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An Abuse of Dominant Bargaining Position in the Japanese Antimonopoly Law

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This paper has two purposes. First, it is to construct the hypothesis that, when we recognize the compensating balance requirements as hostage to maintain long-term ongoing transactions with banks, they are a rational custom for small and medium enterprises. Second, it is to examine the economic conditions when abuse and unfair trade practices by banks of their superior position (which signifies the compensating balance requirements) are exhibited prominently.

The main results can be summarized as follows. Our hypothesis, in which compensating balance requirements are a rational custom for small and medium enterprises, was rejected. 1) The superiority of banks strengthens when small and medium enterprises finance long-term funds and profit rates decline. 2) Their superiority weakens when small and medium enterprises are operated by fully fund managements. 3) When small and medium enterprises raise funds, the superiority of banks did not restrict the business sector, but restricted the financing of individual enterprise.

1. Introduction

The compensating balance requirements (for example, *buzumi-ryōdate yokin*) which banks request for small and medium enterprises (henceforth, "SMEs") as an alleged abuse of their superior position, have been guided in their self-restraint[1] by the Ministry of Finance and the Fair Trade Commission (Kikuchi, 1989).

The first year in which the Ministry of Finance and the Fair Trade Commission started such guidance for banks, was March 1951 and April 1963, respectively.

Both antitrust lawyers and economists have disputed the propriety of compensating balance requirements (henceforth, "CBRs"). The former have mainly disputed the following two points: the unfairness of CBRs as an abuse of superior position, and their validity in private law (Hattori, 1991, Katō, 1977, Tozuka, 1985). The latter have mainly disputed the following two points: the difficulties with SMEs in obtaining funds (especially long-term funds) as a part of "dual structure debate"[2] (Kawaguchi, 1965 and Yamashita, 1969), and the determination of CBRs ratio (Kaneko, 1978, Rōyama, 1982 and Tatsumi, 1977). Neither debate has analyzed the economic conditions when CBRs make business activity for SMEs less favorable.

In general, CBRs have been recognized as a rational custom for banks (lenders) to secure loans and as irrational for SMEs (borrowers).

A final purpose of this paper is to examine economic conditions when the superiority of banks makes business activity or borrowing terms for SMEs less favorable.

As an analytical method, we will construct the following hypothesis and employ the empirical study. That is, we recognize CBRs to be a "hostage" which Williamson (1983) constructed as a means to support exchange. Furthermore, we hypothesize that the use of CBRs is a rational custom for SMEs to maintain long-term ongoing transactions with a particular bank (for example, long-term funds and information for business activities, etc.).

In section 2, we investigate the trends of CBRs in contemporary Japanese economy. The trends have declined gradually, but still remain. As one reason for the remaining CBRs, we will consider a hostage form for the borrower to maintain ongoing transactions. We construct the hypothesis that CBRs are a rational custom not only for lenders but also for borrowers. In section 3, we introduce the analytical method to examine the preceding hypothesis and explain the results of our empirical study, the main points of which are: our hypothesis, in which the CBRs are a rational custom for the SMEs, was rejected. 1) The superiority of banks strengthened when SMEs finance long-term funds and profit rates decline. 2) Their superiority weakened when SMEs are operated by fully fund managements. 3) When SMEs raise funds, the superiority of banks did not restrict the business sector, but restricted the financing of individual enterprise. Finally, in section 4, we consider the subject of antimonopoly policy which was not yet solved in dealing with the CBRs.

2. Compensating Balance Requirements

2.1. The Trends of CBRs

In April 1963, the Fair Trade Commission cautioned banks that the CBRs show an abusive act of their superior position against the SMEs and are suspected of being illegal ([Article 2-(9)-5] in Antimonopoly Law). Since that time, the Commission has supervised self-restraint measures.

Table 1 and Figure 1 show the survey of CBRs which have been practiced by the Commission (March 1964 at the beginning of survey). The surveyed SMEs are in the manufacturing, construction, wholesale trade, retail trade, and service industries which are defined in the Small and Medium Enterprises Basic Law.[3)]

Table 1 shows the trends of enterprises and their borrowings from May 31, 1976 (25th survey) to May 31, 1985 (37th survey). We can see, in every number, that the ratio of "compulsory deposit" tends to be reduced, but that of "non-compulsory deposit" tends to be increased.

Figure 1 shows the time series trends of broadly-defined CBRs, debtor deposits, and non-compulsory deposits. The trends of the first (a) increased to 1977 at the time when CBRs were judged to be illegal by the Supreme Court[4], but thereafter were reduced gradually. Similarly, both the broadly-defined CBRs ratio (b) and the ratio of broadly-defined CBRs to total deposits (c) decreased gradually. On the other hand, the trend of debtor deposit ratio (d) did not show any fluctuation, but non-compulsory deposit ratio (e) tended to increase.

From the above Table and Figure, we notice that the long-term trend of CBRs decreased, but that of non-compulsory deposits increased. These long-term trends show that the effect (self-restraint measures by banks) which the Ministry of Finance and the Fair Trade Commission have guided has come to light gradually and that the banks have realized their social responsibility in the economy. However, as a background in which the banks have mitigated CBRs for SMEs, we must attach importance to a change in the financial market.

For example, 1) in the present situation where the financial market is eas-

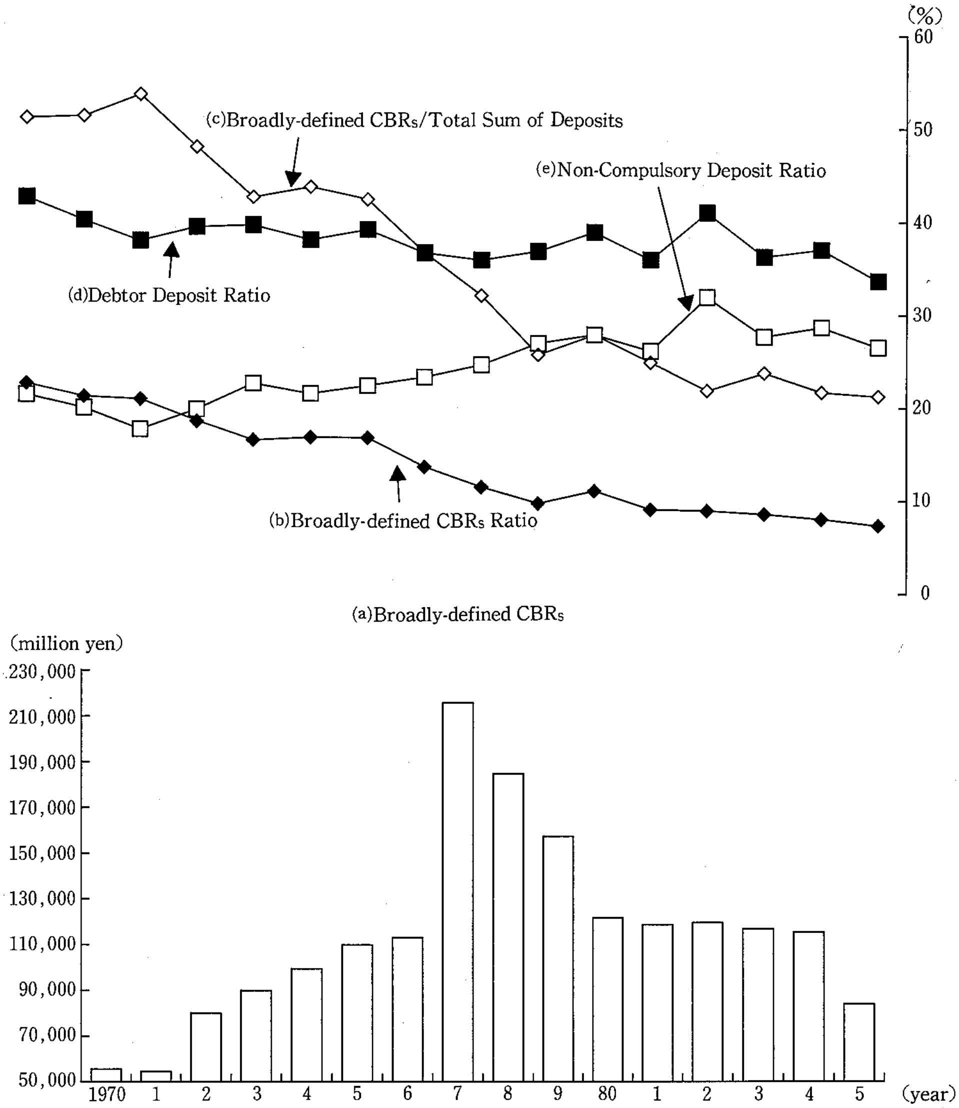
Table 1. The Number of Enterprises and Borrowings

〈Number of Enterprises〉

Classification \ Number of Survey Times	Narrowly-defined CBRs (a)		Virtual CBRs (b)		Both(a) and(b) (c)		Compulsory Deposits (a+b−c)=(d)		Non-Compulsory Deposits (e)		Total (d+e)	
	Enterprises		Enterprises		Enterprises		Enterprises		Enterprises		Enterprises	
25	528	29.0 %	879	48.5 %	216	11.9 %	1,191	65.6 %	625	34.4 %	1,816	100 %
27	963	26.6	1,623	44.9	398	11.0	2,188	60.5	1,430	39.5	3,618	
29	764	23.2	1,280	38.9	237	7.2	1,807	54.9	1,486	45.1	3,289	
31	671	20.0	1,168	34.8	207	6.2	1,632	48.6	1,725	51.4	3,357	
33	676	19.9	1,053	31.0	171	5.0	1,558	45.9	1,836	54.1	3,394	
35	510	15.8	892	27.6	119	3.7	1,406	39.8	1,944	60.2	3,227	
37	438	16.4	657	24.6	96	3.6	999	37.4	1,674	62.6	2,673	
	〈Number of borrowings〉											
	Borrowings		Borrowings		Borrowings		Borrowings		Borrowings		Borrowings	
25	944	16.0 %	3,090	52.4 %	306	5.2 %	3,728	63.2 %	2,170	36.8 %	5,898	100 %
27	1,619	13.9	5,662	48.8	609	5.2	6,672	57.5	4,939	42.5	11,611	
29	1,279	12.2	4,480	42.7	359	3.4	5,400	51.5	5,080	48.5	10,480	
31	999	9.7	3,954	38.5	309	3.0	4,644	45.2	5,629	54.8	10,273	
33	883	9.7	3,223	35.5	199	2.2	3,907	43.0	5,171	57.0	9,078	
35	698	8.2	2,679	31.5	154	1.8	3,223	37.8	5,295	62.2	8,518	
37	574	8.8	1,779	27.3	113	1.7	2,240	34.3	4,283	65.7	6,523	

Source: The Fair Trade Commission, *Annual Rport*.

Figure 1. The Trends of Broadly-defined CBRs, Debtor Deposit Ratio and Non-Compulsory Deposit Ratio



Notes: (a) Broadly-defined CBRs=the sum of "narrowly-defined CBRs" + "virtual ones".
(b) Broadly-defined CBRs ratio=the ratio of broadly-defined CBRs to total sum of borrowings.
(c) This figure is the ratio of broadly-defined CBRs to total sum of deposits.
(d) Debtor deposit ratio=the ratio of total deposits to total sum of borrowings.
(e) Non-Compulsory deposit ratio is(d)-(b).

Source: The Fair Trade Commission, *Annual Report*.

ing, the borrower has an advantage over the lender in the bargaining power of financing. 2) As the direct financing of large corporations has increased, such financing makes them independent of the banks. Therefore, the lending race among city banks has become severe within the SMEs. Recently, the government financial institutions specializing in finance to SMEs have also increased lending activity to SMEs. For these reasons, though the borrowing demand of SMEs for financial institutions is still high, it becomes difficult for banks to require CBRs as the terms for lending in the recent financial market. 3) With the development of financial liberalization, the financing method of banks has also changed to marketable funds. Thus, it is meaningless for banks to require CBRs as a security for the lender's risk. Furthermore, we have recognized the role of CBRs as a means of increasing the effective interest rate, but when the level of loan interest rate is easily reflects the market interest rate, it is less profitable for banks to require the CBRs.

2. 2. CBRs as "Hostage": A Hypothesis

The social problem of CBRs was expressed during the period when the demand for money was greatest. In those days, the loan interest rate was designated lower than that of the prevailing trend by the manipulated low interest policy and the Temporary Money Rates Adjustment Law enacted in 1948. To increase the effective interest rate, the banks required SMEs to deposit a part of their borrowing. As previously debated, CBRs have been reduced with the development of financial liberalization, but still they remain. We must re-consider the reason for retaining CBRs from another view point.

In this section, we consider the CBRs as "hostage" which Williamson (1983) constructed as a means to support exchange, and hypothesize that the use of CBRs is a rational custom for the SMEs to maintain or make long-term ongoing transactions smooth. All information that financial institutions obtain through their customers will improve their "scrutiny ability" (*shinsa nōryoku*) at lending. Higano (1986) emphasized that "this ability, which will combine with managerial resources and form the capital itself rather than a part of the capital, will result in the factor of acquiring high profits" (p. 17). Generally speaking, borrowers and lenders are in position of a uncertainty and asymmetry of information when trade funds. Usually, the former have more correct information on business activities than the latter. Provided that such difference of information between them does not completely disappear, there remains the possibility of market failures (for example, default risk and moral hazard). As long as these risks remain, the lender can recognize the CBRs as a security or compensation for evading such risks. Even if the SMEs did not pay back their borrowed funds to the banks, they are frequently indifferent to a spoiled reputation, future trading, and reduced profits. Accordingly, the banks will invoke the "credible threat" (op. cit., Williamson) that if they are not paid back, they press the SMEs for repayment with all legal measures and suspend future trading, thus causing them heavy damage.

We can understand the CBRs to be a credible threat which signifies a security similar to that of "hostage" (Ramseyer, 1990, pp. 102-105). That is, as the transactions incidental to debt and credit between SMEs and banks (when the former have accepted both the information of managerial resources and the dispatch of officers from the latter), if the latter suspend the transaction-type CBRs, all transactions are also suspended. Thus, the CBRs will fully exhibit the function of a "hostage" (Itō, 1990, p. 127).

On the other hand, when SMEs which belong "within the edge of the economy" (op. cit., Ramseyer, p.104) persuade the banks to maintain long-term ongoing fund transactions, the CBRs will be a favorable security (or "hostage").

The Fair Trade Commission have guided the banks to voluntary restraint on its CBRs as an abuse of their superior position vis-a-vis the SMEs. However, if we recognize the abuse of their position as a request for security, this transaction type is also favorable for SMEs. We mention that the market which finances through a "hostage plan" is an internal market for SMEs, and that self-financing (issue of capital stock) except for this market is external. When SMEs can obtain more opportunity for financing from the outside than from the inside, the motivation for ongoing fund transactions with a particular bank will weaken. We recognize, however, that because self-financing of SMEs has many difficulties, they have provided a "hostage plan" to make the financing smooth.

From the points debated above, we can understand that the CBRs serve as collateral which they provide for the banks, and that the SMEs "will receive both loan and service similar to a guarantee" (Itō and Matsui, 1989, p. 31); that is, long-term ongoing fund transactions and information on business activities. When we interpret CBRs as mentioned above, we can hypothesize that this is a rational "custom" for the SMEs.

3. Investigation

3.1. Analytical Technique

The estimation is based upon the least squares method. The period of analysis is from 1970 to October 1985 when financial liberalization in Japan was initiated. We estimated by means of the following equation, which is explained by seven independent variables, to investigate the superiority of banks for the SMEs.

$$\mathrm{CBRs} = a_0 + \Sigma a_i \cdot X_i + U_i.$$

Where CBRs: the broadly-defined compensating balance requirements ratio (= broadly-defined compensating balance requirements/total sum of borrowings). Broadly-defined compensating balance requirements is the sum of "narrowly-defined CBRs" and "virtual ones".

Independent variables (X_1) are

Long-F : the degree of difficulty in long-term funds borrowing ("Easy" minus "Tight"),

Short-F : the degree of difficulty in short-term funds borrowing ("Easy" minus "Tight"),

D. I.-B : the diffusion index=business sector ("favorable" minus "unfavorable")

D. I.-E : the diffusion index=individual enterprise ("favorable" minus "unfavorable"),

NPSR : the net profit to sales ratio ("rise" minus "fall"),

FE : the financial expense ratio (=financial expense/amount of sales), financial expense=interest and discount expenses,

LR : the liquidity ratio (=current assets/current debts), current assets=cash and deposits+acceptance receivable+account receivable+inventories+securities+others, current debts=acceptance payable+account payable +floating debt+allowance+others.

The CBRs are the figures on May 31 of every fiscal year. From the Long-F to the NPSR are the figures on April-June of every fiscal year, and these figures are the ratio of the number of enterprises concerned to the number of surveyed SMEs. The FE and the LR are the average during every fiscal year.

The following are the data sources: for the CBRs is Kōsei Torihiki Iinkai Nenji Hōkoku, Kakunendoban [The Fair Trade Commission, *Annual Report*]. For the Long-F to the NPSR are Chūshō Kigyō Dōkō Chōsa [The Small Business Finance Corporation, *Economic Trends Survey of SMEs*]. For the FE and the LR are Chūshō Kigyō Hakusho [The Small and Medium Enterprise Agency, *White Paper on Small and Medium Enterprises*] (This original data source is Hōjin Kigyō Tōkei, Kakunendoban [The Ministry of Finance, *Special Issues of Corporate Business Statistics, Annual Edition*]).

3. 2. Signs of Regression Coefficient : Expectation

When we recognize the CBRs to be a "hostage" and hypothesize that this custom is a rational one for SMEs to maintain or make long-term ongoing transactions with banks smooth, we can expect that every sign of independent variables will be the following.

When the SMEs demand funds, the Long-F and the Short-F signify the bargaining power against banks. Therefore, as the superiority of banks strengthens, the signs of these independent variables will be negative. As a result, the CBRs do not fully exhibit their function as "hostage", the bargaining power also weakens, the superiority of banks strengthens, and thus the CBRs increase.

When the SMEs judge business conditions to be unfavorable, the signs of D. I.- B and D. I.- F will be negative. Thus, when business conditions are unfavorable, the superiority of banks strengthens and the CBRs increase.

When the NPSR decreases, we can expect that the sign will be negative. When the results of business are unfavorable, we can consider that the superiority of banks strengthens and the burden (CBRs) for SMEs will increase.

The sign of FE which SMEs pay will be positive. We can consider that when the CBRs are a severe burden to the SMEs, the financial expense will also be a large sum.

As a high LR shows that the SMEs are in a favorable financial position, its sign will be negative.

3. 3. Results of Estimation

Table 2 shows the results of estimation. The signs of Long and Short-F are negative. That is, when the bargaining power of SMEs against the banks weakens, the CBRs increase. Especially, the significance level was higher in long-term funds than in borrowing demand for short-term funds. This finding shows that our hypothesis, in which CBRs are a "hostage" for SMEs to maintain or make long-term ongoing transactions with banks smooth, was rejected. This result still corresponds with Yamashita's conclusion (1969, p. 196), who pointed out that SMEs can not sufficiently borrow long-term funds in comparison with large corporations. We have understood his conclusion as "dual structure debate in financing".

In the diffusion index, when the business sector judges business conditions to be unfavorable (that is, the sign of D. I.- B is negative and its significance is also weak), the CBRs increased. On the other hand, when individual enterprise judges business conditions to be favorable (that is, the sign of D. I.- E is positive), the CBRs increased. Especially, when the SMEs need the borrowing of long-term funds, this result was remarkable. This finding signifies that when the SMEs undertake long-term investment projects, CBRs are expensive for them.

Every regression coefficient of NPSR was negative. This finding shows that, when business performance decreases, the CBRs are expensive.

Contrary to the above result, the FE had a positive and high significance correlation. This finding shows that when business performance does not improve, the burden of financial expense is still high.

As the LR increases, the CBRs decrease. On this finding, we concluded that when the LR increases, the burden of CBRs will decrease for the SMEs.

Table 2. Results of Estimation: 1970-1985

Variables/Equations	(1)	(2)	(3)	(4)
Constants	135.296* (6.946)	140.833* (7.36)	136.716* (9.173)	141.376* (9.724)
Long-F	−0.051*** (−2.187)		−0.051** (−2.304)	
Short-F		−0.049*** (−1.988)		−0.049*** (−2.1)
D. I. -B	−0.012 (−0.123)	−0.005 (−0.047)		
D. I. -E	0.229 (1.274)	0.213 (1.156)	0.21** (2.327)	0.206*** (2.189)
NPSR	−0.215*** (−1.871)	−0.209 (−1.75)	−0.21*** (−2.04)	−0.207*** (−1.924)
FE	6.124* (3.822)	6.44* (3.861)	6.049* (4.3)	6.409* (4.391)
LR	−1.291* (−8.044)	−1.342* (−8.563)	−1.299* (−9.41)	−1.345* (−9.976)
$\overline{R^2}$	0.915	0.91	0.924	0.919
D. W.	2.996 [28.035*]	2.932 [26.258*]	2.998 [37.314*]	2.936 [35.001*]

Notes: $\overline{R^2}$=Coefficient of determination adjusted for degrees of freedom.
( ): t-Values. [ ]: F-Values.
Significance level: *: 1%, **: 5%, ***: 10% (Two-tailed test).

4. Concluding Remarks

The main results of this paper can briefly be summarized as follows. Under circumstances when the SMEs need to borrow long-term funds and their business performances tend to decrease, the superiority of banks which signify an increase of CBRs will strengthen. That is, the CBRs did not play their function as "hostage" which makes SMEs favorable in long-term ongoing transactions with banks. Our hypothesis was rejected. In the raising of funds, CBRs became more unfavorable to individual enterprise than to the business sector. As the FE increased, the superiority of banks also increased. On the other hand, as the LR increased, which shows financial position to be favorable, the burden of CBRs decreased.

The Ministry of Finance and the Fair Trade Commission have supervised or regulated the trend of CBRs which shows an abuse by banks of their superior position (unfair transaction) since 1951 and 1963, respectively. When the Commission in particular regulates an abuse of such position, its feature is the following: "it is not clear to what extent the competitive market relationship is regulated, and thus the standard of illegality also tends to be not clear" (Murakami, 1992, footnote 11, p. 18). Accordingly, we must clear fair competition among borrowers that is obstructed by CBRs.

In this case, we can consider the possibility that the difficulty of raising funds obstructs the following two fair competitions. 1) Direct competitive relationship on plant and equipment investment (productivity drive) among the SMEs. 2) This difficulty obstructs indirect competitive relationship on productive drive against large corporations, and thus the position of SMEs in the industrial structure is forced to its present state.

In antimonopoly policy, we have the following two subjects to be solved. 1) We must construct a statistical method to investigate the obstruction of fair competition by the CBRs. 2) Since Yamashita (1969) has pointed out the "dual structure debate in financing", we have not yet reached a successful settlement. We must recognize again this economic issue and supervise the trend of self-restraint by banks. Especially, when the SMEs need to borrow long-term funds, we must supervise this trend.

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Notes

1. On the history and content of guidance for CBRs in Japan, refer to Arakawa (1977 and 1978). On the problems of CBRs in America, refer to Baxter and Shapiro (1964) and Mullins (1976).
2. The dual structure debate noted that in the Japanese economy there coexisted a "modern sector" mainly composed of large firms, and a "non-modern sector" comprised of agriculture and SMEs, with there continuing to be a substantial differential in wages and productivity between the two sectors (Yokokura, 1988, p. 537).
3. The term SMEs is defined in the Small and Medium Enterprises Basic Law.
   (a) For manufacturing enterprises, those with less than 300 workers or a capitalization of less than ¥100 millon. Of these, small enterprises are those with less than 20 workers.
   (b) For wholesale enterprises, those with fewer than 100 workers or a capitalization of less than ¥30 million. Of these, small enterprises are those with less than 5 workers.
   (c) For retail/service enterprises, those with fewer than 50 workers or a capitalization of less than ¥10 million. Of these, small enterprises are those with less than 5 workers (op. cit., Yokokura, p. 534).
4. The first case which judged CBRs to be illegal in private law was the *"Miyazawa tai Gifu Shōkō Shinyō Kumiai Jiken* (Miyazawa vs. Gifu Commercial, Industrial and Credit Cooperative case)". As commentaries on this case, refer to Funada (1978), Hattori (1991), Katō (1977), and Okushima (1991).

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