additional disinvestments funds, it also incurs a loss of reputation in the political realm. All these caveats notwithstanding, in the new era of profit orientation and balance sheet restructuring the sōgō shōsha have to rid themselves of bad assets in China, too. Thus since 1999 all sōgō shōsha, with the notable exception of Mitsui Bussan, started to liquidate their most unprofitable Chinese investments in accordance with their various strategies to concentrate on chosen core competencies. Consequently, the overall financial status of the China investments improved in 1999 and again in 2000. Some companies even claim that on balance their investments have already yielded a small profit.

It has to be mentioned that at times a kind of compulsory disinvestment occurs. There are cases where the Japanese manufacturing partner firm pushed the sōgō shōsha out of the joint venture in order to manage the business more autonomously. These companies, after being helped to gain market access, no longer see the necessity of a mediator. Finally, it should not be forgotten that direct investments in China can also yield high and steady profits. Generally both the manufacturing of textile, apparel and food products for the Japanese market and the import of raw materials from South East Asia for processing and sale in China are regarded as highly profitable business investments. Apart from that there are also other true success stories in the field of market entry and development. Mitsui Bussan's joint venture with Toto Ltd. to manufacture sanitary facilities for the high-end hotel and real estate market or Marubeni's joint venture with Asahi Glass Co., Ltd., to manufacture LCD (liquid crystal display) glass for personal computers are exemplary cases in point. The sōgō shōsha will have to increase the number of such successful joint ventures and rid themselves of loss-making units if they want to attain their goal of increased profitability in China.

INFRASTRUCTURE PROJECTS

In the course of its industrialization China will constantly need new infrastructure for energy, transport, communication and utility systems to sustain its high economic growth rates. In fact in the 1990s China became the biggest market worldwide for new physical infrastructure. Since the sōgō shōsha have gathered considerable experience in the financing and coordinating of the building of industrial plants and infrastructure capacities in Southeast Asia, they were well equipped to become prime suppliers for China in these areas. As the sōgō shōsha are not engineering companies, their competitive edge is project coordination and project financing. The fact that China became the top receiver of Japanese ODA (overseas development aid) in the 1990s certainly helped the general trading firms to push ahead with their infrastructure business. It is a well-known fact that the Tōkyō headquarters of most sōgō shōsha are within short walking distance to the Japan Bank for International Cooperation, the former Export-Import Bank of Japan, which is the government financial institution that governs Japanese ODA. But the sōgō shōsha do not have to rely on Japanese government finance alone. They have also succeeded in establishing close contacts to multilateral financing institutions such as the World Bank or the Asian Development Bank. Above all the sōgō shōsha are specialists for the private financing of infrastructure projects through so-called BOT or BOO schemes.[10]

[10] 'Built-Operate-Transfer' (BOT); 'Built-Operate-Own' (BOO): Project responsibility and the financial risk lie in the hands of a private investment consortium which builds the facility or plant and then either operates it for a set period of

Infrastructure and plant building is the business line in which the sōgō shōsha cooperate the most with Western partners. In many cases non-Japanese companies posses a technical or organizational edge which cannot be matched by a Japanese supplier. Marubeni's project cooperations with Vivendi (France) in a BOT water supply project for Chengdu municipality, or with Sithe Energies, Inc. (USA) in a BOO coal power generation and distribution project provide concrete illustrations. In other cases the sōgō shōsha prefer foreign cooperation partners simply because they can offer the necessary engineering cheaper than their Japanese competitors. Sometimes project cooperation with foreign partners even opens up access to national government financing or insurance schemes of the foreign partner.[11] These various ventures show that the gradual untieing of Japanese ODA in the 1990s did not work to the disadvantage of the sōgō shōsha but possibly pushed out the less competitive Japanese engineering companies. The ability to react flexibly in a changing financing environment also enabled them to enter into new infrastructure areas in the 1990s. This was most notably the case with the cleaning up of environmentally damaged areas in selected Chinese municipalities. Obviously the sōgō shōsha hold a leading competitive edge in the financing, organization and coordination of large scale, highly complex industrial projects. Although industrial infrastructure construction activity dropped considerably in the late 1990s, it can be foreseen that this demand will resume again. Along with China's rapid economic growth the sōgō shōsha are well positioned to carry out many more infrastructure projects in future.

Industrial parks

A special kind of infrastructure investment is the development of industrial parks, the marketing of these estates to foreign (mostly Japanese) companies and the possible operation of the parks. Leasing space to manufacturing investors is already a profitable business as such. Apart from being an industrial park administrator, the sōgō shōsha are in a very advantageous position to supply their different industry-related services,

time before transferring it to the local government body (BOT) or runs it permanently throughout its operating life (BOO).

11 For example the Japanese government has agreed with the governments of France, Germany, the UK and the US that the respective national insurance agencies are authorized to insure the complete export value from both parties in the case of so-called third-country cooperations. On the topic of third country business cooperation, see Chapter 7.

such as transport, logistics, warehousing, maintenance and distribution to the tenants. Currently there are two major Japanese industrial park development schemes in China. The Dalian Industrial Park scheme was set up by Itōchū with the cooperation of Mitsubishi Shōji, Mitsui Bussan, Marubeni, Nichimen and Tomen among others. Mitsubishi Shōji and Mitsui Bussan have also joined the government of Singapore in the establishment of the Suzhou Industrial Park.

WHOLESALE AND RETAIL TRADE IN CHINA

China figures large in the overall company strategy of the sōgō shōsha to raise revenue from offshore trade. It has been recognized that profit margins are generally very high in China's domestic trade. For serving the general purpose of localizing in China the venture into manufacturing investment in China has not been particularly useful, as profits are absent or have remained quite low, on average. However, the sōgō shōsha should expect to fare better if they become active in business sectors which they handle successfully in the Japanese domestic market, such as transport and logistics, warehousing and, most importantly, retail and wholesale trade. As they already possess an extensive inner-Chinese office network, the sōgō shōsha are potentially well prepared for a rapid business expansion in these sectors. Thus it comes at no surprise that virtually all general trading houses are already successfully doing warehousing and logistic operations in their more important import businesses. These are steel import and processing (Itōchū, Marubeni, Mitsubishi Shōji, Mitsui Bussan, Nichimen, Nisshō Iwai, Sumitomo Shōji), LPG import and warehousing (Marubeni, Mitsubishi Shōji, Nisshō Iwai, Tomen) and semiconductors import (Tomen).

In principal the different domestic service sectors of China are still almost completely closed to foreign companies. But as the Chinese government is gradually opening up to foreign capital and know-how in the service sectors, prior to accession to the WTO, the sōgō shōsha are trying hard to be selected as the first foreign companies to enter these markets. In the trade business as well as in other service sectors there is usually only a very small number of Chinese companies (occasionally only one) that are assumed to be capable business partners for a possibly profitable market entry. Apart from the limited number of opportunities for market entry, the Chinese authorities also seem to appraise the first movers highly and tend to favour them open-handedly in the long run. Naturally, for the sōgō shōsha, the run for the first mover advantage is particularly distinct in the trade sector. In fact some of the sōgō shōsha have been quite successful in establishing a foothold in the foreign trade, the retail trade and the wholesale trade with China.

When the first foreign trade joint venture of China was set up in Shanghai in 1997, Mitsubishi Shōji had the privilege to participate. Dongling Trading Corporation, jointly established by Mitsubishi Shōji (27 per cent), Orient International Co. Ltd. of China (41 per cent), Continental Grain Co. of the US (22 per cent) and Shanghai Foreign Trade Corporation of China (ten per cent), possesses the license for the domestic purchase of exported commodities, for the internal retail of imported commodities, for all international trade including compensation trade, for the import and the export of technology and for processing and assembling of imported materials and parts. The company owns its own foreign exchange accounts and is even authorized to carry out customs clearance. There is only an important restriction for the trade of so-called 'strategic' goods (e.g. fertilizer, steel). Although Dongling Trading was established in order to boost China's industrial exports, its major business turned out to be the import of consumer goods. Dongling Trading has grown to be one of China's major corporations. Apart from Dongling there have been only two other approvals of foreign trade joint ventures of this kind in China, both considerably smaller. They are a foreign trading joint venture in Dalian, in which Daewoo Trading of Korea participates, and Cofcotianding Trading in Shenzen, which is a joint investment with Nichimen (39 per cent), André & CIE SA of Switzerland (ten per cent) and China Oil Seed and Fruit (51 per cent). Similar to Mitsubishi Shōji in the case of Dongling Trading, Nichimen was also the role model for the organizational structure of the newly established trading firm. Cofcotianding Trading is actively exporting food and textile products, and imports industrial and consumer goods. Cofcotianding Trading seems to have even established a first foothold in China's domestic trade.

In the Chinese retail sector the most visible sōgō shōsha is Itōchū, which has set up department stores together with Itō Yokado Co., Ltd. and a Chinese partner in Beijing and in Shanghai. In this booming business Itōchū is targeting foreigners and China's nouveau riche. Brand names are being built up for locally manufactured products such as Asahi Beer or Nisshin food products. On a somewhat smaller scale Mitsubishi Shōji is developing the Chinese retail market, too. Mitsubishi Shōji has opened three supermarkets in Dalian in cooperation with Daiei Inc. and Jafco Co., Ltd.

As the communist legacy of neglect for wholesale trade forms the background for the current backwardness and inefficiency of the existing Chinese wholesale trade system and since goods distribution in China is for the most part the responsibility of the manufacturer, the Chinese wholesale sector would be particularly difficult to develop for any newcomer. Thus most sōgō shōsha start with their import business and try to expand downstream by making use of their logistic and warehousing facilities. Mitsubishi Shōji has gone one step further. Making use of the food wholesale expertise of its Japanese affiliate Ryōshoku Ltd., Mitsubishi Shōji has set up food distribution centres in Shanghai and in Dalian. On-time delivery is guaranteed. Trading know-how is readily transferred to the Chinese retail customers, who receive a special business guide, Marubeni is running a food distribution system in Tianjin in a similar fashion.

Marubeni is also planning an even bolder venture in Chinese wholesale trade. A wholesale joint venture, which is supposed to possess full export and import licenses, has been established together with First Department Store of Shanghai. This joint venture incorporates the first foreign investment in the wholesale trade of China.

Apart from the above mentioned vertical integration into China's domestic trade there are also various other business activities within the framework of the sōgō shōsha's strategic drive for localization. Sumitomo Shōji, Nisshō Iwai and Itōchū have opened internet portals for e-commerce in China. Itōchū, Marubeni, Mitsubishi Shōji, Nichimen and Tomen are active in the field of real estate development. Itōchū has also issued a venture capital fund for internet technologies in China to the amount of USD 300 million. Marubeni is doing special consulting for successful state companies with respect to their restructuring process. They also advise on their export and import activities.

CONCLUSIONS

In the process of the internationalization of the Japanese economy the sōgō shōsha in their traditional function as transaction cost savers (for the benefit of their customers from the Japanese manufacturing industry) have lost much of their original raison d'être. Still they remain important if not indispensable partners for Japanese business. Pressured by scrutinizing financial markets, they are compelled to specialize on skills and markets, most notably on retail and wholesale trade. In their adaptation process the organizational structure of the sōgō shōsha tends to shift from a trading company to a sort of investment holding company. However, all business activities seem to depend in one way or other on the sōgō shōsha's links to global markets. Thus, their traditional foreign trade competence will remain crucially important for their survival. These general findings are reflected in the special analysis of the sōgō shōsha's activities in China, which seems to indicate a general current structural change. Their former status as eminent middlemen in the Sino-Japanese relationship is declining. Their relative share in Sino-Japanese trade has been reduced over the years. Investment has been diversified and often restructured. All sōgō shōsha have undertaken considerable efforts to integrate vertically into China's domestic trade. In China the sōgō shōsha often become an investment holding company. It may be assessed that in the ongoing transformation process of the Japanese economy the sōgō shōsha companies will most probably be able to survive, but the sōgō shōsha firm type will have to adapt and to change to a more Western type. However, by virtue of their integral trading function, the sōgō shōsha is likely to remain different from the Western types.

There are many interesting research topics on sōgō shōsha that can and should be investigated in future. At the theoretical level stylized categories for the 'Japanese sōgō shōsha type firm' and the 'Western investment holding type firm' should be developed so that institutional change can be empirically observed and possibly even measured. At the empirical level the individual efforts to carry out structural change are worth a closer look. Furthermore, the activities and strategies of the sōgō shōsha in other important foreign markets other than China should be assessed.

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