

# Prices, quality and trust

---

## Inter-firm relations in Britain and Japan

MARI SAKO

*Lecturer in Industrial Relations*

*The London School of Economics and Political Science*



**CAMBRIDGE**  
**UNIVERSITY PRESS**

Published by the Press Syndicate of the University of Cambridge  
The Pitt Building, Trumpington Street, Cambridge CB2 1RP  
40 West 20th Street, New York, NY 10011-4211, USA  
10 Stamford road, Oakleigh, Victoria 3166, Australia

© Cambridge University Press 1992

First published 1992

Reprinted 1997

*A catalogue record for this book is available from the British Library*

*Library of Congress cataloguing in publication data*

Sako, Mari.

Prices, quality, and trust: inter-firm relations in Britain and Japan / Mari Sako.

p. cm. – (Cambridge studies in management: 18)

Includes bibliographical references and index.

ISBN 0 521 41386-9 (hardback)

1. Industrial procurement – Japan. 2. Industrial procurement – Great Britain.

3. Industrial procurement – Cross-cultural studies. 4. Electronic industries –

Japan. 5. Electronic industries – Great Britain. I. Title. II. Series.

HD39.5.S25 1992

338.5'22'0941 – dc20 91-40505, CIP

ISBN 0 521 41386 9 hardback

Transferred to digital printing 2003

# Contents

<i>List of figures</i>	<i>page</i>	ix
<i>List of tables</i>		xi
<i>Acknowledgements</i>		xiii
Introduction		1
<b>Part I: Theory and concepts</b>		
1 A spectrum of transactional patterns: from ACR to OCR		9
2 Trust and organisational efficiency		30
<b>Part II: Case studies and survey</b>		
3 Setting the scene		51
4 The three customer companies		65
5 The analysis of supplier companies		107
<b>Part III: Explanations of variations</b>		
6 Economic and technological factors		145
7 The legal framework		158
8 Banks and financial links		177
9 Employment system links		190
10 Entrepreneurship and the dynamics of small firm creation		205
		vii

## *Contents*

### **Part IV: Outcomes and implications**

11	Implications of ACR–OCR patterns for competitiveness	221
12	Conclusions	241
	<i>Appendix</i>	246
	<i>Notes</i>	250
	<i>Bibliography</i>	257
	<i>Index</i>	000

# Figures

1.1	A schema of factors influencing ACR–OCR variations	<i>page</i> 16
3.1	Extent of bought-in materials 1983	59
5.1	The ACR–OCR spectrum for sample suppliers	142
9.1	Male wage differentials by firm size, controlled for age, length of service and education in Japan	196
9.2	Trends in wage differentials by size of enterprise	197

# Tables

1.1	Features of ACR–OCR patterns	<i>page</i> 11
3.1	Sub-contracting in manufacturing, by sector 1984	60
3.2	The suppliers and sub-contractors in the sample	63
4.1	Site X and Site Y, GB Electronics	80
4.2	GB Electronics' suppliers 1989/90	80
4.3	Site Y's non-subsidiary preferred suppliers 1987/8	81
4.4	Site X's preferred suppliers 1989/90	82
4.5	Purchasing personnel at GB Electronics	90
4.6	Organisation of CTV production at TCP (UK) and Fukaya factory	93
5.1	Number of customers and transactional dependence	108
5.2	The size of suppliers' sales department	129
5.3	The ACR–OCR scores	139
5.4	ACR–OCR ranking of sample suppliers	141
6.1	Printed circuit board industry structures in Britain and Japan	152
6.2	Part numbers per supplier in the Japanese PCB industry	154
7.1	Investigations by FTC to enforce DPPL	167
8.1	Distribution of share ownership in Britain and Japan	181
8.2	Share ownership at GB Electronics and JJ Electric	185
8.3	Share ownership at J1210(PCB) and B400(PCB) 1987	187
9.1	Pay differentials by establishment size 1985	194
9.2	Pay differentials by enterprise size and type of workers	195
9.3	Secondment of workers in Japan 1986	200
9.4	Employees in permanent and temporary jobs, by full-time and part-time status 1985	202
10.1	Distribution of establishments and employment by firm size 1985	205

*Tables*

10.2	Use of sub-contractors by sample suppliers	207
10.3	The Nagano PCB Cooperative Association 1987	212
11.1	PCB prices and profitability in the Japanese PCB industry	230

# Introduction

A decade ago, Arthur Okun, in his book *Prices and Quantities*, drew a distinction between auction and customer product markets. He focused on the latter, the ‘vast nonauction area’ (Okun, 1981, p. 134), which in his view prevailed in industrial economies outside of trading in financial assets and commodities. In customer markets, business firms set prices and wages to reflect long-term considerations to reduce costs, as well as short-term changes in markets. The long-term ‘invisible handshake’ (in Okun’s words) between customers and suppliers, and between employers and employees, creates price rigidities which Okun identified as a cause of stagflation.

This book is also about the vast nonauction area in industrial economies. But its topic, buyer–supplier relations, is more narrowly microeconomic than Okun’s, and its methodology very different in its reliance on a case-study-based socio-economic inquiry. This book identifies variations within customer markets in the way firms interact with each other, some by ‘invisible handshake’ and others by ‘visible handshaking’ (Aoki, 1984). Such variations have consequences not only for the way in which *prices* are determined, but also for other performance parameters, perhaps the most important of which today is *quality*.

Since Okun wrote, global competition in manufacturing has become more about coping with volatile market demands and rapid technological change. With correspondingly shorter product development cycles, workers and suppliers who had formerly received finalised work plans and design ‘blue prints’ are now expected to fill in more details themselves in half-formed plans subject to continuous changes. Manufacturing good quality products in small batches cost effectively also requires competent and motivated workers and suppliers who can respond quickly to solve local problems. But the willingness to give, and the capacity to elicit, flexible responses depend much on mutual *trust*. Without trust, it would be too risky to depend on others who may well



## *Introduction*

take advantage, by holding up delivery until prices are renegotiated, or not observing commercial secrecy. Thus, the 'vast nonauction area' has expanded in most advanced industrial economies, as manifested in the form of joint ventures, 'strategic alliances' in R&D, 'flexibly specialised' firms in industrial districts, and sub-contracting 'partnerships' between large and small firms. As a result, there is a heightened need for business firms to rely on trust to achieve competitive success. How trust can be established, where it is deficient or absent, is one major concern of this book.

The main questions addressed in this book are as follows. Why have companies come to rely on different modes of coordinating the design and manufacture of similar products? What company-specific, industry-specific, and society-wide factors affect the mode adopted? And how do alternative modes affect corporate performance? The empirical setting of the book is largely limited to the electronics industry in Britain and Japan. But the analysis and theoretical discussion are of relevance in a wider context.

As a starting point, it cannot be presumed that there is one single characteristic pattern of buyer-supplier relations in Japan and another in Britain. Two ideal types are therefore constructed to capture complex variations in buyer-supplier relations. They are best thought of as lying at the ends of a continuum. At one extreme, firms rely on an Arm's-length Contractual Relation (ACR) if they wish to retain full control over their destiny. Independence is the guiding principle here, which involves not only being unaffected by the decision of other companies, but also by one's own decisions (e.g. over sourcing and sales) made in the past. This often requires not disclosing much information (e.g. about costing and future plans) to existing and potential buyers and suppliers. The arm's length nature of contracts enables firms to engage in a hard commercial bargain to obtain competitive prices, although an excessive use of threats and bluffs may make some firms wary of too much antagonism. At the other extreme, firms enter into an Obligational Contractual Relation (OCR) if they prefer high trust cooperativeness with a commitment to trade over the long run. This commitment may come at the expense of taking on rather a lot of sometimes onerous obligations and requests (e.g. for just-in-time and ship-to-stock delivery). But the benefits of accepting mutual obligations lie in good quality and service, growing or stable orders, and other non-price aspects of trading born out of a tacit understanding over time.

This ACR-OCR framework should better accommodate a study of variations in business practices *within* Japan and Britain as well as

## *Introduction*

between countries. In order to classify business practices along the ACR–OCR spectrum, the empirical part of this book focuses on a three-way comparison of a Japanese customer company, a British customer company, and a Japanese company located in Britain; and an analysis of a matched sample of 18 suppliers each in Britain and Japan in order to enquire into their relationships with their customers. The result shows a considerable variation in trading practices among companies studied. In particular, 4 out of the 18 Japanese suppliers had more ACR practices than the most OCR supplier firm found in Britain. This undoubtedly reflects the importance of individual company strategy concerning the trade-off between growth and short-term profitability, establishing mass or niche markets, and so on. But society-wide norms cannot be ignored, and the attempts to establish OCR-like practices by UK-based Japanese companies, like Toshiba Consumer Products (UK) Limited studied in this book, have encountered more difficulties in Britain where, despite a move towards Preferred Supplier Policy, the trading norm remains largely more ACR than in Japan.

The ACR–OCR framework is also useful for assessing the effects of varying business practices on the competitiveness of companies and, by extension, of national economies. This is a dominant concern of this book, and is a topic which, in the last decade, has attracted an increasing amount of attention. Many people in the past would have concluded, at least when having in mind the market economy vs planned economy contrast, that ACR conduces to efficiency by subjecting firms to the invigorating forces of the market, while cooperating firms in cosy OCR relations are shielded from market forces and thus are not as efficient. Put this way, the ACR–OCR spectrum may be matched with a competitive (= efficient) vs cooperative (= inefficient) contrast.

This book argues that this match, associating all types of ACR with efficiency and all types of OCR with inefficiency, is mistaken. Of course, this point is not novel to those who are familiar with the benefits of buyer–supplier ‘partnerships’. ‘Long-term close trading relationships with a selected few suppliers, based on trust’ (i.e. OCR) has been replacing ‘multiple sourcing from several suppliers on short-term contracts’ (i.e. ACR) as a guiding principle of purchasing policy in British industry. In this respect, Japanese manufacturing firms located in Britain as well as in Japan are held to be exemplary, as they appear to have the desirable competitive outcomes and long-term supplier relationships. Though tempting, this association of efficiency and long-term relations (which is a feature of OCR) is not perfect either. Observe the following alternative interpretations on the sources of Japanese industrial competitiveness.

## *Introduction*

The aspect of inter-firm relations in Japan which has most attracted attention is the way in which they constitute non-tariff barriers to trade. It is precisely this aspect which has resulted in accusations by the EEC and the USA that the Japanese market is closed to foreign producers due to 'unfair trade practices'. If Japanese glass producers persist in buying high-price soda ash from their traditional suppliers instead of much cheaper soda ash from the United States, some final consumer somewhere must be paying for this inefficiency. The markets lack the 'transparency' of price-competitive trading, and the opacity is discriminatory against foreigners. Here, the anti-competitive, protectionist element in the Japanese trading custom is under attack.

An alternative interpretation emphasizes a more positive aspect, namely business efficiency inherent in long-term high-trust business relationships. Thanks to the way in which disputes over the trade aspects of inter-firm relations have highlighted their role, a survey for the Japanese Fair Trade Commission (see Shimada, 1987; EPA 1990, pp. 197–201) was carried out in 1987 to clarify whether the nature of Japanese trading custom had any economic rationale. It attributed the apparent closedness of Japanese markets to the Japanese companies' preference for long-term continuous trading with most trading partners, not just within but across the *Keiretsu* and corporate groupings (*Kigyō Shudan*).<sup>1</sup> Long-term continuous trading appears 'non-transparent' precisely because of the major advantage of such trading practice, namely high-trust cooperative relations. In such relations, the customer company takes it for granted that its suppliers respond flexibly to unforeseen contingencies and fulfill exacting requirements in quality, delivery and price (Shimada, 1987, p. 42). Besides creating incentives to cooperate based on trust, long-term trading has its merit in saving on search and negotiation costs, and in greater openness in the exchange of information (EPA, 1990, pp. 197–8).

A corresponding diagnosis in Britain of its industrial decline is a mirror image of the Japanese explanation. It attributes the exposure to foreign competition of UK domestic markets to the lack of cooperative inter-firm relations: 'an emphasis on price competition and the absence of a supportive inter-firm culture encourages the openness to foreign competition at the upper end of the market on the basis of superior design and quality and at the lower end from low-cost products from NICs' (Hirst and Zeitlin 1989, p. 8).<sup>2</sup> Britain's industrial decline can be reversed, in this view, only if 'a supportive inter-firm culture' is created in regional and national economies, so as to create opportunities for firms to cooperate on innovation, training and other matters.

## *Introduction*

From the above, it appears that high-trust inter-firm relations, just like harmonious industrial relations, have come to be seen as responsible for the superior industrial competitiveness of Japan as compared to Britain. But high-trust cooperativeness in OCR is only necessary, but not sufficient, to achieve the desired outcome. A central question then becomes: if companies can achieve good quality by entering into OCR-type relations, how can they ensure that they also achieve competitive prices? The book identifies the relevant micro-mechanisms which induce OCR-inclined companies to achieve competitive results. They are, in Japan, the practice of cost-reduction targets, the use of value analysis (VA) or value engineering (VE) techniques, the publicised ranking of suppliers according to their performance, and lateral communication between suppliers through the suppliers' associations. These mechanisms give sufficient incentives for suppliers to remain competitive, and ensure that long-term contracting does not lead to cosy familiarity cushioning inefficient practices.

### **Outline of the book**

This book is in four parts. Part I contains a discussion of theories and concepts employed in the book. Chapter 1 outlines the framework of Arm's-length Contractual Relations (ACR) and Obligational Contractual Relations (OCR), while chapter 2 discusses how various types of 'trust' contribute towards enhancing efficiency in inter-firm relations.

Part II presents the empirical analysis. An overview of buyer-supplier relations in Britain and Japan in chapter 3 is followed by a detailed examination of trading relationships at three customer companies in chapter 4, and at 36 supplier companies in Britain and Japan in chapter 5.

The next five chapters in Part III examine the factors influencing companies' disposition to enter into ACR- or OCR-type practices. Economic and technological factors are investigated in chapter 6. Chapter 7 focuses on differences between Britain and Japan in the legal enforceability of contracts and non-legal means of sanctions; chapter 8 on differences in the taste for short-term (rather than long-term) profit and stability of rewards through risk-sharing, which may partly reflect differences in companies' financial structure; chapter 9 on differences in prevailing forms of employment relations, and chapter 10 on opportunities for entrepreneurship.

In Part IV, chapter 11 examines the link between ACR-OCR patterns and corporate performance by focusing on how prices and quantities are determined between trading partners. Chapter 12 provides a summary of

## *Introduction*

the major theoretical and empirical findings of the research, and draws some implications for policy and business practice. The book will hopefully provide a modest contribution to cross-national comparative industrial research, and to furthering our understanding of the sources of long-term industrial competitiveness.