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Retail Distribution Channel Barriers to International Trade

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Abstract
With the referral of the Kodak - Fuji market access dispute to the World Trade Organization, the role of retail distribution channel control by incumbent firms as a barrier to imports has drawn much interest. This paper reviews the issues from an historical perspective and analyzes the difficulties facing firms attempting to sell their products in other nations' automobile and photo supplies markets. There has been a natural evolution of retail distribution channels from „mom and pop" stores to hyper - markets. The earlier the stage in this evolutionary process at which a nation's retail channels stand, the more difficult it is for consumer goods importers to secure their own products' distribution. Volkswagen's early entry into the U.S. automobile market and Nissan's later entry are analyzed as examples of how exclusive distribution channels controlled by incumbents can be surmounted. Key aspects of the Kodak - Fuji case are also examined. The advantages and disadvantages of manufacturers' restraints on their distributors are so complex, the paper concludes, that it would be difficult to adopt uniform international competition policies toward trade-impairing vertical restraints.

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1 Introduction

With tariffs having been reduced through successive rounds of multilateral trade negotiations, structural barriers have moved to the forefront of concern as remaining impediments to free and open international trade. Structural barriers assume many forms. They include domestic preferences and "co-production" requirements in government and government-owned enterprise procurement decisions, "buy at home" biases expressed by privately-owned national champion enterprises beholden to government authority, regulatory procedures and standards that discriminate against imported products (e.g., in new drug approvals, the allocation of radio spectrum, and automobile safety and pollution control equipment requirements), restraints on foreign direct investment (which can either complement or substitute for cross-border trade), buyers' cartels, and the control of distribution channels by domestic tradable goods manufacturers.

Much ink has been spilled over several of these structural barriers -- so much that it is difficult to contribute anything new on the subject. In this paper I therefore focus on the "vertical restraints" question, i.e., on the impediments importers encounter obtaining access to the wholesale and retail distribution channels needed to convey their products to the ultimate consumer.

Although parallel examples can be found in other jurisdictions, claims that Japanese distribution channels are skewed to the disadvantage of imported products have been a source of chronic tension between the United States and Japan.[1] During the late 1980s, Japan and the United States collaborated in "Structural Impediments Initiatives" seeking to allay such complaints. Among other things, it was alleged that weak enforcement of the Japanese anti-monopoly laws permitted the perpetuation of import-limiting vertical restraints. To clarify and perhaps remedy the situation, the Japanese Fair Trade Commission, responsible for enforcing Japan's anti-monopoly law, published in 1991 a 93-page English-language document spelling out its detailed interpretation of the bounds between legality and illegality on such practices as boycotts, exclusive dealing arrangements, full-line forcing, reciprocal dealing, sales territory restrictions, rebates, resale price maintenance, acquisition of ownership interests in vertical trading partners, and the abuse of a dominant bargaining position by retailers.[2]

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1 See Mitsuo Matsushita, "An International Comparison of Distribution and Trade Practices and Competition Policies," draft report of an International Comparative Study Group on Distribution Structures and Trade Practices (Tokyo: Fair Trade Commission: 1986).

2 Fair Trade Commission, The Antimonopoly Act Guidelines Concerning Distribution Systems and Business Practices (Tokyo: July 11, 1991).

Despite (or perhaps because of) these efforts, allegations of restricted vertical access have reappeared as major elements in U.S. firms' complaints against Japanese business practices and as possible explanations for the persistent deficit run by the United States on its trade with Japan. On May 16, 1995, the United States government announced that it would levy 100 percent tariffs on 13 imported Japanese luxury car models unless U.S. manufacturers' products gained substantially enhanced access to Japanese showrooms (for finished vehicles) and original vehicle and repair markets (for parts).[3] The dispute was resolved, at least temporarily, and the tariff threat was withdrawn through last-minute negotiations evoking indefinite promises of improved access to Japanese markets.[4] Two days after punitive auto tariffs were preliminarily announced, the Eastman Kodak Company filed with the U.S. government a complaint alleging that, in league with Japan's Ministry of International Trade and Industry, the Fuji Photo Film Company and its network of domestic wholesalers and distributors sustained anticompetitive practices to limit the Japanese market access of Kodak film and print paper.[5] In August 1996, the matter was referred by the United States to the World Trade Organization for resolution.

These two disputes -- one involving a big-ticket item sold through specialized retail outlets, another a low-price convenience good sold through a vast and diversified array of retailers -- will provide the organizing focus for this paper. Despite having spent all of three weeks in Japan, the author cannot claim to be an expert on the economics of Japanese marketing channels. Therefore, a broader perspective will be adopted. The paper addresses more generally how vertical restraints can affect producers' access to channels of distribution, the historical context within which U.S. and foreign automobile and photographic film manufacturers squared off to compete in each others' home markets, the strategies employed by importers to hurdle distribution channel access barriers, and the successes and failures of competition policy (or in the United States, antitrust policy) in its diverse attempts to minimize those barriers.

2 The Broad Historical Context

To sell their goods, manufacturers need access to consumers. Both the size of individual retail outlets and the number of outlets under common control can affect the ability of imported goods to reach consumers. Small stores have very limited shelf space. Except in the case of narrowly specialized outlets, e.g., boutiques, this

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[3] "100% Tariffs Set on 13 Top Models of Japanese Cars," New York Times, May 17, 1995, p. 1.

[4] "U.S. Settles Trade Dispute, Averting Billions in Tariffs on Japanese Luxury Autos," New York Times, June 29, 1995, p. 1.

[5] "Trade Fight with Japan Is Widening," New York Times, May 19, 1995, p. D1.

plus the need for keeping their merchandise procurement activities simple requires limiting the number of brands displayed -- commonly, to only a single brand -- in any given product category. More often than not, the brand chosen will be one that is well known by all consumers, which usually means a popular domestic brand. Department stores and supermarkets, in contrast, appeal to consumers partly through the wide array of brands they stock. This often means that imported products can more readily secure a shelf space niche. In addition, multi-unit chains have purchasing departments that can search far and wide for products that will enhance their shelf display appeal, and this again provides an opportunity for imported products.

There have been several revolutions in the organization of retail distribution and hence the characteristic size and geographic scope of retailing firms. During the 19th Century, the preponderant retail marketing channel in the United States was the general store in small towns or, in larger cities, the small, conveniently located "Mom and Pop" store specializing in a relatively narrow array of items. Roughly a century ago competition began impinging upon these small retailers in two main forms -- from large department stores merchandising a much wider array of goods, typically sold at prices approximating those charged by smaller, more specialized, outlets; and (especially for rural consumers) from the large mail-order houses such as Sears Roebuck and Montgomery Ward, whose product assortment was much more diverse and lower-priced than that of local merchants, but lacked the advantages of immediacy and on-the-spot inspection. As the 20th Century progressed, new competition arose from chain stores, first in general merchandise (e.g., the "five and dime" stores such as Woolworth's) and then from the food chains (led by A&P). The early chain store outlets were typically small and conveniently located. However, the increased mobility conferred by nearly universal automobile ownership, combined with rising affluence in the wake of World War II, led to the emergence of supermarkets and giant mall-based discount stores offering a great diversity of products at prices kept low by self-service, economies of scale at the store level, and economies of large-scale purchasing and logistic infrastructure spanning multiple units.

Small, locally-owned retailers fought the invasion of large discounters in their home markets and in the halls of Congress. In 1936, informed by a Federal Trade Commission staff study that the chain stores owed at least part of their cost advantage to discriminatory price discounts extracted from manufacturers, Congress passed the Robinson-Patman Act, which declared many forms of competition-lessening price discrimination illegal. The intent of the law, according to its co-sponsor, Wright Patman, was "to give the little business fellows a square deal."[6] In response to heavy

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[6] "Robinson-Patman: Dodo or Golden Rule?" Business Week, November 12, 1966, p. 66.

lobbying, led by the retail pharmacists' trade association, Congress passed in 1937 the Miller-Tydings Resale Price Maintenance Act, which exempted from antitrust penalties most minimum price-setting agreements between manufacturers and retailers in states with permissive laws. The intent was to prevent chains and discount houses from undercutting branded good prices specified by manufacturers and charged by smaller retailers. Neither law, however, was successful in stemming the tide toward large-scale retailing. Powerful retail buyers circumvented the Robinson-Patman law by integrating backward into the manufacture of their own products, by encouraging their suppliers to sell only in large volumes at discounted prices, and by exploiting the law's numerous loopholes in tenacious court battles. Resale price maintenance (RPM) was undermined because many manufacturers chose not to enforce the law against price-cutting merchants who were often their best customers and because price-maintaining retailers found their sales eroded by mail order shipments from states with laws less supportive of RPM. When the Miller-Tydings Act and a later reinforcing statute were repealed in 1975, only an estimated four percent of U.S. retail sales involved minimum price-fixed items.

The revolutions in retailing occurred later in some nations than in others. Having grown up in the United States during the 1930s and 1940s, I experienced directly the progression from small to large-unit chain stores and then to supermarkets and shopping centers. Having lived in Germany for extended periods between the 1950s, 1960s, and 1970s, I witnessed those revolutions again, roughly two decades later. There were several reasons for the delay of what eventually seemed inevitable: a later ascent to postwar affluence; concomitant lags in the spread of automobiles (enhancing consumers' ability to transport large purchases) and large refrigerators (permitting once-a-week food shopping); higher average population density, which raised the opportunity cost of parking space;[7] and (until 1973) permissive laws concerning resale price maintenance.[8]

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7 Congestion and high parking space costs explain why many small neighborhood stores survive in New York City and some sections of other large U.S. cities.

8 However, the number of agreements notified to the Federal Cartel Office was declining even before formal RPM agreements were effectively outlawed in 1973. See F. D. Boggis, "The European Economic Community," in Basil S. Yamey, ed., Resale Price Maintenance (Chicago: Aldine, 1966), pp. 205-206.

Sweden altered its law to discourage RPM beginning in 1954. According to the analysis by U. af Trolle in the Yamey compendium, p. 134, "dramatic changes in the structure of Swedish distribution" -- notably, the emergence of self-service stores and low-price supermarkets -- "would not have taken place" without the abolition of a rigid RPM system and new firm entry restrictions.

France was tardier than Germany in the transition to very large retail outlets, in part because shopping at small neighborhood stores was even more deeply entrenched in the French way of life than it was in Germany. The first French supermarket was opened in 1957; the first giant discount store (Hypermarche) in 1963.[9] Although France passed a law declaring resale price maintenance presumptively illegal in 1953, many manufacturers, at the urging of their smaller merchant customers, refused to supply retailers who sold their products at discount prices. Discount store pioneer Edouard Leclerc led a struggle which eventually elicited the intervention of President Charles de Gaulle and a 1962 high court decision declaring such resale price-maintaining refusals to sell illegal.[10] The small merchants fought back by inducing the French Parliament, where they enjoyed stronger political support than in the administration, to pass a series of laws culminating in 1973 in *le loi Royer* (a law introduced by M. Royer), which required anyone proposing to establish a retail outlet with a selling area in excess of 1,500 square meters (1,000 square meters in smaller cities) to obtain approval from a local planning commission, nine of whose 20 members were local merchants.[11] The early attempts of hypermarket advocates to circumvent or overturn *le loi Royer* achieved only mixed success. Nevertheless, according to Adams, the spread of discount retailing in France was accelerated by the campaign M. Leclerc and others sustained against the boycotting of discounters and *le loi Royer*.[12]

Japan has lagged behind the United States and major western European nations in the movement toward large retail outlets. Recent national statistical sources reveal the number of retail establishments (excluding auto dealers, gasoline and fuel dealers, and restaurants) per thousand inhabitants (first column) and average employment per

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Similarly, in the United Kingdom, according to Ann Rosemarie Everton, "With the advent of the Resale Prices Act of 1964 ... and the eventually virtual prohibition of [resale price maintenance], the way was opened for the lawful pursuit of pricing policies including price discrimination, and this contributed to the blossoming of new shopping forms and the concomitant demise of the corner shop." "Discrimination and Predation in the United Kingdom: Small Grocers and Small Bus Companies -- A Decade of Domestic Competition Policy," 14 European Competition Law Review 6, 7 (January/February 1993).

9 William James Adams, Restructuring the French Economy (Washington: Brookings Institution, 1989), pp. 220-221.

10 Adams, supra note 9, pp. 224-229.

11 Adams, supra note 9, p. 209-210. On similar efforts in Spain, see "Small Family-Run Stores in Spain Are Fighting to Limit the Hypermarkets," New York Times, January 6, 1996, p. 18.

12 Adams, supra note 9, pp. 228-229. See also "Over There: Teardrops on the Shelves," Business Week, February 12, 1996, p. 6.

establishment (second column) in Japan and four comparable nations to be as follows:[13]

	Stores per 1.000 Population	Employees per Store
Japan (1988)	11.79	4.09
United States (1987)	6.52	6.01
Germany (1992)	6.16	5.79
United Kingdom (1990)	6.08	7.07
Sweden (1992)	6.42	n.a.

Takatoshi Ito reports that the average Japanese retail outlet had 55.4 square meters of floor space in 1982, compared to 167.9 square meters in Germany.[14] No U.S. comparison was attempted. The U.S. Census of Retail Trade for 1987 reports only limited floor space statistics. For 9,903 outlets classified as department stores (excluding food retailing outlets), the average selling space was 6,650 square meters per store.[15] Japanese statistics tally a total of 2,343 "large-scale" retail outlets in 1987, including both department stores and retail super-markets.[16] The average

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[13] Sources: Japan Statistical Yearbook: 1995,, p. 396; Statistical Abstract of the United States: 1993, p. 775; Statistisches Jahrbuch für die Bundesrepublik Deutschland: 1995, p. 261; U.K. Central Statistical Office, Annual Abstract of Statistics: 1995, Table 11.1; and Statistisk Årsbok för Sverige: 1995, p. 118. Not counted in the U.S. employment data, and, from the definitions given, presumably also in the foreign data are self-employed employers. If one adds to each U.S. retail outlet with no reported employees the services of the proprietor as a single employee, the average employment count per U.S. establishment rises to 6.98.

In The Japanese Economy (Cambridge: MIT Press, 1992), p. 287, Takatoshi Ito reports a study by M. Maruyama and others showing that Japan had 14.5 retail establishments per 1,000 residents in 1982. It is unclear whether the data are completely comparable to those reported above.

[14] Ito, supra note 13.

[15] U.S. Bureau of the Census, 1987 Census of Retail Trade, "Miscellaneous Subjects," RC87-S-4 (October 1990), p. 4-139.

[16] Japan Statistical Yearbook: 1995, supra note 13, at pp. 398-399.

selling space per outlet was 6,798 square meters -- quite close to the average for the 4.2 times as many U.S. department stores. The 125,595 U.S. grocery stores of all sizes, large and small, operating at the end of 1987 had an average selling area of 553 square meters. No comparable statistic for all Japanese retail grocery outlets was reported. It seems reasonable to infer from the Ito data that the average Japanese store was much smaller.

The factors that inhibited the spread of large-scale retailing in postwar Europe recur in Japan. High population densities, high land costs, and road congestion well beyond levels prevailing in most American and European cities discourage the use of automobiles as a means of conveying large purchases. Japan's Fair Trade Commission was generous in granting exemptions to resale price maintenance prohibitions contained in the 1953 anti-monopoly law. Informal attempts by manufacturers to set retail price floors through suasion and boycotts of price-cutting retailers were effective until they were challenged in a precedent-setting 1993 court decision precipitated by a discounter's law suit.[17] The Large Retail Store Law of 1974, amended in 1979, emplaced time-consuming and sometimes formidable procedural hurdles that must be surmounted before sizeable new retail outlets can be constructed.[18] Merchandise typically moves onto retailers' shelves in Japan through one and sometimes two tiers of wholesalers, many of which are controlled directly (through vertical stockholdings) or informally (through long-standing relationships) by the manufacturers whose products are being distributed. The owners of small retail shops are often alumni of the manufacturers whose products they stock, given a "golden handshake" at age 55 and required to make ends meet by embracing a new profession. These circumstances and limited shelf space often lead retailers, by explicit contract or (more frequently) by informal understanding, to handle only the products of their traditional suppliers and not to sell competing brands, including imported brands. Consequently, as Takatoshi Ito reports:[19]

> The Japanese distribution system has become the focus of extensive criticism, both abroad and within Japan. The Japanese market is "closed," complain many foreign manufact-urers who have tried and failed to export to Japan. Their complaints center around the hostility of the Japanese distribution system to new entrants. Japanese wholesalers and retailers are said to be unwilling to put discounted imported commodities on the shelves, because they are pressured by the distributors of competing Japanese products ... not to do so.

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[17] "Japanese Court Orders Reinstatement of Discounter Terminated by Cosmetics Maker," Antitrust and Trade Regulation Report, October 7, 1993, pp. 479-480.

[18] See Ito, supra note 13, at pp. 394-396.

[19] Ito, supra note 13, at p. 385.

Nevertheless, in Japan, as in western Europe during earlier decades, there are signs of gradual change -- more glacial, to be sure, than the developments in Germany and France. As a Japanese Fair Trade Commission study group reported:[20]

> There is much in this overseas criticism that deserves serious consideration, but there is also much that goes beyond the realm of competition policy and public policy.... Distribution structure and business practices are not artificially designed ... in any country. Instead, they evolve naturally over the long years of history, having a certain rationality in light of the prevailing constraints that govern social behavior, and there is thus a limit to how much policy actions can influence these cultural-heritage aspects.

Although there are good reasons for expecting imported goods to experience difficulty reaching consumers, given the small-store environment prevailing in Japan and persisting to some extent even in France, qualifications and exceptions must be recognized. W. J. Adams concludes his analysis of the French experience with an observation that the rise of discount retailing may have facilitated the introduction of foreign products into French markets.[21] He notes, however, a 1983 study finding no correlation between import penetration ratios and large outlets' share of white goods (e.g., refrigerators, washing machines, etc.) and clothing sales in France.[22] In white goods, small shops stocked products imported from low-cost nations to compete with and differentiate their offerings from those of the larger stores. In clothing, manufacturers procured semi-finished items from low-wage nations, adding only finishing touches, and independent wholesalers sold the garments they obtained abroad to both small traditional retail shops and chains.

3 Access to Automobile Consumers

Some of the most insistent complaints during recent years concerning restricted access to the Japanese market have come from U.S. automobile manufacturers. In the dispute that escalated to a crisis point during 1995, U.S. automobile makers levied five specific allegations: (1) that restrictive zoning and high land prices made it

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[20] Matsushita, "An International Comparison," supra note 1, at p. 23. See also F. M. Scherer, Competition Policies for an Integrated World Economy (Washington: Brookings: 1994), pp. 74-78.

[21] Adams, supra note 9, at p. 242. See also p. 208.

[22] Adams, supra note 9, at p. 242, note 95, referencing Frederic Jenny, "Rapport sur la Relation Pouvant Exister entre les Pratiques de Certain Types de Distributeurs et la Penetration Croissante de Notre Marche par les Produits Etrangers." Adams' discussion of the evidence has been supplemented through correspondence with Professor Jenny.

virtually impossible to establish their own dealerships within Japan;[23] (2) that the retailers selling Japanese cars in Japan deal exclusively in the vehicles of the domestic manufacturer whose franchise they hold, or, if they handle American cars at all, do so unenthusiastically; (3) that because of restrictive governmental regulations governing annual auto safety inspections and long-standing ties between some 20,000 "designated" repair shops and manufacturers, opportunities for U.S. companies to sell repair parts to Japanese automobile service outlets are constrained; (4) that despite the sharp fall of the dollar relative to the yen, U.S. sales of original equipment parts to Japan increased only trivially; and (5) that in their rapidly growing American transplant manufacturing operations, Japanese companies favored home sources or U.S. sources owned by Japanese parents over U.S. producers in procuring original equipment parts to be assembled into Japanese nameplate cars. Through more aggressive enforcement of Japan's anti-monopoly law against exclusive dealing arrangements and the other vertical restraints underlying charges (1) - (4), it has been argued, the structural barriers to U.S. vehicle and parts sales in Japan might be reduced. The fifth allegation, concerning purchases for use within the United States, has no import restraint implications and hence will not be considered in detail here, even though such purchases probably represent the largest sales opportunity for U.S. parts manufacturers.[24]

U.S. manufacturers were not always unsuccessful in selling their products to Japanese consumers.[25] A significant demand for motor-propelled vehicles first emerged in Japan to support reconstruction after the great earthquake of 1923. Ford Motor Company was the first to respond, and in 1925, it established a Yokohama plant to assemble parts imported from the United States. General Motors and Chrysler followed with "knockdown" assembly plants in 1927 and 1929 respectively. Between 1925 and 1932, Japanese motor vehicle imports included 26,412 assembled vehicles and 132,425 "knockdown" vehicle kits. Domestic production in the same interval totalled 3,481 units, although companies such as Nissan accumulated experience producing some parts for U.S. companies' assembly operations. As the military gained political strength during the 1930s and feared dependence upon

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[23] See "Cars, Trade, Power, and the Legacy of Frustration," New York Times, May 8, 1995, p. D2, in which a Ford Motor Company executive is quoted, "You can build a whole plant in China for what it costs to open five new showrooms in Tokyo."

[24] Thus, in 1994, Japanese transplant car assemblers in the United States purchased approximately $17 billion in parts from U.S.-based sources. Parts exports from the United States to Japan were $3 billion; assembled motor vehicle exports amounted to less than $2 billion. "U.S. Plans To Threaten Japan with Tariffs," New York Times, April 13, 1995, p. D7.

[25] This paragraph is based upon Hiroko Yotsumoto, "The Japanese Automobile Industry Before World War II," term paper submitted at the John F. Kennedy School of Government, 1995.

foreign sources, measures were taken by the Japanese government to encourage domestic production. The Automobile Manufacturing Industry Law of 1936 licensed Toyota, Nissan, and Diesel Motor to produce vehicles under government protection and restricted assembly operations by the American manufacturers. General Motors and Ford tried to remain in the Japanese market by affiliating with Japanese firms, but those efforts failed, and in 1939 the U.S. companies terminated their operations.

During the late 1940s American companies again became the leading motor vehicle suppliers in Japan, but the demand for their products was limited severely by the poverty of a war-shattered economy; the unsuitability of large American cars to narrow, rough Japanese roads;[26] and (when the economy began recovering) high protective tariffs. The Korean War provided a strong impetus to the renaissance of a domestic automobile industry.[27] It is unclear whether U.S. manufacturers attempted to reestablish assembly operations in Japan. If they did, it is likely that their investments would have been restricted by a Japanese government eager to protect the development of a viable domestic industry.[28] What is clear is that by 1960 imports had shrunk to only one percent of the Japanese market and domestic producers had built strong retail distribution channels to serve rapidly growing demand.

3.1 Foreign Firms' Experience Penetrating U.S. Markets

How does a foreign producer secure channels of distribution after being absent from the market, during which time local manufacturers have established their own exclusive retail dealer networks? For Japan I have virtually no evidence on this question. However, much can be learned from the experience of foreign automobile makers who successfully penetrated the U.S. market, where American firms enjoyed at least as strong a position as Japanese manufacturers possess in their home market.

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[26] The Japanese preference for small cars continues to limit U.S. manufacturers' market opportunities, absent the development of new cars especially suited to Japanese demands. In 1994, 79.5 percent of all new Japanese cars (excluding mini-cars with engine displacements below 660 cubic centimeters) had engine displacements between 660 and 2000 cc -- a category in which the U.S. Big Three offered no models. In the above 3000 cc category, U.S. auto makers achieved a 1994 market share estimated at 28.5 percent. Data from the Japan Automobile Manufactuers Association and the Japan Automobile Importers Association.

[27] See David Halberstam, The Reckoning (New York: Morrow, 1986) (on the evolution of Nissan).

[28] See Ito, supra note 13, at pp. 201-202, on MITI's unsuccessful efforts in 1955 and 1961 to limit the number of domestic companies producing automobiles.

That the exclusive dealing relationships inhibiting U.S. firms' access to Japanese auto consumers should be mirrored in the United States is not a foregone conclusion. Antitrust fears could have induced greater openness. Indeed, a leading Japanese antitrust scholar observed in a discussion of exclusive dealership arrangements that "The easy accessibility of the U.S. distribution structure has clearly been one factor working to the advantage of Japanese companies wishing to export to the United States."[29] Under the somewhat unclear legal precedents existing during the 1950s, a small auto manufacturer could successfully defend itself against antitrust charges when it cancelled a dealer's franchise for diffusing sales efforts by taking on a competing auto line, but it is unlikely that the Big Three, with their large market shares, could have done so.[30] However, auto manufacturers had means more subtle than explicit contractual restrictions for maintaining the exclusivity of their dealers. The dealer who strayed too far from the fold was likely to have difficulty securing timely delivery of the models it sought -- especially "hot" selling cars in times of shortage. Despite the passage of so-called "dealer day in court" laws inhibiting franchise cancellations without just cause,[31] unfaithful dealers were also susceptible to various other forms of harassment by their manufacturer-suppliers.

As a result, and probably also because scale economies can be realized from dealer specialization when a sufficient volume of a single manufacturer's cars can be sold,[32] most of the dealerships handling the leading American producers' cars have remained effectively exclusive to a single manufacturer's offerings.[33] In 1960, for example, although 33 percent of all General Motors car dealers in the United States carried more than one GM nameplate (e.g., Pontiac and Cadillac), a mere 0.5 percent of "Big Four" dealers stocked the cars of competing manufact-urers.[34] However, among the

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29 Matsushita, supra note 1, at p. 6.

30 Compare Hudson Sales Corp. v. Waldrip, 211 F 2nd 268 (1954); in re General Motors, 34 F.T.C. Reports 58 (1941); and (on exclusive dealing in petroleum retailing), Standard Oil of California et al. v. U.S., 337 U.S. 293 (1949). See also Report of the Attorney General's National Committee To Study the Antitrust Laws (USGPO: March 31, 1955), pp. 141-145.

31 Automobile Dealer Franchise Act, Public Law 1026 (August 1956), 15 U.S.C. 1221-25.

32 See B. P. Pashigian, The Distribution of Automobiles: An Economic Analysis of the Franchise System (Prentice-Hall: 1961).

33 On changes becoming evident during the mid-1990s, see "Revolution in the Showroom," Business Week, Feburary 19, 1996, pp. 70-75.

34 Stanley E. Boyle, A Reorganization of the U.S. Automobile Industry, Committee Print, U.S. Senate Committee on the Judiciary, Subcommittee on Antitrust and Monopoly (February 28, 1974), pp. 192-196.

6,023 dealerships carrying imported cars other than those produced by foreign branches of a U.S. manufacturer, only 20 percent dealt exclusively in the products of a single company.[35] For importers, the easiest, if not the most effective, access to the U.S. market was through a dealer marketing other foreign cars. By 1995, the situation had changed appreciably. Among the 17,872 dealers holding franchises to sell new U.S. Big Three cars, 2.0 percent carried competing companies' vehicles. Among the 4,545 dealerships specializing in imported cars, 22 percent carried competing makes.[36]

Most of the foreign cars that sought U.S. sales during the period following World War II were in fact sold through multi-manufacturer foreign car specialists. Their success was characteristicaly modest. Volkswagen was the first to pursue an alternative strategy aggressively. Its first two attempts to establish dealerships during the late 1940s were abject failures.[37] In 1950, a distributor also selling Porsches and Jaguars was enlisted in New York. Through that distributor's efforts and word-of-mouth from American soldiers returning from European tours of duty, other foreign car dealers began adding VW to their lineups. As sales rose, Volkswagen in 1954 reorganized its haphazard network and dispatched two key persons from Germany to build an effective distribution system. Its chief recognized that in the United States "a completely new structure was needed to sell VWs effectively, different from the slightly tatty cinder-block establishments maintained by many multibrand foreign-car retailers."[38] VW's eastern United States head travelled from city to city interviewing potential dealers and, for those who joined up, "encouraging, pushing, checking,

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35 Boyle, supra note 34, at pp. 196-199.

36 Automotive News 1995 Market Data Book (Detroit: 1995), p. 105. On average, imported car dealers carried 2.75 brands.

A dealership is defined here as a single physical facility. Separate facilities owned by a single parent may deal in different manufacturers' brands and still be deemed exclusive. The Manhattan telephone directory for 1995 lists four Potamkin auto dealerships at separate locations -- one handling Cadillacs, Buicks, and Chevrolets; one Chryslers, Plymouths, and Dodges; one Mazda, Toyota, and Volkswagen; and one Sterling and Mitsubishi. In 1987, the ten largest new and used car retailing "enterprises" in the United States, each with total sales of $250 million or more, owned an average of 15.4 establishments per enterprise. The average number of establishments for all 41,351 reporting enterprises was 1.06 per corporate entity. U.S. Bureau of the Census, Enterprise Statistics: 1987, Company Summary, ES87-3, p. 89.

37 See Walter Henry Nelson, Small Wonder: The Amazing Story of Volkswagen (Boston: Little, Brown, 1967), pp. 173-174, from which much of this account is drawn.

38 Frank Rowsome, Jr., Think Small: The Story of Those Volkswagen Ads (Brattleboro: Stephen Greene Press, 1970), p. 46.

admonishing -- and always infecting us with his complete and utter faith in the small car."[39] ...

> "One of the first things we had to do," remember[ed] one veteran of these visits, "was to get in there and have them clean up the dirt in their workshops. We wanted these to be neat and uniform ... so that Volkswagen facilities could have the same single and recognizable image in the country that the car had. We wanted our workshops to be attractive and tidy, even to have flowers placed out front if possible, so as to make them really stand out from other dealerships."[40]

Seeking to avoid the problems that beset British, French, Italian, and Swedish imports, Volkswagen placed great stress on having its new dealers maintain repair facilities that could provide high-quality service for every car sold. The formula was sufficiently successful that, according to Nelson, many of the early VW dealers became millionaires.[41] By 1959, Volkswagen's annual sales in the United States had climbed to 120,442 new sedans (i.e., Beetles) plus 30,159 minibuses and trucks Between 1960 and 1966, Volkswagens comprised 57 percent of the 3.3 million foreign cars sold in the United States.[42]

During the late 1950s, Volkswagen began insisting that its dealers sell Volkswagens exclusively from buildings rigorously standardized to have the unique Volkswagen look.[43] However, this plus its attempts to specify the prices at which dealers sold drew an antitrust challenge from the Department of Justice. (Because VW orders were chronically backlogged during the late 1950s, most sales were at list price.) Rejecting Volkswagen's motion to dismiss, a federal district judge distinguished the Volkswagen case from others in which exclusive dealing arrangements had been

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[39] Nelson, supra note 37, at p. 191.

[40] Nelson, supra note 37, at pp. 195-196.

[41] For an extraordinarily detailed study of the profitability of U.S. Volkswagen dealers, see Veikko Leivo, Influence of the Location and Size of the Automobile Dealership Upon Its Profitability (Helsinki: Helsinki Research Institute for Business Economics, 1967).

[42] Nelson, supra note 37, at pp. 213, 215, and 307; and Lawrence J. White, The Automobile Industry Since 1945 (Cambridge: Harvard University Press: 1971), pp. 295-304.

[43] Nelson, supra note 37, at 205-207. Nelson quotes VW chairman Heinz Nordhoff as suggesting that his U.S. representatives "go after people who had no automobile franchises at all, because so many of the best dealers had been taken on by Detroit."

approved because of the resale price maintenance provisions.[44] In 1962, Volkswagen agreed to a consent decree barring it from setting resale prices and requiring it to send to its dealers a letter stating that "Volkswagen dealers may sell and service other makes of automobiles," but noting also the Justice Department's recognition "that we may insist that each distributor and dealer fairly and fully discharge his responsibility under the Volkswagen dealer franchise agreement."[45] As events ensued, VW's retail channels remained substantially exclusive. In 1966, four of its nearly 1,000 U.S. dealers also sold Mercedes-Benz cars and some 15 to 20 percent sold Porsches (with whose producer VW had an ongoing design consultation relationship).[46]

The next outstanding success of foreign car manufacturers in entering the U.S. market was achieved by several Japanese firms, notably, Toyota, Honda, and Nissan. David Halberstam's Pulitzer Prize winning book provides an enthralling account of Nissan's entry.[47] The first Nissan expeditionary force found Nissan's only car model, the Datsun, ill-suited to the American market: "simply terrible, crude and underpowered."[48] But in 1958 a beachhead was established on the West Coast for the sale of pickup trucks. As Volkswagen had done earlier, after the first few dealers were recruited, executives were dispatched from Japan in 1960 to take charge -- one on the West Coast and one on the East Coast. The Middlewest, where wide open spaces favored large cars, was temporarily neglected. The West Coast efforts were at first more successful. Nissan's West Coast head recognized early on that in America, unlike Japan, the dealer network was crucial:[49]

> If the dealers were strong and vital, then the company might succeed.... Gradually [Katayama] created a network of dealers along the West Coast that he was very proud of.... They were, in truth, a most unlikely group, with a high incidence of eccentricity. Many of them were men who had been around cars

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[44] U.S. v. Volkswagen of America, Inc., et al., CCH 1960 Trade Cases para. 69,643, District Court of New Jersey (February 1960). But see the decision in a parallel private suit, in which Volkswagen's termination of a dealer who also sold a competing brand was sustained. Reliable Volkswagen Sales and Service Co. v. Volkswagen of America Inc. et al., CCH 1960 Trade Cases para. 69,644, District Court of New Jersey (February 1960).

[45] U.S. v. Volkswagen of America, Inc., CCH 1962 Trade Cases para. 70,256, District of New Jersey (May 1962).

[46] Nelson, supra note 37, at p. 209.

[47] Halberstam, supra note 27, especially Chapters 16, 24, and 25.

[48] Halberstam, supra note 27, at p. 420.

[49] Halberstam, supra note 27, at p. 422.

all their lives, often as repairmen, but had never been able to come up with the large amount of money required for an American dealership.

As one early Datsun dealer recounted:[50]

> "There was no way someone like me -- a mechanic -- was ever going to have a Ford dealership.... The best I could hope for was a used-car dealership, and a lot of us Datsun dealers had been in the used-car business, and we knew the poorer customers [those who bought inexpensive, underpowered early Japanese cars] very well."

To win dealers' loyalty, Nissan offered them an 18 to 20 percent gross profit from the average car's sale, in contrast to the 12 to 13 percent margin customary with American manufact-urers. As with Volkswagen a decade earlier, many early signers became millionaires.[51] Despite language difficulties, which found him speaking "a kind of Janglish," Nissan's top West Coast representative exhibited such winning enthusiasm that many Americans reached out to help him.[52] Studying Volkswagen's experience, he became "absolutely convinced that the most important factor in gaining success was providing adequate service."[53] He recognized that "Volkswagen customers believed that they were treated better, respected more, than they would be if they were trying to buy at the lower end of the American lines."[54] At first, the Datsun car was so primitive that it could only be sold at a huge discount relative to American cars and the Volkswagen. But Nissan sent engineers to the United States who tinkered with their product, suggested countless minor improvements in its design, and pleaded with reluctant company leaders in Tokyo to design a completely new model better-suited to the U.S. market. Finally, in 1969, the engineers' wish came true in the Datsun 510, patterned after BMW's 1600, but priced at $1,800, well below the BMW's $3,200 price.[55] Nissan sales soared, among other things inducing the defection of some Volkswagen dealers. As other Japanese car makers experienced analogous successes, imports from Japan exceeded those from Germany

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[50] Halberstam, supra note 27, at 422.

[51] Halberstam, supra note 27, at pp. 422 and 435.

[52] Halberstam, supra note 27, at p. 423.

[53] Halberstam, supra note 27, at p. 424.

[54] Halberstam, supra note 27, at p. 425.

[55] Halberstam, supra note 27, at p. 442.

for the first time in 1972 and, beginning in 1974, moved rapidly ahead of German imports.

From these two case studies some preliminary morals can be drawn. It is not easy to build strong auto distribution for imported cars in a market already well-supplied by domestic models, even in the American market, which to the first Nissan observer "appeared blithely open ... the only regulation seemed to be that the cars must have sealed-beam headlights from General Electric."[56] Exclusive dealing is as common, at least for the leading car makes, in the United States as it is in Japan. It is not sufficient merely to piggy-back one's offerings into retail outlets already selling other makes; a dedicated dealer network must be built. For the missionaries who lead the recruitment effort far from home, language difficulties must be overcome, but unbounded enthusiasm more than compensates. In the Japanese case, but not initially for the Beetle, designs had to undergo significant adaptations to local demand idiosyncracies. Neither Volkswagen nor the Japanese manufacturers achieved their market penetration by focusing their attention on political decision-makers; they succeeded at the grass-roots market level, in the repair bays, and in the design shops.

3.2 Antitrust and Auto Parts Distribution Channels

U.S. automobile manufacturers have complained that both in Japan and in the United States, Japanese auto assemblers and (only in Japan) repair shops buy too few parts from U.S. sources. They have proposed two kinds of remedies: "managed trade," i.e., government-imposed requirements that some minimum fraction of Japanese parts be purchased from U.S. sources; and invigorated enforcement of Japan's anti-monopoly law to break open de facto exclusive dealing relationships between manufacturers and their suppliers. Here I emphasize the competition policy facet of the debate.

For preliminary perspective on the issues, it must be recognized that the structures of Japanese and U.S. automobile manufacturers differ markedly. The U.S. firms are much more integrated vertically than their Japanese counterparts. Reliable data on this point are difficult to obtain, but the estimates of an OECD team will suffice.[57] In 1985, General Motors is said to have procured from internal company divisions roughly half, and Ford Motor Company 38 percent, of the parts they assembled into automobiles. In contrast, Nissan, Honda, and Toyota sourced 17 to 19 percent of their parts internally. The Japanese companies purchased the vast majority of their parts from other firms, with many of whom they had "vertical Keiretsu" relationships through partial shareholdings and loans. If a level playing field had to be created, it

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[56] Halberstam, supra note 27, at p. 293.

[57] <u>Globalization of Industrial Activities: Four Case Studies</u> (Paris: OECD, 1992), p. 43.

would undoubtedly be easier to merge the Japanese Keiretsu parts makers into their customer firms than to break off General Motors and Ford parts divisions from their parents (although Chrysler and to a lesser degree Ford did divest some parts operations under financial stress during the early 1980s). But this is hardly what the U.S. firms have sought. And for them to chafe about Keiretsu ties when they have approached similar parts procurement challenges by fully integrating their operations is disingenuous.

Even when there are no interlocking ownership ties, Japanese auto manufacturers have sought to maintain strong long-term relationships with their parts suppliers because it is their traditional way of doing business and because Kanban (just-in-time) production requires close coordination, both in planning and logistics, between parts suppliers and assembly lines. During the past decade U.S. auto makers have recognized the attractions of just-in-time organization.[58] They have also discovered that entering long-term contracts with firms supplying components subject to substantial product-specific economies of scale can be more economical than dividing orders between two or more vendors and forcing the vendors to compete each year for shares of the total production requirements -- the traditional Detroit approach. In 1985, for example, the Ford Motor Company negotiated a long-term contract to produce all the automatic transmissions for its new World Truck line to a joint venture between Eaton Corporation and Clark Equipment Company. The Dana Corporation, which had previously supplied transmissions for Ford trucks, was left out in the cold. Dana sued, alleging antitrust violations,[59] but withdrew its action when it recognized that litigation could harm its long-term relationship with Ford for the production of other automobile components.

The Federal antitrust enforcement agencies have intervened repeatedly in attempts to wedge open market opportunities for replacement parts suppliers within the United States.[60] Once a consumer has purchased an automobile, he or she is locked into a continuing stream of replacement parts purchases. Auto manufacturers wielded threats of franchise cancellation to induce their dealers to purchase replacement parts exclusively from the manufacturer and sometimes to meet ambitious quotas for the

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[58] See James P. Womack et al., The Machine That Changed the World (New York: Macmillan, 1990), Chapters 4 and 6.

[59] Dana Corporation v. Eaton Corporation and Clark Equipment Company, civil action C85-7210, Northern District of Ohio.

[60] For historical surveys, see U.S. Senate, Committee on the Judiciary, Subcommittee on Antitrust and Monopoly, Staff Report, A Study of the Antitrust Laws (Washington: USGPO: 1956); and Simon N. Whitney, Antitrust Policies: American Experience in Twenty Industries (New York: Twentieth Century Fund, 1958), vol. I, Chapter 8.

quantity of parts they would order, even when the parts were unwanted. In this way, the manufacturers sought to realize high prices and profits through the monopoly power they derived from the combination of consumer and franchisee lock-in. This worked to the disadvantage not only of consumers, but also of independent parts manufacturers who sought to sell their own products, presumably at lower prices, through auto dealerships.

After an extensive Federal Trade Commission investigation, General Motors agreed in a 1941 consent decree that it would cease coercing its dealers to stock only General Motors replacement parts.[61] However, General Motors (and later, other leading auto manufacturers) were allowed to include in their franchise agreements stipulations that the dealer would use and sell only the car manufacturer's parts when they were "necessary to the mechanical operation of an automobile, and which [were] not available, in like quantity and design, from other sources of supply." This left considerable opportunity for disagreement over which parts met the stated "mechanical operation" criteria. Two years later the FTC approved a General Motors compliance report stating inter alia that GM's dealer contracts were changed to require that for the affected parts, the dealer would not sell as genuine new General Motors parts any parts that were not in fact "genuine." This led to further ambiguities. For instance, many of the parts channeled by the auto manufacturers to their dealers were produced by independent parts suppliers. The auto assemblers stamped or packaged the parts they purchased as "genuine" when directing them through their own marketing channels, but prevented the independent parts makers from labelling their parts as "genuine" when they sold the same items directly to franchised automobile dealers (or through independent auto parts wholesalers). To help win the imprimatur of being "genuine," some parts manufacturers offered discounts well in excess of large-scale-production cost savings on the parts sold to the auto assemblers for original equipment (as distinguished from replacement) installation. For example, the Champion Spark Plug Co. sold identical plugs to Ford Motor Company at 6 cents each for original equipment insertion and at 22 cents for replacement purposes.[62] This allowed the three leading spark plug makers to secure an 80 percent share of the replacement parts market even though they faced approximately 40 competitors.

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[61] In re General Motors Corporation, 34 FTC 58 (1941).

[62] In the Matter of Champion Spark Plug Company, 50 F.T.C. 30 (July 1953). See also two parallel cases -- In the Matter of General Motors Corp. et al. (i.e., regarding AC spark plugs), 50 F.T.C. 54 (1953); and In the Matter of The Electric Auto-Lite Company, 50 F.T.C. 73 (1953). In its preoccupation with protecting competing distributors from one another, the F.T.C. condemned price discrimination on sales to different distributors but let stand the much greater differentiation of prices on original equipment, as distinguished from replacement part, uses.

The federal antitrust enforcement agencies struggled for years, but in the end without noteworthy success, to unscramble the complex problems posed by an essentially unavoidable circumstance: the automobile assemblers' control over the specifications for their parts and the power they wield over their franchised dealers.[63] To the extent that dealers have been able to stock mechanical (or more recently, electronic) parts from competitive independent sources, it has been mainly because the ability of the auto assemblers to terminate franchises arbitrarily is constrained by Dealer Day in Court laws.

The Federal Trade Commission broke its spear again in an attempt to eliminate anticompetitive distortions in the vertical channels through which automobile "crash parts" are distributed.[64] There the problem entailed not market access for those who produced replacement parts (i.e., the automobile assemblers and independent firms to whom they had issued production contracts), but restricted ability to <u>purchase</u> parts for the roughly 32,000 independent body shops (IBSs) who competed with franchised auto dealerships in the repair of damaged automobile bodies. Because the dies from which auto body parts are stamped are durable but enormously expensive, it is difficult (but not impossible) for independent firms to cut new dies and produce parts that compete with the original manufacturer's fenders, door panels, and rear decks.[65] The stamped "crash" parts must then find their way to franchised dealers and independent body shops. After one round of government interventions, General Motors implemented a system (imitated with minor variations by other auto assemblers) under which its dealers not only purchased from GM warehouses crash parts for their own use, but served as wholesalers for neighboring IBSs. GM sold parts for its dealers' use at 40 percent off list price (with a further 5 percent discount for stock orders), but granted to dealers an additional 15 percent discount on parts they supplied as wholesalers to IBSs. Under this system, two problems arose. First, the franchised dealers typically did not grant the independent body shops the full 40

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63 As a Senate staff report concluded in 1956, "The effectiveness of the [Federal Trade] Commission's 1941 cease and desist order against General Motors can only be measured by its applicability and enforceability. It appears that the Commission's order fails both tests." <u>A Study of the Antitrust Laws</u>, supra note 60, at p. 101.

64 <u>In the matter of General Motors Corporation</u>, 99 F.T.C. 464 (1982).

65 There are three main sources of competition: junk yards, "chop shops" that steal cars to order for their parts, and a quite new phenomenon -- factories that take contour measurements of the part to be imitated and program numerically controlled milling machines to produce relatively inexpensive dies. The auto manu-facturers have advertised aggressively that parts from the third of these sources are inferior to their original equipment parts. It is unclear whether they have taken more active steps to discourage their franchised dealers from using them. Such parts, often produced outside the United States, are now used extensively by independent body shops.

percent discount that would put the competing IBSs on an equal footing; the average discount was nearer 27 percent. Second, the dealers sometimes claimed the 15 percent wholesaler discount on parts they were in fact using internally. This enhanced their cost advantage over the independents, inhibiting the ability of the IBSs to compete for jobs and reimbursement by auto insurers. To level the playing field, the Federal Trade Commission staff proposed that General Motors supply parts to its dealers and IBSs from GM's decentralized parts warehouses on essentially equal terms. General Motors argued inconclusively that this would be prohibitively expensive.[66] Weighing the benefits of enhanced competition from independent body shops against the alleged but uncertain costs of the proposed new distribution system and the likelihood that the new system would require extensive government monitoring, three members of the Commission (with one dissenting) concluded that "we cannot say that [GM's refusal to open its warehouses] is arbitrary and without business justification."[67] Thus, after more than a decade of investigation and litigation, the Commission decided to attempt no change in what it recognized to be an unsatisfactory status quo.

In these experiences there is once again a moral relevant to the disputes over access to Japanese repair parts markets. The vertical channels through which automobile parts reach ultimate consumers are characterized by extremely complex inter-firm relationships. There are good business reasons for exclusivity and for concentrating one's outside purchases on entities with whom one has developed strong relationships; there are also bad (i.e., anticompetitive) reasons. It is hard to sort them out, and it would be harder yet to monitor a system of rules that imposed open access upon unwilling participants. Except in the most egregious cases, the U.S. antitrust agencies have not had much success in their attempts to pry open vertical channels and facilitate the entry of new competitors. The U.S. auto manufacturers and (sometimes, as in the crash parts case) their dealers have vigorously opposed governmental efforts to alter vertical distribution practices. It would be unreasonable and perhaps hypocritical to expect that the Japanese Fair Trade Commission or a (presently non-existent) supra-national competition policy authority would experience greater success in applying antitrust law to reform Japanese auto parts purchasing practices.

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[66] In the early stages of the case, the author visited as FTC chief economist a General Motors body parts warehouse for an inspection of order-filling facilities and procedures. There was little evidence that major changes would be required to accommodate pickups by IBSs.

[67] 99 F.T.C. 464, 610.

4 The Distribution of Photographic Film and Paper

Eastman Kodak's May 1995 petition seeking Section 301 relief against Fuji of Japan was accompanied by a 300-page brief alleging several categories of unfair practices that inhibited Kodak's access to Japanese photographic film and paper markets.[68] At first, Kodak's sales were restricted by quantitative import limits (until 1960), high tariffs (e.g., on color film, 40 percent in 1964, reduced to 16 percent in 1973 and phased out completely by 1990), and prohibitions on foreign direct investment in Japan (relaxed in 1971 to permit 50-50 joint ventures and eliminated in 1976). As tariffs and foreign direct investment restraints were phased down during the 1970s, Fuji is alleged to have embarked, with the advice and consent of MITI, upon a campaign to consolidate its control over retail distribution channels through four exclusive primary wholesalers (*tokuyakuten*), who in turn supply several hundred secondary wholesalers serving smaller retail outlets. Sales of photographic printing paper are said to have been insulated through Fuji's ownership of, or financial interlocks with, large numbers of processing laboratories. Exclusive dealing in Fuji film and papers by secondary wholesalers, retail outlets, and laboratories is said to have been encouraged by rebates conditional upon meeting stringent sales volume targets and efforts to sustain dealer loyalty through the maintenance of high resale prices. These vertical restraints were orchestrated by Fuji, Kodak alleges, with the knowledge and acquiescence of Japan's Fair Trade Commission, the agency responsible for enforcing Japan's Anti-Monopoly Law. Fuji's substantial control over the vertical channels through which photographic materials reach consumers, Kodak argues, has made it difficult for foreign firms to gain appreciable market shares in the Japanese market.

In an even longer reply brief,[69] Fuji flatly denies many of the historical "facts" asserted by Kodak -- e.g., the timing of Fuji's development of exclusive wholesaler relationships, the exclusivity of its secondary wholesalers, the size and structure of its rebates, the existence of resale price maintenance, and the failure of the Fair Trade Commission to enforce Japan's anti-monopoly law against Fuji. These facets of the dispute cannot detain us here. I focus instead on two more fundamental assertions by Fuji: that a principal cause of Kodak's difficulties in Japan lay in Kodak's own distribution channel strategy errors, and that the lack of artificial trade barriers in Japan is shown by the symmetry of Fuji's position in America to Kodak's position in Japan.

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68 Privatizing Protection: Japanese Market Barriers in Consumer Photographic Film and Consumer Photographic Paper, memorandum prepared by Dewey Ballantine, May 1995.

69 Rewriting History: Kodak's Revisionist Account of the Japanese Consumer Photographic Market, report prepared by Willkie Farr & Gallagher, July 31, 1995.

4.1 Symmetric Market Positions

Taking up the latter point first, Kodak claims as evidence that it has been treated unfairly the fact that Fuji retains a 70 percent share of photographic film sales in Japan while Kodak, despite vigorous market penetration efforts, held only a nine percent share in 1994.[70] In Europe and other parts of the world (excluding the United States), on the other hand, Kodak's market share substantially exceeds Fuji's. Fuji argues in return that despite its own strenuous efforts to gain ground, its share of color film sales in the United States has fluctuated between 9 and 13 percent, while Kodak's share is 71 percent.[71] Thus, Fuji continues, "unless one also concludes that Fujifilm's low share in the United States reflects the continuing presence of significant market barriers in the U.S. market," one strains logic in concluding from market share disparities that there are unfair barriers to Kodak's sales in Japan.[72]

4.2 Access to Small Retailers

From the differences between retail distribution outlets in Japan and the United States, one would expect it to be more difficult for a small manufacturer or new entrant to secure wide retail distribution in Japan than in the United States. Japan's retail outlets, we have seen, are characteristically smaller and more numerous than their counterparts in the United States. Photographic film is sold in approximately 400,000 Japanese retail establishments.[73] With severely limited shelf and inventory storage space, small stores are likely to specialize in the products of only a single manufacturer -- usually, the best-known brand.[74] They also buy from the secondary wholesalers Fuji is alleged to dominate; only the high-volume outlets purchase directly from the manufacturer.[75] Kodak states that it has experienced greater difficulty gaining access to small retailers, especially those in rural areas, than to large retailers, supermarkets, and convenience stores.[76] Fuji claims that it faces the same

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70 Privatizing Protection, supra note 68, at p. 1.

71 Rewriting History, supra note 69, at p. 156. Fuji's brief notes that Kodak's share of sales in Japan has fluctuated between 9 and 13 percent in recent years.

72 Rewriting History, supra note 69, at pp. 18-19.

73 Privatizing Protection, supra note 68, at p. 5.

74 See Privatizing Protection, supra note 68, p. 151.

75 Privatizing Protection, supra note 68, p. 5.

76 Privatizing Protection, supra note 68, at pp. 130 and 146. In its second-round reply brief, Fuji reports survey evidence showing that although Kodak film was not available in the majority of smaller outlets, such outlets account for only a modest fraction -- approximately one-fourth --

obstacles in the United States.[77] But with relatively more film sold through large discount houses, pharmacy chains, and convenience store chains in the United States, it should be easier for a new or small firm to secure access through direct manufacturer-to-retailer sales.

This expectation was confirmed, with some surprises, through a non-random survey conducted by the author during two weeks of August 1995. Each retail outlet the author visited in that period was checked to see whether photographic film was carried, and, if so, which brands. A few stores that otherwise would have been bypassed by were included in the expectation that they would sell photo supplies. Table 1 summarizes the results. All eleven outlets carried a range of Kodak products. Eight of the eleven carried Polaroid instant-photo film -- a product for which Kodak had no close substitute. Fuji brand film was carried by only three of the eleven; a fourth carried the film of Fuji's Japanese rival, Konica. Three of the four were large outlets with extensive photographic supplies inventories. At the well-known Cambridge photo supplies specialist, there was a special display of Fuji films, prominently located; in the large discount house, there was also a sizeable Fuji display, but it was so far above normal eye level that one would observe it only by accident or careful search. At the food supermarket, only one in every three checkout displays included film items. The few Fuji items included both film and Quik-Snap cameras. Two other outlets carried Fuji Quik-Snap disposable cameras -- a product Fuji pioneered -- but no separately packaged Fuji film. To the extent that the results of this survey can be generalized, it seems clear that Kodak is able to attain virtually ubiquitous distribution in its home market, whereas foreigners place their film products mainly on the shelves of high-volume outlets.[78] Except in the case of the food supermarket, the success of foreign film producers does not appear to depend upon whether or not a store belongs to a chain. High unit film sales explain foreign film stocking better than large-scale, possibly multi-unit, purchasing.

4.3 First-Mover Advantages and Newcomer Strategy Choices

Kodak's ability to be the film of choice for small U.S. retailers, when only one brand can be stocked, and Fuji's similar ability in Japan, are almost surely the result of what

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of total film sales in Japan. Kodak film was available in more than 92 percent of the Tokyo stores, 66 percent of the Osaka and Kyoto stores, and 51 percent of the provincial city stores selling 2,000 or more rolls of film per year. Fujifilm's Rebuttal Regarding the Alleged "Distribution Bottleneck," brief submitted by Willkie Farr & Gallagher, December 21, 1995, pp. 2 and 34.

77 Rewriting History, supra note 69, at pp. 89 and 159.

78 Compare note 76 supra, revealing a similar pattern of Kodak penetration in Japanese stores.

economists recognized as the pioneers in their markets are able to maintain sizeable market shares, often despite charging premium prices; and secure favorable placement on retailers' shelves while spending substantially less per dollar of sales on advertising and other forms of promotion than their smaller, late-entrant rivals.[79] First-mover advantages appear to be particularly potent in consumer goods industries, especially when it is difficult to tell from mere inspection, i.e., without actual consumption experience, whether a product is of superior quality and when inferior quality can impose significant costs upon the consumer (e.g., in the case of photos, when a unique experience is recorded unsuccessfully).[80]

Brands that are well-established in their home markets have a natural first-mover advantage over newcomers, including imported products. Plainly, however, imports succeed in overcoming incumbents' first-mover advantage in at least a substantial class of cases. A key question is, how?

For at least the most cosmopolitan consumers -- presumably, a modest minority of all consumers -- foreign brands have a panache that leads to preference over local brands, other things (such as quality) being held equal. From my first trip to Japan, I remember vividly being told that it would be almost insulting to offer my interpreter a gift of Suntory whiskey, even though its intrinsic quality was considered to be equal to that of foreign Scotch whiskeys. The gift had to be a more expensive leading Scotch brand. This "snob appeal" effect apparently applies over a wider array of imported brands in Japan. How important it is quantitatively is unclear.

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79 See Ronald Bond and David Lean, Sales Promotion and Product Differentiation in Two Prescription Drug Markets (Federal Trade Commission Staff Report: 1977); and Robert D. Buzzell and Paul W. Farris, "Marketing Costs in Consumer Goods Industries," in Hans J. Thorelli, ed., Strategy + Structure = Performance (Indiana University Press: 1977), pp. 122-145.

80 See Richard Schmalensee, "Product Differentiation Advantages of Pioneering Brands," 72 American Economic Review 349 (June 1982).

Table 1: Photographic Film Brand Coverage of Eleven Stores: August 1995

Store Type	*Location*	*Film Brands Stocked*
Large, well-known single- unit photo equipment and supplies specialist	Cambridge, MA	Kodak, Fuji, Polaroid, Ilford
Photo equipment specialist, unit of chain, in large shopping mall	Cambridge, MA	Kodak, Polaroid, Fuji (Quik-Snap camera only)
Small photo supplies and processing outlet, single-unit	Charlestown, MA	Kodak, Polaroid
Discount house; largest unit of local chain	Cambridge, MA	Kodak, Fuji, Polaroid, Konica
Large retail pharmacy, unit of leading chain	Charlestown, MA	Kodak, Polaroid, Japanese private-label
Large retail pharmacy, prime location, single-unit	Brookline, MA	Kodak, Polaroid, Konica
Small retail pharmacy, off location, single-unit	Brookline, MA	Kodak
Large food supermarket, part of local chain	Charlestown, MA	Kodak, Fuji, Polaroid
Convenience store, part of regional chain	Charlestown, MA	Kodak, Polaroid, Fuji (Quik-Snap camera only)
News shop at resort	Hot Springs, VA	Kodak
News shop, Logan Airport	Boston, MA	Kodak

One way a first-mover advantage can be lost, often with dramatic rapidity, is to be caught delivering products of demonstrably inferior quality. Shoddy workmanship operated to the disadvantage of American automobiles and to the advantage of Japanese imports during the late 1970s and early 1980s.[81] There is also an example from photographic film sales in Japan. Fuji was not always the leading Japanese manufacturer. Konica lost its dominant position when it marketed a defective new film during the mid 1950s and refused to offer replacements to dissatisfied consumers.[82] Within three years, Fuji's market share had risen from 20 to 60 percent.

Absent quality slips by leading incumbents, newcomers are most apt to overcome strongly-entrenched first-mover advantages through innovation -- e.g., by introducing technologically superior new products.[83] Fuji's shelf position in smaller U.S. outlets appears attributable in part to an innovation -- its disposable "Quik-Snap" camera.[84] Fuji attributes its strong presence in Japan in part to that innovation and also to its two-year lead over Kodak in introducing ISO 400 film with resolution equivalent to slower ISO 100 film.[85] Kodak's most rapid penetration into the Japanese market (during the 1970s) came with the introduction of an innovative 110 format film.[86] Kodak's brief seeking Section 301 redress states that Fuji moved from a position of technological inferiority to rough technological parity with Kodak in the late 1970s.[87] During the next decade, Fuji sought to increase its U.S. market share by introducing new color film emulsions that were brighter, faster, and more fine-grained than Kodak's.[88] Kodak significantly increased its R&D expenditures and, in an interaction process that resembled a qualitative arms race, it retaliated quickly to most of these

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81 See Fred Mannering and Clifford Winston, "Brand Loyalty and the Decline of American Automobile Firms," Brookings Papers on Economic Activity: Microeconomics, 1991, pp. 67-103.

82 Privatizing Protection, supra note 68, at p. 63.

83 This phenomenon was first demonstrated empirically by Bond and Lean, supra note 80.

84 According to Rewriting History, supra note 69, at p. 191, Kodak responded in Japan to Fuji's innovation with its own disposable product, but with a lag of two years.

85 Rewriting History, supra note 69, at 188-190.

86 Rewriting History, supra note 69, at p. 57.

87 Privatizing Protection, supra note 68, at p. 63.

88 See F. M. Scherer, International High-Technology Competition (Harvard University Press: 1992), p. 77.

Fuji initiatives. Kodak's fast but costly responses were undoubtedly one reason why Fuji failed to attain its declared 15 percent U.S. market share goal.

These technological efforts were accompanied by heavy expenditures on advertising and other aspects of product promotion. Fuji asserts that it has invested more to promote its product entries into the U.S. market than Kodak spent in Japan.[89] The data available on this claim are insufficient to evaluate its validity.

Another possible means of overcoming first-mover advantages is for the newcomer to set its price below the level to which incumbents are willing to descend, hoping thereby to avoid a price war. Between 1971 and 1974 and again between 1979 and 1981, Kodak's prices in Japan were reduced, first when tariffs fell and then when Fuji raised its prices following abrupt increases in the price of silver (used in photographic emulsions).[90] On both occasions, Kodak made substantial market share gains, achieving an all-time peak Japanese film market share of 18 percent. However, Kodak then shifted back to a high-price policy, refraining from price reductions even after 1986, when the dollar dropped sharply in value relative to the yen and Kodak's yen cost of film delivered to Japan from the U.S. fell. There were at least three plausible reasons for its more recent pricing strategy choice.[91] Kodak may have been fearful of triggering a price war; it may have preferred to realize high profits on modest volume over sacrificing profit margins to gain volume; and/or it may have feared that reducing prices would signal that Kodak's film was of inferior quality relative Fuji's.[92] However, in 1995, after filing its Section 301 complaint against Fuji, Kodak effected a 50 percent price reduction on a new film carrying the brand names of both Kodak and a Japanese wholesale chain, Nichiryu.[93] This is presumably a market segmentation strategy, under which Kodak strives to gain market share through price-cutting on one brand while attempting through product differentiation to avert image-impairing spillover harm to its main brand.

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89 Rewriting History, supra note 69, at p. 179.

90 See Privatizing Protection, supra note 68, pp. 105-106 and 124-130; and Rewriting History, supra note 69, pp. 168-172.

91 See the quotation in Rewriting History, supra note 69, at p. 13.

92 On similar "signalling quality through price" strategies in automobiles and beer, see F. M. Scherer, Industry Structure, Strategy, and Public Policy (New York: HarperCollins: 1996), pp. 302-303 and 400-403.

93 "Kodak of Japan To Halve Price," New York Times, August 24, 1995, p. D8.

4.4 Access to Wholesale Distribution Channels

A key component in Kodak's claim is that its market access to Japan has been unfairly restricted through exclusive dealing by the four primary wholesalers used by Fuji in distributing its film to retailers. These *tokuyakuten*, it is argued, achieve much more complete market coverage than Kodak's wholesalers. Fuji replies that photographic supplies distribution was gravitating toward exclusivity long before traditional trade and investment barriers fell during the 1970s, that Kodak (along with Konica) also chose to develop their own exclusive wholesalers, and that Kodak's loss of a particularly important wholesaler to Fuji resulted from a flawed strategic decision by Kodak.

The briefs of Kodak and Fuji are at odds on the reasons for Kodak's early distribution strategy weakness.[94] Kodak was "reportedly" forced by the Japanese government in 1960 to select a single principal wholesaler to handle its imports, apparently because exclusive distribution would facilitate governmental control of import volumes. Kodak chose Nagase & Co., a specialist in wholesaling chemical products to industry. Although Nagase subsequently built expertise in photo supplies wholesaling, it continued to be less effective than Fuji's wholesalers. Fuji asserts that after the liberalization measures of the 1970s, Kodak could have bought a 50 percent or greater ownership share in Nagase or another wholesaler and built up its marketing potential. It refrained from doing so until 1984, when it purchased Nagase's Kodak division and established a Kodak-owned wholesale channel.[95] According to the first president of Japan's Kodak operation, "The glaring mistake was waiting so long to take aggressive action in this market. We should have been here with [company-owned distribution channels] ten years ago [i.e., in 1978]."[96]

Kodak acknowledges making a further strategic error in its wholesale distribution strategy.[97] During the early 1970s, Japan's leading *tokuyakuten*, Asanuma, was not exclusive. It sold an estimated 5 billion yen of Kodak products as well as 18 billion

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[94] Compare Privatizing Protection, supra note 68, p. 68; and Rewriting History, supra note 69, pp. 180-182.

[95] For a first-hand account of the merger negotiations by the person Kodak assigned in 1984 to become president of its Japanese operations, see Albert L. Sieg, The Tokyo Chronicles: An American Gaijin Reveals the Hidden Truths of Japanese Life and Business (Essex Junction, VT: Oliver Wright, 1995), pp. 101-108.

[96] Rewriting History, supra note 69, pp. 182-183, quoting Albert Sieg from a Look magazine interview.

[97] Compare Privatizing Protection, supra note 68, pp. 93 and 116-118; and Rewriting History, supra note 69, pp. 9-10, 37, 67-69, and 175-184.

yen of Fuji products. Asanuma was unhappy, however, having to obtain its Kodak products through Nagase. When Kodak's 110 Instamatic camera was marketed in Japan, Asanuma preferred the Kodak camera and film over Fuji's imitation, but Nagase refused to assure Asanuma of sufficient supplies to meet the latter's projected needs wholesaling only Kodak and not Fuji Instamatics. According to the Fuji brief, Asanuma officials travelled to Rochester in 1973 to seek a direct purchase arrangement with Kodak, but they were rebuffed. It would appear that this trip preceded Nagase's refusal to assure Instamatic film supplies to Asanuma. What is clear is that in 1975, Japan's most powerful *tokuyakuten* decided on the basis of these experiences to become an exclusive Fuji wholesaler. Attributing Nagase's Instamatic decision (apparently, unilaterally, without consulting Kodak) to fear of Asanuma as "a powerful competitive threat," and lamenting the "fatal" circumstances that led to the loss of an important opportunity, Kodak's brief says that "Kodak did not even learn of the opportunity it had missed until many years later."[98]

What is striking to this observer, but not made explicit in either party's briefs, is that the events of 1973-75 reflected a colossal failure of intelligence (in the military sense) at Kodak. Kodak had no employee in Japan at the time who could read contemporary Japanese trade press accounts of the Nagase-Asanuma dispute, understand the importance of securing Asanuma as a primary Kodak wholesaler, and intervene to override Nagase's self-serving actions. Not until 1977 did Kodak open a liaison office in Japan to oversee inter alia the activities of Nagase. Only in 1984 was a permanent team dispatched from Rochester to "launch" Kodak-managed operations in Japan.[99] In sharp contrast were the market-opening efforts of Volkswagen and Toyota, who at the outset sent their own English-speaking personnel to the United States, first to assess market opportunities and then to implement their entry decisions.

The first-person account by Albert Sieg, Kodak's first Japanese subsidiary president, reveals another important facet of Kodak's intelligence failure.[100] At one of the many social functions he was obliged to attend, Mr. Sieg was approached politely by a Japanese professional photographer and, after preliminary formalities, reproached for the poor rendition Kodak color film provided of black-haired Japanese subjects wearing light-colored clothing. The film's color balance had been optimized for

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98 Privatizing Protection, supra note 68, at p. 118.

99 See Sieg, supra note 96, especially pp. xi-xii and xviii.

100 Sieg, supra note 96, at 140-142. Mr. Sieg explains, "Because we had sold through third-party distributors for the past forty years, we never got the kind of firsthand feedback that was essential to satisfying our customers -- feedback like the kind that Hatano-san offered us at the New Year party."

charactistically fairer American and European subjects. After investigating the complaint further, Mr. Sieg persuaded Rochester to develop new emulsions better-suited to the Japanese market. But this correction occurred only in the mid 1980s, more than a decade after liberalization reduced tariff and direct foreign investment barriers to Kodak's Japanese presence.

5 Conclusion

It is not easy for a would-be importer attempting to sell its wares in a foreign country to obtain access to the necessary channels of distribution. Incumbents with well-established brand reputations will normally have assimilated the most able wholesalers and retailers. They may also have built up ties of exclusivity with their dealers -- ties that may or may not have stepped beyond the bounds staked out under local competition policies. Overcoming these hurdles requires intelligence and determined, painstaking effort. Viable vertical channels can seldom be created through brief jet-lagged visits during which distribution contracts, duly filtered through interpreters, are negotiated and signed, after which responsibility is passed to the new middlemen.

In my monograph on Competition Policies for an Integrated World Economy,[101] I lay out a tentative proposal for rules establishing a line between permissible and impermissible restraints of competition in international trade, to be agreed upon by GATT signatory nations and enforced both by national authorities and, in cases of conflict, by a prospective new office within the World Trade Organization. My proposal would encompass, on a time-phased basis, export and import cartels, the abuse of monopoly power by enterprises dominating a product line in international trade, mergers that concentrate 40 percent or more of international trade in a single firm, domination of world trade for periods exceeding 20 years through the control of intellectual property, and (in the final phase) "other monopolistic practices that distort international trade but not expressly covered by the policies [identified above]." Although I acknowledged that vertical restraints could act as barriers to trade, I did not include rules governing them in my explicit proposal, relegating them to the final-phase catch-all category.

This choice was deliberate. Vertical restraints are recognized by both economists and competition policy authorities to have both benefits and competition-impeding costs.[102] It is difficult to draw neat lines between those that should be allowed and

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[101] Supra note 20, Chapter 5.

[102] For surveys of the economic literature, see F. M. Scherer and David Ross, Industrial Market Structure and Economic Performance (third ed.; Hughton-Mifflin: 1990), Chapter 15; and Michael L. Katz, "Vertical Contractual Restraints," in Richard Schmalensee and Robert D. Willig, eds., Handbook of Industrial Organization, vol. I (North-Holland, 1989), Chapter 11.

those that should be prohibited. Even when those lines have been drawn, as my analysis of U.S. antitrust policy toward automobile parts distribution has shown, enforcement of the vertical restraints law has often been a muddle. If nations have difficulty determining the correct policies and enforcing them within their own borders, it will surely be much more difficult to adjudicate such policies internationally -- either under a compact harmonizing competition policy rules, or through aggressive unilateralism, i.e., the extraterritorial enforcement of domestic antitrust laws against alleged violators overseas. This pessimistic conclusion may leave an occasionally significant barrier to international trade untouched. But wisdom in public policy analysis begins with the recognition that not all problems can be solved.

For diverse views on the law, see Richard A. Posner, "The Rule of Reason and the Economic Approach: Reflections on the Sylvania Decision," 45 University of Chicago Law Review 1 (Fall 1977); the symposium on "The Economics of Vertical Restraints" in 52 Antitrust Law Journal 685-754 (1983); U.S. Department of Justice Vertical Restraints Guidelines, reprinted in 48 Antitrust & Trade Regulation Report special supplement (January 24, 1985) (rescinded in 1993); National Association of Attorneys General Vertical Restraints Guidelines, reprinted in 68 Antitrust & Trade Regulation Report special supplement (March 30, 1995); and Warren S. Grimes, "Spiff, Polish, and Consumer Demand Quality: Vertical Price Restraints Revisited," 80 California Law Review 817 (July 1992).