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

