

# Globalization of the Distribution System and the 1985 Shock in Japan

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The Japanese distribution system has two distinctive characteristics: too many very small retailers and multiple layers of wholesalers. Up until the present day, these two features have been noted by researchers in Japan as well as other countries. In reality, however, Japan's distribution system went through a dramatic and historic change known as the "1985 Shock." This resulted in a decrease in the number of retail stores and challenged the long-held belief that Japan's distribution system was characterized by a multitude of such retail stores. This change marked a shift towards the so-called the global standard or "globalization."

This study analyzes the 1985 Shock and describes the true state of the globalization of Japan's distribution system. This paper consists of four sections: Outline of the "1985 Shock" in Japan's distribution structure, Innovations in Japan Supermarkets, Innovations in Japan's Convenience Stores, and Conclusion.

## **The "1985 Shock" : Changes in the Japanese Distribution Structure**<sup>1</sup>

### *Explanations by existing studies*

A number of researchers, both in Japan and in other countries, have studied the major characteristics of the Japanese retail industry. These characteristics include: (1) consumers' tendency to purchase goods in small amounts and at frequent intervals<sup>2</sup>; (2) the majority of small-sized retail stores are run as family businesses<sup>3</sup>; (3) the preferential tax treatments granted to these retail stores<sup>4</sup>; (4) the regulations placed on large-scale retail stores<sup>5</sup>; and (5) the role of these stores as a meeting place for neighborhood residents.<sup>6</sup> In addition to these factors, some researchers<sup>7</sup> have pointed to the complex factors at work behind the abundance of small retail stores.

Recent studies of the Japanese retail industry published in Japanese are far too numerous to be surveyed briefly. We would, therefore, like to single out Masanori Tamura as one of the outstanding

studies by Japanese scholars.<sup>8</sup> Tamura's book attempted to identify the important characteristics of the distribution system in Japan. Far more comprehensive and systematic in its arguments than most of the English-language studies cited above,<sup>9</sup> Tamura's book is widely accepted as having set the standard for inquiries into Japan's distribution system from the perspective of commercial science. Summarized below are Tamura's major contentions (Tamura 1986: pp.31–128), which are useful in understanding how the retail industry in Japan is conventionally portrayed from the standpoint of commercial science.

Tamura asserts that the retail industry in Japan retains features more reminiscent of those found in quasi- or less-developed economies than in advanced economies, for example, the extremely high density of retail stores; their small size; and their nature as family businesses. Historically, these features have been typical among retailers of daily necessities, particularly the beverage and food retailing sectors. The beverage and food retailing sectors decreased only very slowly (Tamura 1986: p. 59) in the period from 1960 to 1979. The density of food retail stores also decreased slowly (p. 58); and in the late 1970s, labor productivity remained low in the retail sector that dealt in food, beverages and other daily consumer goods (p. 44).

According to Tamura, the basic structure of the retail industry in Japan was shaped and/or maintained in the pre-rapid growth period by the retardation of Japanese capitalism, first during the rapid growth period by the presence of a "slack in the retail markets," and in the post-rapid growth period by the presence of "institutional mechanisms." The presence of a "slack in the retail market" here refers to the fact that the growth of the retail markets during the rapid growth period was so great that large-sized corporate retailers were unable to take advantage of the many new business opportunities that developed, with the result that small-sized retail stores were able to avail themselves of some of the expanding business opportunities (p. 61). Tamara uses the term "institutional mechanisms" to refer to institutional restraints on the activities of large retail stores, typically those stipulated in the Large-Scale Retail Store Law (LSRSL) of 1974, which was legislated as a "new pillar sustaining the Japanese-type retail industry structure" (p. 80). Writing in 1986, Tamura asserts that the LSRSL was by far "the most crucial factor in determining the course of development of the retail industry in Japan over the past dozen years or so" (p. 102).

We have offered above a fairly detailed overview of Tamura's argument because it mirrors the view of the distribution system in Japan that is held by scholars of business economics. In the wake of the

conclusion of the Japan-US Structural Impediments Initiative (SII) Talks of 1989–1990, there have been a number of studies by scholars of applied economics that propose alternative explanations for the most important characteristics of Japan's distribution system. The studies of Masahiro Maruyama (1992) and Tatsuhiko Nariu (1994) are representative.<sup>10</sup>

Maruyama summarized his findings about the most important characteristics of Japan's retail industry as follows: There are a large number of small retail stores dispersed throughout Japan. There is a strong relationship between this phenomenon and the sales activities of retailers and the fact that consumers purchase small amounts of goods at frequent intervals. Retailers' sales activities are conditioned by the costs involved in placing orders with suppliers and the costs of maintaining inventories. The behavior of consumers is conditioned by the cost of maintaining supplies at home and the costs of going out shopping.

Similarly, Nariu asserts that the existence of a large number of retail stores makes it possible for consumers to purchase small quantities of goods at frequent intervals, thereby saving the cost of shopping and storing. In Japan, where the diffusion rate of passenger cars is relatively low, road conditions poor, and residential space at a premium, consumers must bear relatively high costs of shopping and storing goods in their homes, and are thus less efficient in shopping and storage activities than their counterparts in some advanced countries of the West.

On the other hand, Japanese retailers are able to perform their distributive tasks more efficiently than those in Western countries, thanks to the high diffusion rate of automobiles for commercial use in Japan and the compact nature of the country's land area (which translates into shorter distribution distances). According to Nariu, the high density of retail stores in Japan, especially those dealing in daily necessities, shows how the country's distribution system has adapted itself efficiently to the peculiar social and economic surroundings, by shifting the burdens of carrying out certain tasks from the relatively inefficient consumers to more efficient retailers.

The basic tenets of the arguments by Maruyama and Nariu are similar. At any rate, it is clear that applied microeconomists invariably ascribe the high density of retail stores in Japan to the behavioral patterns of consumers or to their limited ability to perform distributive tasks.

### *Historical Perspective and the 1985 Shock*

In listening to applied microeconomists' discussion of the Japanese distribution system, one problem immediately comes to mind. Their approach, unlike the approach taken by Tamura, pays absolutely no attention to the historical factors that underlie the structure. Take, for instance, Nariu, who refers to the low rate of diffusion of passenger cars, the less-than-satisfactory road conditions, and the limited space of Japanese dwellings when he explains Japanese consumers' limited capability to perform distributive tasks. At the same time, he points to the limited size of Japan (put another way, short distribution distances) and the high diffusion rate of automobiles for commercial use to explain the high level of performance of Japan's retailers in carrying out their distribution tasks.

But significant changes have taken place, however, in all the factors cited by Nariu, except for those concerning limited land space, reflecting changes in the economy since the end of World War II. Nariu, along with Maruyama, nevertheless fails to account for these changes in the factors he describes. Thus, in contrast to Tamura's theories, the attempts to explain the features of the Japanese distribution system from the standpoint of applied microeconomic theory gloss over the ways the Japanese economic climate has changed from the pre-rapid growth, to the rapid-growth, and on to the post-rapid growth periods. Neglecting the changes in the basic economic climate would be less serious had Japan's distribution system remained basically unchanged since the end of World War II. However, Japan's distribution system experienced the 1985 Shock mentioned in the introduction.

As is evident in **Table 1**, the number of retail stores in Japan began to decline, beginning in 1985. Yutaka Kakeda analyzed the causes of the changes by looking at store size, business categories, and organizational form.<sup>11</sup> He notes that stores that decreased most conspicuously were very small stores with two or fewer attendants, those dealing in food and beverages, and "mom and pop" stores, often run as family businesses without regular employees. Kakeda then points out that this decline in the number of retail stores that began in 1985, the phenomenon known as the 1985 Shock, was brought about by both the decrease in the rate of openings of new stores and by the increase in the rate of closures of existing stores (**Figure 1**). Kakeda also finds that the decline in the rate of opening of new retail stores was most conspicuous for very small stores, and for food and beverage stores in particular (**Table 2**).

**Table 1.** Retail Stores in Japan, Broken down by Size, Business Category, and Organizational Form, 1970-1994.

<b>Year</b>	<b>1970</b>	<b>1979</b>	<b>1982</b>	<b>1985</b>	<b>1988</b>	<b>1991</b>	<b>1994</b>
Number of retail store (1,000)	1,471	1,674	1,721	1,629	1,620	1,591	1,500
Breakdown by size (%)							
2 persons or less	63.9	61.1	60.2	57.7	54.0	53.2	51.0
3-4 persons	22.5	24.0	24.0	25.1	26.1	26.2	24.7
5-9 persons	9.6	10.5	10.9	11.7	13.2	13.4	14.8
10-49 persons	3.7	4.1	4.6	5.1	6.3	6.6	8.8
50 persons or more	0.3	0.3	0.4	0.4	0.5	0.5	0.7
Breakdown by business category (%)							
Miscellaneous goods	0.2	0.2	0.2	0.2	0.2	0.3	0.3
Textiles, clothing, and accessories	13.8	14.2	14.1	14.1	14.6	15.1	15.0
Foodstuffs and beverages	48.3	43.9	42.1	41.2	40.4	39.1	38.0
Automobiles and bicycles	4.0	4.4	4.9	5.2	5.5	5.9	6.0
Furniture, furnishings, and fixtures	10.6	10.9	11.0	10.6	10.3	9.9	9.6
Other stores	23.1	26.4	27.6	28.7	29.0	29.6	31.1
Breakdown by organizational form (%)							
Incorporated stores	16.1	22.8	25.3	27.6	31.1	35.5	38.7
Individually owned stores	83.9	77.2	74.7	72.4	88.9	64.5	61.3
Individually owned stores							
without regular employees	73.8	56.4	58.8	54.5	41.4	42.9	43.4

Source: Tsushosangyosho [Ministry of International Trade and Industry], *Shogyo Tokei Hyo (Sokatsu-hen)* [Statistical Table of Commerce: Summary], various annual issues.

**Figure 1.** Rates of New Openings and Closures of Retail Stores, 1970-1991.



Source: Kakeda (1993).

**Table 2.** Number of Newly Opened Retail Stores, Broken Down by Size and Business Category, 1970-1991.

Year	1970	1979	1982	1985	1988	1991
Number of newly opened retail stores	65,552	68,890	62,412	48,123	46,073	46,944
Number of newly opened stores by size						
2 persons or less	44,867	43,967	36,879	25,385	21,307	20,827
3-4 persons	11,805	14,338	13,670	12,047	11,977	12,606
5-9 persons	6,010	6,946	7,606	6,864	7,889	8,415
10-49 persons	2,627	3,376	3,989	3,666	4,696	4,871
50 persons or more	243	263	268	161	204	225
Number of newly opened stores by business category						
Miscellaneous goods	107	186	184	124	170	154
Textiles, clothing, and accessories	8,832	11,362	10,775	9,496	10,571	10,945
Foodstuffs and beverages	28,874	27,456	22,805	17,295	15,900	14,301
Automobiles and bicycles	2,446	3,348	3,410	2,810	2,472	3,172
Furniture, furnishings, and fixtures	8,425	7,167	6,223	4,068	3,510	3,389
Other stores	16,868	19,371	19,015	14,330	13,450	14,983

Source: Kakeda (1993). Note: years refer to those in which the surveys for the original sources Tsushosangyosho (Ministry of International Trade and Industry), *Shogyo Tokei Hyo (Sokatsu-hen)* [Statistical Table of Commerce: Summary] (various Annual issues) were conducted. The numbers of newly opened stores for each year are the estimates for the year preceding the year of the survey

Thus, Kakeda's analysis points out that the 1985 shock can be characterized primarily as a phenomenal decrease in very small retail stores dealing in food and beverages, often run as family businesses. The question is: Why did these stores begin to decrease beginning in the mid-1980s? Unfortunately, a plausible answer to the question is not forthcoming even from Tamura's analysis cited above, despite its historically oriented approach. This is partly due to the way Tamura organizes his argument. In assessing the post-rapid-growth period, he emphasizes the significance of the LSRS and other institutional measures so strongly as to make it appear that he has overlooked the significant changes that took place in the mid-1980s.<sup>12</sup>

The most persuasive analysis available to date regarding the cause the 1985 Shock has been made by Junzo Ishii who sheds new light on the family-business nature of small-size retail stores.<sup>13</sup> In identifying the main causes of the shock, he points to both the growing inclination among members of store-owning families to separate their business and family, on one hand, and the declining size of store-owner families, on the other. More sociological than economic, Ishii's analysis is convincing, insofar as it identifies fundamental problems (or what Ishii calls "the enemy within") inherent in very small retail stores.

At the same time, however, there is no denying that Ishii's analysis leaves one important question unanswered, namely, the question of why the 1985 Shock manifested itself in the form of a decline in the number of small-sized food and beverage stores. A clue to the answer to this question is offered by Table 3, which reveals, among other things, that the period from 1982 to 1991 was one of a steady increase in the number of grocery supermarkets and a conspicuous increase in the number of convenience stores. In discussing the growth in the number of grocery supermarkets in the 1980s, it is important to bear in mind the observations made by Azuchi Satoshi, the pen-name of Arai Shin'ya, president of the Summit Store supermarket.<sup>14</sup> Unlike the original meaning of the term "supermarket," which refers to a grocery supermarket, big stores such as Daiei and Itoh Yokado, usually regarded in Japan as typical supermarkets, are closer to department stores than to supermarkets.

In the early years of their development, grocery supermarkets were faced with various constraints posed by wholesale markets in urban centers, which were operated in ways advantageous to smaller stores, and by the deficient skills of workers engaged in the handling of perishable goods. It was not until the early 1980s that grocery supermarkets began to establish competitive advantages over traditional meat shops, fish stores, and vegetable stores, by overcoming these constraints and by establishing their

own operations. This argument, if accurate, basically answers the workings of the 1985 Shock. More specifically, Azuchi suggests that as grocery supermarkets systematized themselves, they made it increasingly difficult for operators of small-sized food and beverage stores active in the same geographical market to sustain their operations and also made it difficult for potential newcomers to enter the market.<sup>15</sup>

Existing studies tend to focus on the growth of supermarkets (more specifically, on the growth of both big general supermarkets and not-yet-fully-systematized grocery supermarkets), and to conclude emphatically that their growth in Japan did not cause small-sized retail stores, especially those dealing in food and beverages, to decline in number.<sup>16</sup> We should remember, however, that the big stores and small-sized food and beverage stores do not compete directly in the same market. In order to better understand the 1985 Shock, therefore, it is imperative that the situation developing around these small-sized food and beverage stores (the very pivot of the 1985 Shock) be analyzed side by side with the situation developing around their direct competitors in the same market, namely grocery supermarkets. Examining the concrete example of systematized operations at Kansai Supermarket, and determining the relationship between the managerial innovations undertaken by these grocery supermarkets in the 1980s and the 1985 shock, will be central in analyzing the globalization of Japan's distribution system.

**Table 3.** Retail Stores in Japan, Broken down by Business Category, 1982-1991.

<b>Year</b>	<b>1982</b>	<b>1985</b>	<b>1988</b>	<b>1991</b>
Department stores	461	428	433	455
General merchandising stores	1,507	1,634	1,851	1,924
Clothing supermarkets	606	520	571	618
Grocery supermarkets	4,358	4,707	4,877	5,185
Household goods supermarkets	531	646	949	1,327
Convenience stores	23,235	29,236	34,550	41,847
Other supermarkets	58,777	59,643	53,834	67,473
Ordinary retail stores	1,631,990	1,531,820	1,522,687	1,472,394

Source: Tsushosangyosho [Ministry of International Trade and Industry], *Shogyo Tokei Hyo (Gyotakbetsu Tokei-hen)* [Statistical Table of Commerce: Summary], various annual issues.

Another point possibly relevant to the 1985 Shock appears in **Table 3**. Here we see the phenomenal increase in the number of convenience stores during the 1980s. We can assume that a large percentage of the rapidly growing convenience stores must have been opened by new operators who previously would have opened small-sized food and beverage stores and by existing owners of such retail stores who shut them down and switched to this alternative, more lucrative business.

In the following sections, we will examine the growth of supermarkets and convenience stores and the innovations made in their management systems.

### **Innovations in Japan's Supermarkets**

As pointed out in Section 2, one of the causes of the 1985 Shock was innovation in the supermarket system. In this section, the nature of this innovation will be analyzed in relation to the behavior of consumers during the high growth period of Japan's economy.

In the late 1950s, the supermarket system from the United States was introduced to Japan's market. At that time, most of the retailers and wholesalers in the traditional distribution channels were very apprehensive about the arrival of the supermarket system because of its power to drive them out of business. In this climate, *Ryutsu kakumei* [The Distribution Revolution], a book by Shuji Hayashi, was published in 1962 and became a best-seller. Its title also became very popular.<sup>17</sup> Hayashi stressed two points in his arguments. First, the development of supermarkets would be accompanied by an increasing trend among retailers to expand their store size, which would render negligible the existence of small retailers. Second, advances in the mass production system and the establishment of the mass sales system would result in the elimination of the wholesalers and lead to a drastic reduction in the number of distributors.

Actual events did not follow the course Hayashi had predicted, however. As shown in Table 1, the number of small retail shops (four persons or less) in Japan continued to increase up until the early 1980s, and only in the mid-1980s did this trend reverse itself.<sup>18</sup> On the other hand, through the high-growth period, supermarkets expanded their businesses. *Serufu Sabisu ten tokei* [Self-service Shop Statistics]<sup>19</sup> issued annually by the Ministry of International Trade and Industry (MITI) shows the increase in the sales [in millions of yen] of supermarkets in Japan.

1964—392,373

1966—581,146

1968—1,028,570

1970—1,162,459

1972—2,447,583

1974—4,253,531

1976—6,750,221

From these figures, we can see that, while the growth rate in supermarket sales for the two-year period 1964–1966 was slightly under 50 percent, the two-year growth rate beginning with 1966 and ending in 1976 consistently exceeded 50 percent. Moreover, this rapid growth in supermarket sales from the 1960s to the mid-1970s was coupled with the increase in the supermarket's share of total household expenditures.<sup>20</sup>

When the above facts are taken into consideration, there is another question that naturally arises: Why did the number of small retailers increase until 1985, in spite of the dynamic growth of supermarkets in the high growth period? This is because, during the high growth period, supermarkets were different from the original meaning of “supermarkets,” that is, they were general merchandising stores. Those big stores did not compete directly with small retail shops (especially food and beverage stores) in the same market, because they tended not to handle food and beverages, and were located in or around cities where department stores usually operate. The next question to be asked is: Why did the original “supermarkets” (grocery supermarkets), which operated in direct competition with small retailers in the same market, not expand their businesses during this period? To answer this question, we must turn our attention to the behavior of consumers during the high-growth period in Japan.

In the period of high-growth, while the popularity of Western foods increased, there was still the preference for freshness<sup>21</sup> This westernization of food tastes favored the development of big stores and grocery supermarkets.<sup>22</sup> But traditional consumption patterns, with the strong consumer predilection for the freshness of their food, consequently restricted development of grocery supermarkets. The supermarket system could only be successful with the pre-package system, because it was centered on self-service operations. At that time, grocery supermarkets did not have the skill to pre-package perishable foods. Therefore, it was not until the early 1980s that grocery supermarkets began to establish

competitive advantages over traditional meat shops, fish stores, and others, by establishing their own system for pre-packaging perishable foods.

Next, let us look at how grocery supermarkets overcame their problem of deficient skills.<sup>23</sup> When grocery supermarkets were introduced in Japan, they had two ways to compensate for their lack of pre-packaging skills. One was the employment of skilled workers to sell perishable foods, and the other was the introduction of a tenant system which involved renting space to specialists in certain food products. Both of these involved in-person sales or giving up the pre-packaging system. In the early years of development, grocery supermarkets selected the tenant system, because the skills of their workers engaged in the handling of perishable foods were deficient. On the other hand, the tenant system had problems. First, the tenant enterprises avoided opening shops in more than two or three supermarket stores, and so grocery supermarkets could not standardize the quality of the goods. Second, the tenant enterprises acted as they had when they functioned as family businesses. Consequently, grocery supermarkets in the period of high-growth still had to grapple with the problems of establishing a system for pre-packaging perishable foods.

In the late 1970s the system for pre-packaging perishable foods was established. We can see how the pre-packaging system developed by studying the example of Kansai Supermarket, which played a central role in innovations in Japan.<sup>24</sup>

The invention of a system for pre-packaging perishable foods consisted of inventions both in hardware and software. First, in hardware, the introduction of the equipment for maintaining the freshness of the perishable foods and the improvement of the back area of the store were important. When the All Japanese Supermarkets Association (AJS) held the “First Training Session in Hawaii and America” in 1967, Mr. Kitano, president of Kansai Supermarket, was astonished by the Times Supermarket in Hawaii, where perishable foods were displayed in an open refrigerator. Following this training session, he introduced the open refrigerator into his shops, and at the same time began to develop a new open refrigerator, which would be suitable for perishable foods in Japan. He developed a successful open refrigerator in 1967.

In hardware innovation, the following factors were also important: improvement of carts and cooking sinks, stopping up the ditch, flattening of the floor of refrigerators, and introduction of automatic packing devices. These improvements were aimed at efficient utilization of part-time workers. There was

a steady increase in the use of part-time workers because of rising wages, which started around the recession in 1965.

Now let us consider developments in software that occurred simultaneously with hardware development. At first, fruits and vegetables were treated in accordance with the tenets of basic botanical physiology learned from specialists at Osaka Prefectural University. Then, techniques learned from the automobile and electricity industries were introduced, making efficient use of part-time workers through simplification and standardization. As a result, fish could be sold through self-service operations instead of through in-person sales beginning in 1970. Finally, there was the sale of meat without reliance on tenant shopkeepers in 1973, based on techniques learned from Hawai'i's Star Market.

As the above process indicates, the pre-packaging system at Kansai Supermarket was completed in the late 1970s. However, it took about ten years for the pre-packaging system that was introduced by the Kansai Supermarket to spread throughout Japan. AJS played a major role in spreading the pre-packaging system for perishable foods. AJS, which was established in 1962 for the purpose of exchange of information among managers of grocery supermarkets, supported the introduction of the system for pre-packaging perishable foods to its members. Consequently, the pre-packaging system, which was introduced by the Kansai Supermarket, was adopted countrywide in the middle of 1980s. Innovation in the pre-packaging system enabled grocery supermarkets to expand their businesses. This innovation was one of the underlying causes of the 1985 Shock.

### **Innovations in Japan's Convenience Stores**

Another economic cause of the 1985 Shock was the development of the convenience store industry in the 1970s. In this section, similar to Section 3 we will examine the growth of convenience stores and their innovations in relation to consumers' behavior during this period.

In 1969, far later than in the United States, the convenience store industry began in Japan. Since then, the convenience store industry in Japan has rapidly expanded. *MCR tokei* [Convenience-store statistics]<sup>25</sup> issued annually by the Manufacturer Convenience Researcher, shows increases in the number and the sales (in hundred million-yen) of convenience stores in Japan.

a) number of convenience stores

1970—30 1973—500 1976—3,000 1979—9,000 1982—18,800

1985—28,350 1988—35,980 1991—41,050 1994—45,208 1997—50,121

b) sales of convenience stores

1982—18,126 1985—31,550 1988—50,860 1991—68,962 1994—71,260 1997—75,108

From these figures, we can see that the growth rate in both convenience stores' numbers and in sales were very high in the 1970s and 1980s.

The phenomenal growth of convenience stores in the 1970s and 80s naturally became a threat to traditional small retailers. As a survey conducted in 1982 by the Labor Department of the Miyagi Prefecture Government suggests, those most affected were the small retailers of fruits and vegetables, foodstuffs, household goods, and books and stationery.<sup>26</sup> From this survey, we can assume that the rapid growth of convenience stores was one of the underlying factors of the 1985 Shock.

Why did the convenience stores achieve such a dominant position over traditional small retailers? The answer can be found in the behavior of consumers in this period. Basically, the favorable business environment, particularly the diffusion of an instant consumption pattern, nurtured the quick growth of the convenience store business in Japan. The instant consumption pattern necessitated the accessibility and variety of goods.

The convenience stores fulfilled a need for accessibility, which had been satisfied by traditional small retailers, as well as the need for variety of goods, which had been satisfied by large retailers like the supermarkets. Consequently, the traditional small retailers, who competed with convenience stores directly in the same market, could not match the convenience stores in the variety of goods and/or the hours of operation.

The next question is how the convenience stores provided a variety of goods, despite the limitations of their store size? To answer this question, we must turn our attention to the systems innovations in convenience store enterprises. Two system innovations contributed to the convenience stores' ability to provide an assortment of goods. One innovation occurred within individual stores, and the other innovation had to do with suppliers. First, let us consider the former. As evident from **Table 4**, most of the convenience store enterprises in Japan adopted a franchise system instead of a regular chain system,<sup>27</sup>

in contrast to the convenience store enterprises in the United States. Japanese convenience store enterprises (for example, Seven-Eleven Japan Co.) selected a franchise system because they had to find a remedy for the small store handicap, which was an inadequate assortment of goods.<sup>28</sup> To provide an ample assortment of goods fulfilling consumer needs in the limited area of small stores, the convenience store enterprises invested a huge sum of money in the construction of a physical system for distribution and communications. They needed to improve the cost-effectiveness of their expenditures for physical distribution and communications. In other words, they had to take economies of scale into consideration. They needed to increase the number of their stores rapidly. However, traditional small retailers in Japan were reluctant to relinquish their stores. This is the reason convenience store enterprises in Japan adopted a franchise system instead of a regular chain system, which would have required transformation of ownership from traditional small retailers to convenience store enterprises.<sup>29</sup> Adoption of the franchise system enabled the convenience store enterprises to expand their businesses rapidly, and consequently contributed to the assortment of goods in convenience stores.

**Table 4.** Number of Convenience Stores in Japan, Broken down by Ownership, 1982-1997.

Year	1982		1985		1988		1991		1994		1997	
	Number	(%)	Number	(%)	Numer	(%)	Number	(%)	Number	(%)	Number	(%)
Franchise Chain	3,881	44.1	8,814	58.4	13,708	61.5	17,761	58.2	26,847	71.7	34,150	71.7
Voluntary Chain	3,582	40.7	4,352	28.9	5,127	23.0	7,355	24.1	7,499	20.0	4,923	10.3
Regular Chain	827	9.4	1,500	9.9	3,054	13.7	5,127	16.8	2,905	7.8	7,224	15.2
Others	510	5.8	434	2.8	401	1.8	275	0.9	181	0.5	1,318	2.8
Total	8,800	100.0	15,100	100.0	22,290	100.0	30,518	100.0	37,432	100.0	47,615	100.0

Sources: Shogyo-kai [Chamber of Commerce], *Konbiniensu Sutoa no Machandaijingu Dai-kenkyu* [Study of the Merchandising of the Convenience Store Industry], 1990; *Konbiniensu Sutoa no Subete*, [Everything You Need to Know about the Convenience-store Industry], 1990/1993; *Konbini 1998 Haru-go* [Convenience Store Business (Spring) 1998], 1998.

Next, we briefly look at the innovations involving suppliers, based on the example of Seven-Eleven Japan, which played a central role in innovation in Japan.<sup>30</sup> As already pointed out, it was crucial for the

convenience store enterprise to provide an adequate assortment of goods in the limited space of their small stores. To realize this goal required frequent deliveries because of limits on store space. However, frequent deliveries were costly, especially in Japan. Under the traditional distribution system in Japan, retailers had access to manufacturers only through multiple layers of wholesalers. Each manufacturer chose a wholesaler to handle its products and each wholesaler often chose a second or third wholesaler to deliver the goods that they handled. Therefore, delivery costs from manufacturer to retailers were enormous.

Because of this situation, Seven-Eleven Japan started to improve its delivery system with suppliers. First, in 1976, Seven-Eleven Japan consolidated its suppliers. This resulted in the reduction of the number of daily deliveries and of their delivery costs. Second, also in 1976, they began to combine the delivery of products with different handling needs. Up to this time, the products delivered by a wholesaler were grouped together according to their shipping requirements, such as temperature. Seven-Eleven Japan made their wholesalers bring all products, sorted by store, to each convenience store. This also resulted in the reduction of delivery costs.

These two innovations enabled convenience-stores to provide an adequate assortment of goods at a reasonable cost in the limited space of a small store. Consequently, these innovations were one of the underlying factors of the 1985 Shock.

## **Conclusions**

In this study, we have mentioned the innovations that took place both in supermarket and convenience stores in Japan in order to clarify the causes of the 1985 Shock. This was the turning point for the Japan's distribution system and started it on the road towards globalization. The conclusions can be summarized as follows.

One cause of the 1985 Shock was the innovation in Japan's supermarkets. Supermarkets, which are in direct competition with small retailers in the same market, did not expand their business until the late 1970s. This is because, during the high-growth period, traditional consumption patterns, with a strong consumer predilection for food freshness, restricted the development of grocery supermarkets. The system for pre-packaging perishable foods, which was introduced by Kansai Supermarket in the late 1970s, was only adopted countrywide in the middle of the 1980s. The innovations in the pre-packaging

system enabled grocery supermarkets to expand their business, and consequently caused a decrease in the number of small retail stores that sold food. This innovation was one of the causes of the 1985 Shock.

Another factor in the Shock was the innovation in Japan's convenience stores. The phenomenal growth of convenience stores in the 1970s and 1980s became a threat to small retailers. This dominance of convenience stores over the traditional small retailers developed because of two innovations instituted by convenience store enterprises. One innovation occurred within individual retail stores—adoption and refinement of the franchise system. The other innovation of the system involved suppliers—rationalization of the delivery system. These two innovations enabled convenience stores to provide an adequate assortment of goods at reasonable cost in the limited space of small stores. We assume that these innovations were also factors behind the 1985 Shock.

Most existing studies on Japan's distribution system have tended to focus on external factors. However, it is clear that we must pay more attention to corporate activity in order to fully understand the true picture of the globalization of Japan's distribution system.

## Notes

<sup>1</sup>The contents of this section are a summary of Takeo Kikkawa and Mika Takaoka. "A New Perspective on the Japanese Distribution System," University of Tokyo *Social Science Japan Journal* 1:1 (1998), pp. 101-19.

<sup>2</sup>Y. Tsurumi, "Managing Consumer and Industrial Marketing Systems in Japan," *Sloan Management Review* 24:1 (1982), pp. 41-50, and D. Flath, "Why Are There So Many Retail Stores in Japan?" *Japan and the World Economy* 2:4 (1990), pp. 365-86.

<sup>3</sup>E. Batzer and H. Laumer, *Marketing Strategies and Distribution Channels of Foreign Companies in Japan* (Boulder, CO: Westview Press, 1980).

<sup>4</sup>H. T. Patrick, and T. P. Rohlen, "Small-scale Family Enterprises," in *The Political Economy of Japan*, Vol.1: *The Domestic Transformation*, K. Yamamura and Y. Yasuba, eds. (Stanford: Stanford University Press, 1987).

<sup>5</sup>T. K. McCraw and P.A. O'Brien, "Production and Distribution." In *America versus Japan*, T. K. McCraw, ed. (Boston: Harvard Business School Press, 1986).

6 T.C. Bestor, *Neighborhood Tokyo* (Stanford: Stanford University Press, 1989). The summary here is based on the one by Jeroen C.A. Potjes, *Empirical Studies in Japanese Retailing* (Amsterdam: Thesis Publishers, 1993), p. 38).

7 M. Shimaguchi, "New Developments in Channel Strategy in Japan," in *The Japanese Distribution System*, M.R. Czinkota and M.Kotabe, ed. (Chicago: Probus Co., 1993).

8 M. Tamura, *Nihon-gata ryutsu shisutemu* [The Japanese-type Distribution System] (Tokyo: Chikura Shobo, 1986),.

<sup>9</sup> It should be noted, however, that the studies by D.Flath, a close associate of Nariu Tatsuhiko to be discussed later, are fairly systematic.

<sup>10</sup> While most of these new studies attempt to explain the trade practices in the distribution system, these two studies focus on the distribution system. See Maruyama, Masahiro *Ryutsu no keizai bunseki* [An Economic Analysis of Distribution] (Tokyo: Sobunsha, 1988) and Nariu, Tatsuhiko *Ryutsu no keizai riron* [The Economic Theory of Distribution] (Nagoya: Nagoya University Press, 1994).

11 Kakeda, Yutaka. "Shogyo tokei ni yoru wagakuni ryutsugyo no kozo bunseki" [A Structural Analysis of the Japanese Distribution Industry Based on Commercial Statistics], in *Wagakuni ryutsu no genjo to kadai* [The Present State of the Japanese Distribution System and Current Problems], Ryutsugyo Seisansei Kenkyu Iinkai, ed. (Tokyo: Japan Productivity Center, 1993).

<sup>12</sup> Note that Tamura (1992) emphasizes that the Japanese distribution system began to undergo significant changes in the early 1990's, only because of the relaxation of the LSRSL.

13 Ishii, Junzo "Shonin to kazoku" [Shopkeepers and Their Families] (Kobe University *Kokumin keizai zasshi* 170:1 (1994), pp. 19-36.

14 Azuchi, Satoshi. *Yasuuri raisan ni igi ari* [Objections to the Glorification of Cut-rate Selling] (Tokyo: Toyo Keizai Shimposha, 1995).

15 We are concerned here not so much with the quantitative increase in grocery supermarkets during the 1980's, as with the quantitative changes undergone by them. This is why we pay attention to grocery supermarkets rather than to general supermarkets, in spite of the fact that the rate of increase for the former in the period from 1982 to 1991, 1.19 times, was lower than that for the latter, 1.28 times (see **Table 3**).

<sup>16</sup> See, for instance, Tamura (1986) pp. 54-58.

<sup>17</sup> Hayashi, Shuji *Ryutsu kakumei* [The Distribution Revolution] (Tokyo: Chuko Shinsho, 1962).

<sup>18</sup> Similarly, wholesalers were not eliminated from Japan's distribution channels from the late 1960's onwards, and it was only from the mid-1980's that a trend towards reduction finally began in distribution channels. The more detailed discussion of this point can be found in Takaoka 1998.

<sup>19</sup> See Ministry of International Trade and Industry, *Serufu-sabisu ten tokei* [Self-service Shop Statistics] (1983). I included only those retail shops that had a floor space of at least 100 square meters, of which at least 50 percent was used in a self-service format.

<sup>20</sup> See Takaoka (1998), pp. 82-83.

<sup>21</sup> A more detailed discussion of this point can be found in Kikkawa and Takaoka (1997).

<sup>22</sup> Other factors contributing to the development of big stores and grocery supermarkets are: the establishment of a mass production system, the increase in suburban populations and the number of households, the beginnings of motorization, the expansion of the part-time workforce, and absence of the LSRSLS until 1974.

<sup>23</sup> See Kikkawa and Takaoka (1998).

<sup>24</sup> The contents of this argument are based on the experience with the Kansai Supermarket, see *Kansai Supa 25nen no ayumi* [A 25-Year History of the Kansai Supermarket] (1985).

<sup>25</sup> See Shogyo-kai (1998).

<sup>26</sup> See Sato (1983).

<sup>27</sup> The franchise system means the continuous relationship between the franchiser and the franchisees, which consist of the payment of royalties by franchisees and the several supporting actions by franchiser including giving the right to open a convenience-store business, helping with the ordering decisions, merchandising, and display.

<sup>28</sup> A more detailed discussion of this can be found in Takaoka (1999).

<sup>29</sup> The franchise system adopted by convenience-store enterprises was also beneficial to traditional small-size retailers. It is more profitable for many traditional small retailers (e.g., liquor stores) to transform themselves into franchisee shops in convenience-store chains, because they receive additional support. The franchise system was adopted and continued because of the mutual benefits to convenience store enterprises as franchisers and to traditional small-size retailers as franchisees.

<sup>30</sup> See J. Bernstein, "7-Eleven in America and Japan," Case No. N9-797-030 (Harvard Business School,

1996).

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