

Relational Contracts between Japanese Manufacturers and Their Suppliers

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Inter-firm transaction between Japanese automobile manufacturers and suppliers

- General Motors (in 70s)
 - Development & production of components (e.g. brake, transmission, interior etc.) are done in-house
 - Commodity-like parts for components purchased from a large number of suppliers
 - Price is the most important factor
 - Supplier may be switched in short-term to cheaper one
- Toyota
 - Development & production of components are subcontracted to a limited number of Tier-1 suppliers
 - Tier-1 suppliers have Tier-2 suppliers, and so on
 - Requires capable and reliable Tier-1 suppliers
 - Long-term relationship enabling coordination and cooperation: “relational contract”

Inter-firm transaction between Japanese automobile manufacturers and suppliers

- Relation-specific investment
 - Investment that has lower value when applied to other relationships
 - Underinvestment due to “hold-up problem”
- However, simple long-term commitment would induce moral hazard
- How do Japanese automobile manufacturers incentivize suppliers to make relation-specific investment while preventing their moral hazard?

How Japanese supplier system is structured

- Multiple bilateral contracts between manufacturer and Tier-1
 - Master agreement governing basic relationship
 - “Sourcing” of components
 - Monthly placement of orders
- Bidding competition by a limited number of Tier-1 suppliers for each model, which last for 4 years
 - Multiple vendor policy, non-switching policy
 - Stability with repeated competition
- Limited commitment on the amount (1 month) and price (3-6 months)
- Close coordination in development & design
- Rating system of suppliers based on quality, delivery, technological capability, etc.

How Japanese supplier system is structured

- Cooperation and information sharing among suppliers by suppliers' association
 - Horizontal multi-party contract is not used
- Exchange of personnel?
- Minority investment in suppliers' shares?

- Cf. "*keiretsu*"
 - Has multiple meanings (supply chain, distribution chain, conglomerates, corporate groups, cross-shareholdings) and could be misleading

Implications from Japanese supplier system

- Multiple layers of bilateral contracts, tailored to incentivize and discipline parties
- Some practices may be left unwritten, based on customs
 - E.g. Compensation for unrecovered R&D cost when the sales was far below expectations
- More sophisticated contracts are used to replicate the mechanism in other industries/jurisdictions when no custom is shared (e.g. Gilson, Sabel & Scott (2009))
- Desirable content of contracts may differ from industry to industry
 - E.g. Electronics, distribution/franchised chain, future automobile?
- No special legal form is used other than regular contracts

Some thoughts on Italian *“contratto di rete”*

- Can be used for multiple purposes
 - Limited liability, affirmative asset-partitioning
 - Sharing intellectual property
 - Controlling supply chain
 - Loose joint-projects
- Japan: no one-legal form fits all
 - Joint venture with limited liability: stock corporations, LLCs
 - Joint purchasing/selling: cooperatives (e.g. agriculture, fishery)
 - Sharing intellectual property: trust
 - Supply/distribution chain, business alliance, franchise: (sophisticated) contract

References

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