<Case>

Sanko Steamship Company, Ltd.

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Sanko Steamship Company, Ltd., one of the three largest sea transport companies in Japan, was suffering through a long spell of financial crises with chronic deficits beginning as early as 1978 (see *Exhibit 1*). Its current account deficits in the 1982 fiscal year alone (April 1982 through March 1983) amounted to 56 billion yen (or about U.S. $ 233 million) of its total sales of 264.7 billion yen(about U.S. $ 1,103 million).

Starting in early 1983, however, Sanko Steamship became an instant star of the press, with every move of its top management being reported in industry newspapers almost daily. In the latter part of 1982, press reporters learned that managers of Sanko Steamship were busy contacting various Japanese shipbuilders to order handy-sized bulk carriers.[1] Such contact between executives of shipping companies and shipbuiling companies was not newsworthy in itself, since annually the shipping and shipbuilding companies jointly plan the following year's order of new ships. What intrigued the reporters was the number of ships being ordered by Sanko. Generally a company of Sanko's size would order 4∼6 bulkers in order to replace aging ships within its fleet. If the shipping company planned to increase the size of its fleet, it would order perhaps 10 or so new ships. This time, however, the information reporters were gathering indicated that Sanko was intending to order 40 to 60 bulk carriers, all in the range of 30,000 to 40,000 dwt.

The reporters' observations of Sanko's move were summarized in an article in the February 25, 1983 edition of *Kaiji Press*, the most authoritative newapaper of the Japanese shipping and shipbuilding industries.

Sanko Steamship Moves to Order New Bulkers

Sanko Steamship seems to be on the move to order new bulk carriers. Informed sources report that the operator has sent inquiries to quite a few shipyards on handy-size bulk carriers. Some of the inquiries are likely to lead to contracts soon, according to the sources.

The year before last, Sanko Steamship disclosed a mass bulker building program, but the program was later postponed as the trampship market became stagnant, and because Sanko's performance deteriorated immediately after the plan was announced.

But the operator seems at last to have begun to move, judging that the prices of new ships have hit bottom and that the market will recover sometime from the latter half of 1984 through 1985, when the ships now on order are to be completed. At any rate, Sanko Steamship is compelled to replace its aging fleet.

Shipyards are of course interested in contracting

1) A term traditionally used to describe a bulk carrier of roughly 20,000 to 40,000 dwt(dead weight tonnage). Dwt expresses the weight of all cargoes a ship can load, including fuel, crewmen, and their baggage. Therefore, the actual shipping tonnage of commercial cargoes is less than dwt.

Exhibit 1. Sanko Steamship Company, Ltd.

Consolidated Income Statements (Years Ending March 31) (Millions of yen)

Accounts	1979	%	1980	%	1981	%	1982	%	1983	%
Incomes for Shipping Business	212,958	100.0	368,183	100.0	375,511	100.0	343,300	100.0	264,676	100.0
Expenses for Shipping Business	263,620	86.6	335,542	91.1	343,700	91.5	341,036	99.3	306,003	115.6
Gross Operating Profit	9,338	3.4	32,641	8.9	31,809	8.5	2,264	0.7	△41,326	△15.6
Administrative Expenses	4,969	1.8	4,766	1.3	5,429	1.5	6,381	1.9	5,761	2.2
Operating Profit	4,369	1.6	27,875	7.6	26,380	7.0	△4,117	△1.2	△47,087	△17.8
Nonoperating Income	19,931	7.3	20,988	5.7	16,534	4.4	27,475	8.0	20,104	7.6
Nonoperating Expenses	36,524	13.4	46,009	12.5	41,859	11.2	41,309	12.0	29,000	11.0
Ordinary Profit	△12,224	△4.5	2,854	0.8	1,055	0.3	△17,951	△5.2	△55,983	△21.2
Special Gains	5,607	2.1	7,737	2.1	3,301	0.9	15,739	4.6	4,634	1.8
Special Losses	4,872	1.8	7,927	2.2	7,160	1.9	—	—	8,038	3.0
Net Profit Before Tax Movements	△11,489	△4.2	2,664	0.7	△2,804	△0.8	△2,212	△0.6	△59,388	△22.4
From Special Reserve Fund	10,270	3.8	5,199	1.4	5,696	1.5	4,945	1.4	11,778	4.4
In Special Reserve Fund	—	—	5,750	1.5	1,890	0.5	1,000	0.3	—	—
Profit Before Tax	△1,219	△0.4	2,113	0.6	1,002	0.3	1,773	0.5	△47,610	△18.0
Income Tax	18	0.0	929	0.3	884	0.2	—	—	550	0.2
Net Income After Tax	△1,237	△0.4	1,184	0.3	118	0.0	1,733	0.5	△47,059	△17.8
The Surplus at the Beginning of a Period	—	—	—	—	—	—	—	—	2,199	0.9
Unnetted Loss for the Year	—	—	—	—	—	—	—	—	44,859	16.9

for Sanko's projects, as they are suffering from a scarcity of new building work. But they will have to settle financial problems before they can take Sanko's mass new building orders.

Inquiries recently sent to shipyards cover mainly 30,000~40,000 dwt handy-size bulkers. Sanko is said to be planning to order 40 to 60 ships.

The shipyards receiving inquiries from Sanko so far include Mitsubishi Heavy Industries, Kawasaki Heavy Industries, and some other major shipbuilders, as well as some medium shipbuilders, such as Namura Shipbuilding and Kurushima Dockyard.

Sanko hopes the planned ships will be delivered between the latter half of 1984 and early 1985.

Industry observers judged that Sanko Steamship would face serious difficulty in securing financial assistance from banks, since the project was rather adventurous and risky and Sanko's financial position was weak. The industry practice was for a single company to place a small number of orders each year over say five to six years, so as to avoid serious problems associated with simultaneous orders of a large number of similarly designed ships. In addition to this unorthodox practice, Sanko's project was considered risky because Sanko did not have any cargoes to back up the ship operation; ordinarily a shipping company would not order a large number of new ships without having secured sufficient cargoes.

As an alternative to the banks, Sanko could apply for direct financing by the shipyards that were to build its ships. This alternative, however, did not seem feasible. The shipping industry in Japan, as around the world, was believed to be at bottom around the first quarter of 1983, so it was unlikely that traditionally conservative Japanese shipbuilding companies would be prepared to invest huge sums of money in such a financially troubled company.

It seemed doubtful that Sanko's project would proceed as planned, since the financing Sanko needed to secure might amount to well over 100 billion yen (or U.S. $ 417 million). This amount was roughly 2.5 times that of Sanko's paid-in capital, or 23% of its total assets as of March 31, 1983 (see *Exhibit 2*).

Company History

Sanko Steamship Company was established in 1934 by Toshio Komoto, then a 25-year-old self-made entrepreneur. Starting as a domestic liner, the company soon moved into coastal transportation between China, Korea, and Japan with small ships of less than 1,000 dwt. From 1949 to 1952 the company expanded its fleet by adding 10,000 dwt class freighters through Keikaku Zosen (the government-sponsored shipbuilding program). In 1960, however, the company decided not to rely on government financing any more, as the government program required small to medium shipping companies, including Sanko, to be affiliated with larger shipping companies.

Without government support, which most of Sanko's peers accepted in exchange for their economic independence, Sanko had to resort to self-financing in order to keep growing. Sanko used two means of self-financing: issuance of new stocks at market prices, and trade of its own stocks at the securities market. Consequently, its paid-in capital of 40.3 billion yen as of March 31, 1983 made it second in size, after Nippon Yusen Kaisha, while its equity/asset ratio was the highest among the ten largest shipping companies in Japan (see *Exhibit 3*). Sanko's financing practices were not common in the Japanese business environment, and consequently the company was considered a maverick in the industry from the early days.

Sanko's self-financing through the securities market was initiated by the company's current chairman, Hiroshi Okaniwa, who joined the company in 1943 as director. More like a scholar than a businessman in looks and behavior, Okaniwa had written several books about the shipping industry as well as about stock management. He had a much-coveted doctoral degree in economics from Keio University and continued to teach in a nearby university. He was

Exhibit 2. Sanko Steamship Company, Ltd.

Consolidated Balance Sheets(Years Ending March 31) (Millions of yen)

Accounts	1979	%	1980	%	1981	%	1982	%	1983	%
Assets										
Current Assets	218,830	34.4	253,623	38.9	235,929	39.6	266,507	44.5	201,398	46.7
Fixed Assets	416,968	65.6	385,028	60.3	359,863	60.4	337,681	55.9	229,998	53.3
Tangibles	266,216	41.9	271,929	42.6	258,403	43.4	252,848	41.9	159,810	37.0
(Ship)	243,046	—	269,877	—	254,709	—	242,098	—	262,815	—
Intangibles	6	0.0	8	0.0	7	0.0	7	0.0	7	0.0
Investment and Other Assets	150,746	23.7	113,091	17.7	101,453	17.0	84,836	14.0	70,179	16.3
Deferred Charges	78	0.0	62	0.0	49	0.0	39	0.0	28	0.0
Total Assets	635,876	100.0	638,718	100.0	595,841	100.0	604,237	100.0	431,426	100.0
Liabilities										
Current Liabilities	173,934	17.4	184,479	28.9	192,543	29.0	190,655	31.5	150,028	34.8
Fixed Liabilities	328,002	51.6	322,811	50.5	285,618	49.6	290,804	48.1	211,049	48.9
Special Reserve Fund	18,979	3.0	19,530	3.1	15,724	2.6	11,779	2.0	—	—
Total Liabilities	520,915	82.0	526,820	82.5	483,885	81.2	483,238	81.6	361,077	83.7
Shareholders' Equity	114,961	18.0	111,893	17.5	111,956	18.8	110,999	18.4	70,349	16.3
Total Liabilities and Equity	635,876	100.0	638,713	100.0	595,841	100.0	604,237	100.0	431,426	100.0

Exhibit 3. Sanko Steamship Company, Ltd.

Equity/Asset Ratio of Top Ten Japanese Shipping Companies

Company[a]	(1968)	(1973)	(1974)	(1975)	(1976)	(1977)	(1978)
NYK	10.17	8.73	9.16	9.31	9.61	10.21	13.34
MOL	15.37	10.55	10.10	9.87	10.37	10.35	11.73
SANKO	9.24	31.71	30.70	28.03	23.25	24.22	22.09
J-LINE	18.56	8.91	11.68	14.45	15.13	8.20	2.31
K-LINE	12.77	11.15	10.18	9.71	10.07	10.69	10.16
YS LINE	10.84	10.02	9.39	10.14	10.18	10.50	11.29
SHOWA	14.00	7.54	7.14	7.28	6.90	7.57	7.63
SHINWA	12.25	10.02	9.00	13.41	13.54	11.96	11.67
DAIICHI	11.54	5.87	11.22	11.42	11.06	12.29	14.23
IINO	23.23	14.33	12.15	11.39	12.40	12.88	11.66

[a]NYK: Nippon Yusen Kaisha Ltd.
SANKO: The Sanko Steamship Co., Ltd.
K-LINE: Kawasaki Kisen Kaisha Ltd.
SHOWA: Showa Line Ltd.
DAIICHI: Daiichi Chuo Kisen Kaisha
MOL: Mitsui O.S.K. Lines Ltd.
J-LINE: Japan Line Ltd.
YS LINE: Yamashita Shinnihon Steamship Co., Ltd.
SHINWA: Shinwa Kaiun Kaisha Ltd.
IINO: Iino Kaiun Kaisha

Source: *Management Comparison of Shipping Industry*, ed. by Kyoikusha, Tokyo, Kyoikusha, Ltd., 1980, p. 182.

generally considered the leading authority in the Japanese securities industry.

The founder, Toshio Komoto, officially resigned from his position as company president in 1967 to enter politics. Backed with a hefty source of money, he quickly rose to various powerful positions in the ruling Liberal Democratic Party (LDP). Between December 1974 and December 1976, he served as minister in the powerful Ministry of International Trade and Industry (MITI) under Prime Minister Takeo Miki. His immediate predecessors at MITI's post included Takeo Miki, Kakuei Tanaka, and Yasuhiro Nakasone, all of whom subsequently served as prime ministers of Japan. In 1982, Komoto ran for prime minister himself but lost his bid in a very close election with Yasuhiro Nakasone. Nevertheless, it had been widely speculated that he had a good chance of becoming Nakasone's successor.

Sanko Steamship's fleet of 30 vessels in 1967 increased to 106 in 1971, while its 1964 vessel tonnage of 260,000 dwt increased to over 20 million dwt in 1975. This quantum leap in Sanko's shipping capacity was prompted in part in the 1960s by the rapid growth of the Japanese economy, especially the steel industry, which generated a need to transport a big volume of iron ore from Australia and other overseas countries, and in part in the 1970s by the change in Japanese energy consumption from coal to oil, which necessitated the importation of crude from the Middle East. Each time, Sanko had predicted the surge in demand for sea transportation and was able to build in advance a large fleet of iron ore carriers and crude tankers. Thus the company was able to grow in an explosive fashion, riding the crest of the shipping booms (see *Exhibit 4*).

By the beginning of 1983, Sanko Steamship was firmly established as a major tanker-owning and -operating company in Japan as well as worldwide. Its owned fleet consisted of 32 tankers with a combined tonnage of 6.4 million dwt out of a total owned tonnage of 7.9 million dwt. With 39 chartered tankers with 5.6 million

Exhibit 4. Sanko Steamship Company, Ltd.

Trends in Sanko's Operating Fleet

	Tankers			Combined Carriers			LPG Ships			Bulkers, Car/Bulkers			Total			Index
	No.	.000 dwt	%	No.	.000 dwt	%	No.	.000 dwt	%	No.	.000 dwt	%	No.	.000 dwt	%	
March 1973	24	4, 102	42. 3	26	3, 210	33. 1	18	565	5. 7	72	1, 833	18. 9	140	9, 700	100. 0	100. 0
March 1974	32	5, 592	44. 7	28	3, 453	27. 5	19	610	4. 9	109	2, 851	22. 8	184	12, 506	100. 0	128. 9
March 1975	54	9, 253	51. 4	32	3, 790	21. 0	26	892	5. 0	147	4, 078	22. 6	259	18, 014	100. 0	185. 7
March 1976	92	13, 984	62. 8	31	3, 725	16. 7	7	344	1. 6	141	4, 200	18. 9	271	22, 253	100. 0	229. 4
March 1977	113	15, 057	53. 7	32	3, 889	15. 4	10	512	2. 1	161	4, 746	18. 8	316	25, 203	100. 0	259. 8
March 1978	105	15, 292	62. 3	29	3, 657	14. 9	11	568	2. 3	167	5, 027	20. 5	312	24, 544	100. 0	253. 0
March 1979	104	15, 239	61. 9	30	3, 730	15. 1	11	578	2. 3	160	5, 099	20. 7	305	24, 537	100. 0	254. 0
March 1980	100	14, 521	60. 8	33	4, 298	18. 4	12	621	2. 6	132	4, 334	18. 2	277	23, 876	100. 0	246. 1
March 1981	98	13, 315	60. 8	31	3, 973	17. 5	11	573	2. 5	131	4, 362	19. 2	271	22, 722	100. 0	234. 3
March 1982	101	14, 086	61. 6	29	3, 984	17. 0	11	565	2. 5	113	4, 322	18. 9	254	22, 357	100. 0	235. 6
March 1983 (est.)	71	12, 000	59. 1	—	—	—	—	—	—	—	—	—	220	20, 300	100. 0	209. 3

Source: *Kaiji Press*, April 22, 1983, p. 3.

dwt, out of its chartered fleet totaling 12. 4 million dwt, Sanko-operated tankers comprised 60% of its total fleet.

This lopsided dependence on tankers made the company the most serious victim of the bottomless slump of the tanker market, which started in the late 1970s. Consequently, Sanko found itself in dire financial straits. It posted an operating loss of 7. 4 billion yen for fiscal 1981. Its business performance in the following fiscal year became even worse, with its operating loss for fiscal 1982 reaching a staggering 56 billion yen, while its net loss before tax amounted to 59. 4 billion yen (compared with the previous year's loss of 3. 7 billion yen). Sanko's financial crisis became a serious concern to its major shareholders, to the banking institutions, and to the general trading companies in Japan having large contracts with Sanko.

Sanko's management thought that the only alternative remaining to them was to reduce its tonnage and to change the composition of its fleet. Therefore, its fleet was reduced to 20 million dwt in 1983 from the record-setting 25 million dwt of 1977, and the company was planning to cut another 10 million dwt dy 1984 through the disposition of uneconomical vessels such as VLCCs (very large crude carriers). In the meantime, Sanko was planning to compensate for the reduction with the order of new handy-sized bulkers of 60 ships of 35, 000 dwt to add 2. 1 million dwt to its fleet, which would raise the fleet only to 12 million dwt, about the same size as the 1974 fleet.

One of the intriguing questions was Sanko's ability to dispose of 10 million dwt in the next couple of years. The market prices of secondhand ships, either for demolition or for further use, did not show any sign of improvement. On the other hand, the book values of the ships Sanko hoped to sell were not yet low enough. Most of Sanko's 10-year-old VLCCs still had book values of $10 million or so, while their highest selling price would be $4 million. The differential was large. In other words, Sanko was highly likely to incur losses either way by disposing or by not disosing of its ships: if it wanted to sell them no matter what the market situation was, then it would certainly suffer serious losses, and if it did not sell them, the uneconomical ships would continue to generate losses.

One industry observer characterized Sanko as clever and aggressive. While not receiving any government funds would generally be considered a source of weakness within the Japanese content, independence allowed Sanko's top management to make decisions without outside supervision and consent. Therefore, the company could move freely and take advantage of the inertia prevalent among the competitors, which were more or less bound by the traditional rules of the game in the shipping industry. Indeed, nobody denied the high correlation between Sanko's financial independence and its managerial success. And being virtually a one-man company under an owner with a strong character, the company could move very quickly and aggressively. Thanks to its management style, Sanko earned the dubious nickname of "a lone wolf" and was always considered an industry outsider, despite its position among the top three in the shipping industry according to most of the major indicators such as vessel tonnage and revenues.

General Trading Companies Finance Sanko's Order

Only a week after the first *Kaiji Press* article on Sanko's project, another, much more optimistic one appeared. The following is an excerpt of the March 4 article entitled "Sanko Steamship Books Yards for 50 Bulkers".

> Sanko Steamship's mass bulker order plan is already well under way, and the yards of major shipbuilders have been booked for about 50 out of 65 handy-size bulk carriers the operator is ordering in the near future.
>
> Sanko is conducting negotiations with shipbuilders on the type and prices of these ships, and on the mode of ownerhip and the charter rates with trading firms and leasing companies linked with specific city banks.
>
> Once the negotiations with the two sides have been concluded, Sanko will probably place orders for the planned ships shortly.

The report revealed that Sanko Steamship started with shipbuilding companies in negotiating the building of a fleet of handy-sized bulkers. Initially Sanko asked each of them to present estimates on 27,000~40,000 dwt standard bulk carriers, to provide financing for the project, and to indicate how many of the planned bulkers it was able to build. However, most of the major shipbuilders approached by Sanko were reluctant to provide financing, because they were experiencing a financial squeeze themselves and also regarded Sanko's project as risky. Thus, they simply presented the price estimates, the lowest of which was 80,000 yen (U.S. $ 333 at the then prevailing rate of $ 1=¥240) per dwt. This price was generally considered to be the rock bottom.

Recognizing the difficulty in mobilizing shipbuilders' financial resources, Sanko also approached general trading companies and leasing companies. Marubeni Corporation and Sumitomo Corporation, which had collaborated in the mass tanker building by Sanko in the early 1970s, reacted favorably to Sanko's request. Nissho-Iwai and Mitsubishi Corporation joined to help Sanko, and the weaker members of the nine general trading companies in Japan (i.e., Domen, Nichimen, and Kanematsu-gosho) followed the leaders.

Regarding ownership, as well as the choice of nominal orders of new vessels, Sanko did not follow the traditional formula of channeling orders through foreign owners or of setting up a joint venture with the trading companies. Instead, the new ships were to be officially ordered and owned by overseas subsidiaries of general trading companies or leasing firms, from which Sanko would charter the ships. The charter rates in the initial three years were expected to be set at a level barely high enough to cover the operating costs and interest, and the rates would be raised to allow for depreciation. This meant that the initial charter rate would average \$5.00 or so, which was higher than the current market rate of \$2.50~\$3.00 but lower than what would allow depreciation of the building costs.

The general trading companies participating in the project were expected to receive a commission of one percent of the ship price from Sanko Steamship. The charter rate itself was not terribly low as compared with the charter rate in the trampship market, but the commission was the only tangible benefit the trading companies could derive from the project.[2]

A manager in one of the general trading companies participating in the project described the situation he confronted:

> Surely, the deal involves a certain risk for us, in case Sanko fails to pay chartering fees to us. But the price of the ships is so low that we think we can sell them and still make some profits. We had such an experience in the past. Alternatively, we can charter them to other operating companies. Marubeni has its own shipping division, and they can charter the ships if we cannot find suitable operating companies.
>
> But the more important thing for us was that we had no choice when Sanko management approached us and asked us to participate in the project. Since we have grown up along with the Japanese economy, we always wanted to remain in the center of its economic structure. If we refuse to participate in the project in this case, we have to stay outside. This is a big risk, and perhaps larger than the risk that we may have if we participate. Historically, we started as an export department of the Japanese industries, and such intention still remains. We cannot go alone; we always have to go together with the Japanese industries, including the shipbuilding industry. By participating in the project, we are forcing the manufacturers to go along with us in the future as well. We don't want to sacrifice or kill future business possibilities. There are a lot of opportunities in the future. For example, when they want to dispose of the ships, we can claim our share. We can ask them that we act as an exporter of the ships, so there is another business. Also, we may be able to ask them to buy bunker oil from us in operating the ships. Some of the shipbuilding materials can also be supplied through our company. This is what we call "Shoken" (commercial right). We have to protect our business territories.

Sanko Increases Its Order to 111

The industry observers' initial estimate of the number of bulkers to be ordered by Sanko Steamship was 40. In February the estimate was changed to 50~65, which had increased to 70 before the end of March. On April 1 the revised estimate was 73~74, then 86, and by July 18 it was 111. *Exhibit 5* shows the shipbuilder and the owner of each of these ships. Along with the breathless pace of increase in the number of bulkers to be ordered by Sanko Steamship, other related information was disclosed.

American Banks' Participation: It was released in the press that Sanko contacted the Bank of America, Citibank, and Chase Manhattan on the possibility of their financing the project. Their financing would be confined to ships to be owned by Sanko's overseas subsidiaries. Some foreign banks said that should they decide to finance the project, the proper interest rate would be the Euro interest rate plus a spread of up to one percentage point, and the proper repayment period would be seven to eight years.[3]

Sanko's Negotiation Process: The process of negotiations used by Sanko Steamship on its mass bulker building strategv included three steps. First, Sanko negotiated with a shipyard on the specifications, price, and number of ships to be ordered. Second, when an agreement was reached with the shipyard on these matters, Sanko proceeded to negotiate with a trading company(or a leasing company), which was to be the nominal owner of the ships involoved.

2) *Kaiji Press*, May 4, 1983, p. 20.
3) *Kaiji Press*, March 22, 1983, pp. 8-9.

Exhibit 5. Sanko Steamship Company, Ltd.

Owners and Shipbuilders in Sanko Steamship Project

Builders \ Owners	Sanko	Mitsubishi Corp.	Sumitomo Corp.	Marubeni Corp.	Nisshoiwai Corp.	Kanematsugosho Ltd.	Tomen	Nichimen Corp.	Japan Lease	Kawasho Corp.	Others Tokyo Boeki	Total
MHI	6	—	—	—	—	—	—	—	—	—	—	6
MHI	1	6	2	2	—	1	—	—	—	—	—	12
IHI	—	—	—	5	4	—	—	—	1	—	—	10
IHI	—	1	—	2	—	1	3	—	2	1	—	10
Mitsui	—	—	10	—	—	—	—	—	—	—	—	10
KHI	—	—	—	2	—	0	—	2	—	2	—	6
Hitachi	—	—	—	—	4	2	—	—	—	—	—	6
Ohshima	—	—	6	—	—	—	—	—	—	—	—	6
Koyo	—	—	—	3	—	—	—	—	—	—	—	3
Namura	—	—	—	4	—	—	—	—	—	—	—	4
Kurushima	—	—	2	3	—	—	2	—	3	—	5	15
Kurushima	—	—	—	—	—	—	—	—	—	—	10	10
Sanoyasu	—	—	—	—	—	2	—	—	—	—	—	2
Osaka	—	—	—	—	3	—	—	—	—	—	—	3
Kanda	—	—	—	—	—	—	—	4	—	—	—	4
Minaminippon	—	—	—	—	—	—	—	—	4	—	—	4
Total	7	7	20	21	11	6	5	6	10	3	15	111

The major issues of these negotiations were the financing and chartering of the ships. Third, a nominal order of shipbuilding was formalized between the trading company and the shipyard.

The April 1 issue of *Kaiji Press* provided the following specific instance of Sanko's negotiating strategy:

> Sumitomo Corporation is the first trading company that has taken definite action on Sanko's project. It has already formalized a charter party with Sanko and signed shipbuilding contracts with shipyards ......According to the agreement reached by Sanko and Sumitomo, the bulkers built are to be owned by Sumitomo's Liberian subsidiary and bareboat-chartered to Sanko over 10 years. The rate, constant for the 10 years, includes the building cost, depreciation, and interest rate fractions. According to the charter party, Sumitomo can confer with Sanko on the sale of the ships, if it so wishes, during the term of the charter party. In that case, the terms of sale are to be "flexibly decided." Also, the charter party gives Sanko a purchase option after its expiry. Sanko won't necessarily assign Japanese crew to the bareboat-chartered ships. It is more likely that the management of the ships will be left to ship management companies, who will man them with foreign crews......
>
> Other trading firms participating in the Sanko program may do the same. Some trading firms are likely to ask their subsidiary leasing companies to own some of the vessels they control. In such a case, the trading firms involved will assist their leasing companies financially. Yet in other cases, leasing companies may participate directly in the Sanko program....

A typical arrangement among the parties involved in the Sanko project would look like the one shown in *Figure A*.

Features of the Bulkers: The May 10 issue of *Kaiji Press* described the features of the bulkers ordered by Sanko. "Sanko Steamship's mass handy-bulker building program is turning out to be a very well deliberated and highly efficient program. The handy-size bulkers built under this program, according to our analysis, will be fully competitive even in an era of overtonnage." In describing the features of the newly built bulkers, it focused on four points.

First, all the Sanko bulkers were powered by

Interaction of Parties Involved in Sanko Project

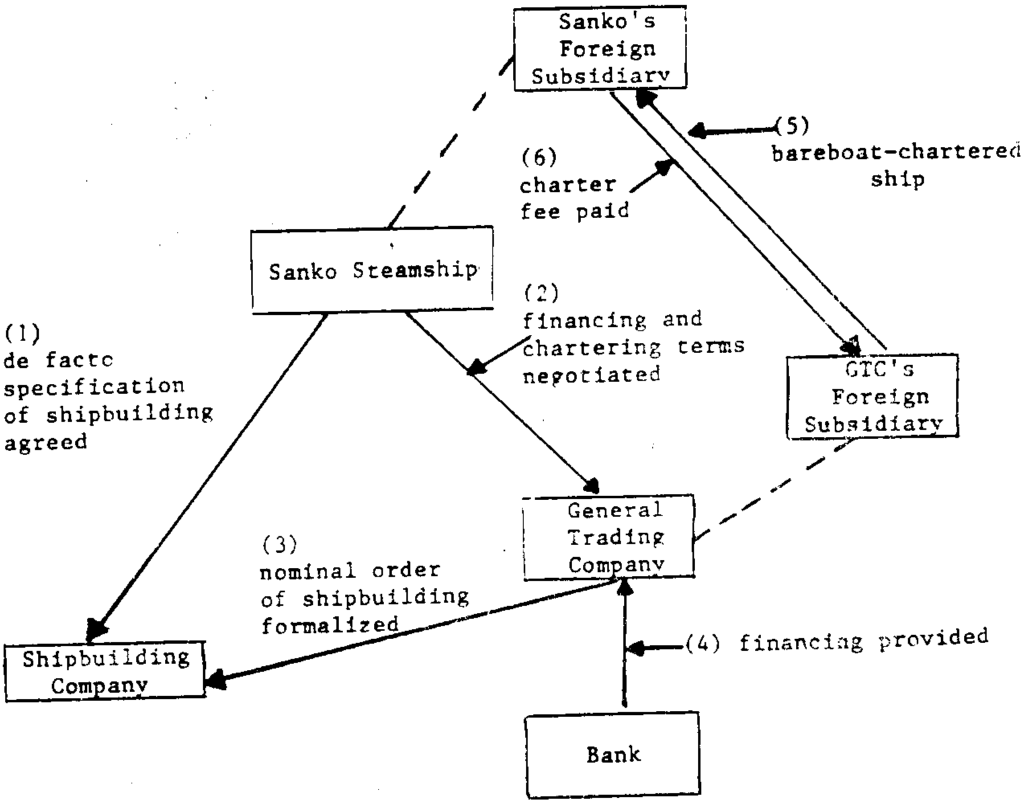


Fig. A

the most advanced energy-efficient diesels of derated specifications, whose energy consumption could go down 40 percent from that of similar, existing handy bulkers. Energy-efficient diesels had been made available only recently. The shipbuilders involved, who had not previously done much to develop energy-efficient handy bulkers, finally came out with a new design.

Second, Sanko was obtaining the bulkers at a very low price, in exchange for leaving the choice of machine firms to the discretion of the shipyards. It was the shipyard's responsibility to find proper machine makers and to cut down the total building cost to a minimal level.

Third, in ordering these bulkers, Sanko took into full consideration the changing transport needs favoring movement of small consignments of a large variety of cargoes. Thus, Sanko attached utmost importance to the special cargo capacity of the new bulkers. Also, the Sanko ships were characterized by shallow drafts and a wide breadth, so they could be sent to the ports of developing countries. The on-deck cargo space also was large, allowing steel products and lumber to be moved on the deck.

Fourth, in order to facilitate sale of the ships at high prices, the ships had new facilities and equipment that would satisfy potential buyers.

One industry observer questioned whether Sanko could edge out its competitors in the bulker market even with such newly designed ships. He explained:

It is true that Sanko's new ships are cost-competitive and, therefore, theoretically speaking, can drive out its competitors. But actually competition is quite hard, and there is no rule or friendships in the highly competitive shipping circle. There are big shipping countries like Norway, Greece, Hong Kong, and Japan. Sanko is only one of many shipping companies in Japan. If the competitors in Japan and in other countries think they lost market because of Sanko, they will attack the market. Then the shipping market will become like a jungle, dictated only by jungle laws. In this regard, cost-competitive ships do not necessarily mean winning in the market. It is not easy for Sanko to increase its share in the bulker market even with the new ships. The cometitors will compete with Sanko even if they lose money in the bulker market, because they can absorb such losses in other parts of their shipping business.

Indeed, it is very difficult to realize such a theory that better ships increase market share. Due to the aggressiveness of the communist fleet in the 1960s, British shipping business was down to a terrible operating level. Norwegians the same. Even the Japanese shipping business lost a certain market share. The fleet of the communist countries at that time was not cost-competitive. But, as you know, they had a centrally planned and controlled economic system, and therefore they could offer quite low freight charges to the shippers. And nowadays developing countries such as India, Brazil, and Indonesia are going to have their own fleet to handle a certain portion of their cargoes. So the shipping industry has changed in recent years, and such factors will give Sanko another burden as they try to increase their market share in the bulker market.

Shipbuilders' Hesitant Attitude: The attitude of the shipbuilders involved was one of the key factors in the execution of Sanko's project. Initially, the shipbuilders regarded Sanko's project as a shower in the midst of a long drought, because the order of 111 bulkers to be built within a year or two had the immediate effect of providing substantial jobs for order-hungry shipyards. This order was also expected to help their long-term strategy of turning the current buyer's market into a seller's market.

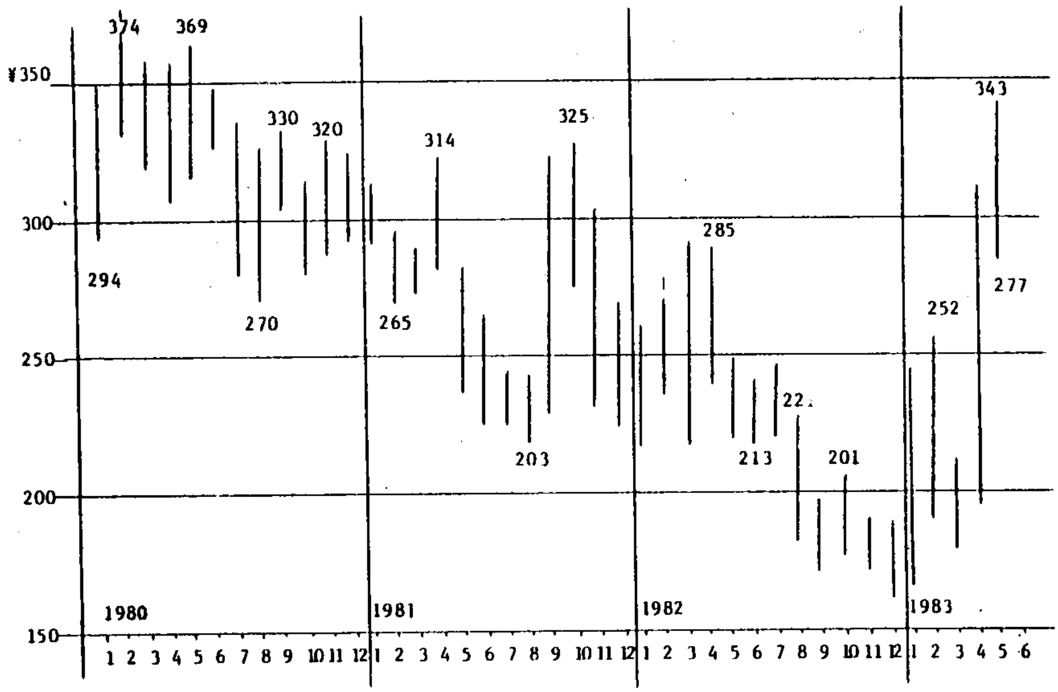
Nevertheless, the order was worth only three months' workload against their total capacity of building 400 standard-sized bulkers per year, while the price quoted was far from the usual level. The shipbuilders also feared that such a large order of bulkers without a concurrent increase in shipping demands might further delay the recovery of the already sluggish bulker-transport market, diminishing even the replacement orders of bulkers by existing shipowners. Indeed, some foreign shipowners who had planned to order new bulkers canceled their plans.

In order to reduce the risk factor, shipbuilders accepted an order only on the basis of cash payment. However, a manager in one of the participating shipbuilding companies argued that "there is no business on earth that is risk-free." In the case of the Sanko project, he pointed out that

> It is always possible that the orderer [the general trading company] may ask us to postpone the delivery of ships or even to cancel the whole order, if the shipping market continues to remain stagnant. Indeed, according to our market research, oversupply of bulker tonnage in the near future will be quite big. Furthermore, in the next two years, every week one bulker will go into service if 111 vessels ordered by Sanko are completely built. Then the market will be very much depressed, and some cancellation or request for delayed delivery may occur. Or perhaps they might ask for a change of ship design so that it can be used for other purposes. There have been many cases in the past when shipowners requested these things while we were building ships for them.

Therefore, the shipbuilders' decision to participate in the project was based simply on the fact that it would at least temporarily fill up the yards, which were in danger of being idle. According to the shipbuilding manager quoted above, "Shipbuilding companies are now trying to find business for the next year, at the expense of the following year's big fall-down. Shipbuilding companies are now discussing only the merits of the project and show big appreciation for it. As I said, however, demerits will occur later. But, right now, no one speaks loud-

Exhibit 6. Sanko Steamship Company, Ltd.
Trends in Sanko Shipping's Stock Price



Source: *Weekly Diamond*, May 28, 1983, p. 5.

ly about the demerits. That is a problem."

The number of ships to be built by each shipbullding company reflected its attitude toward risk factors in general, and toward the Sanko project in particular. As shown in *Exhibit* 5, the rather small-sized Kurushima Docks had 25 ships on hand, while much bigger companies such as Kawasaki and Hitachi had only 6 ships each. Another big shipbuilder, Sumitomo Heavy Industries, was not participating in the project at all.

Kurushima Docks was considered a maverick or an outsider in Japanese shipbuilding, as it was owned and controlled by President Tsuneishi in the same way Sanko Steamship was owned and controlled by ex-President Komoto. It was not coincidental that Kurushima Docks, a one-man company, had the largest share in the project initiated by another one-man company, Sanko Steamship.

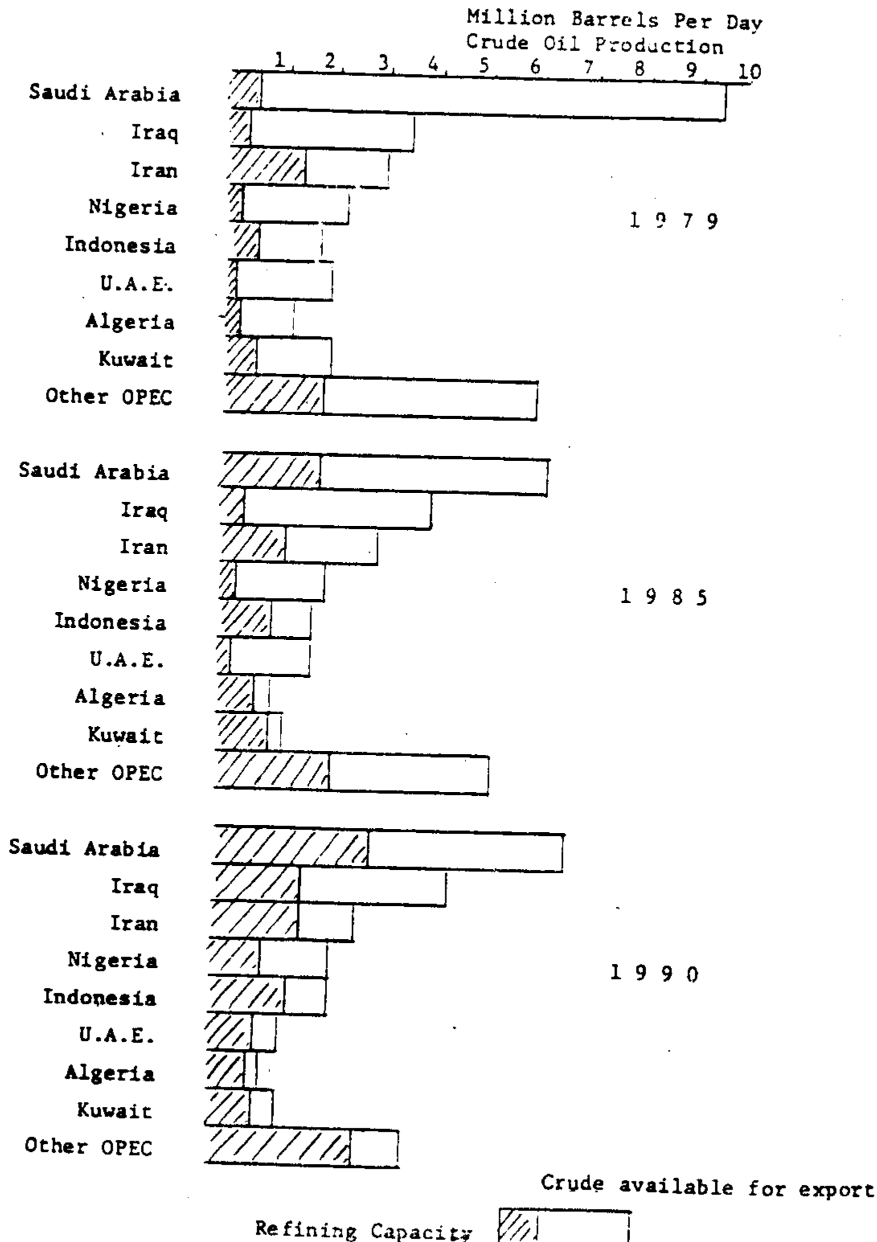
The management of Kawasaki Heavy Industries considered six an adequate number of ships because it was more oriented toward specialized ships such as submarines and liquid natural gas/liquid petroleum gas carriers. Thus they did not feel that participation in the Sanko project would provide them with any substantial merits in technology improvement except in the area of cost-saving construction. Furthermore, the price and quality of orders in the Sanko project was not considered attractive enough to justify building more than six ships.

Sumitomo Heavy Industries was recognized as a conservative company with an aversion to risky ventures. Moreover, Sumitomo's building docks were smaller and therefore more cost-effective than its competitors'. Because of this factor, they were not as worried as other shipbuilding companies about finding orders to fill up their docks. Also, the Sumitomo Group, to which Sumitomo Heavy Industries belonged, had another shipbuilding company by the name of Oshima Shipbuilding, which was building six ships for Sanko.

Sanko Issues New Shares

On May 2, Chairman Okaniwa of Sanko Steamship officially declared the issuance of new

Exhibit 7. Sanko Steamship Company, Ltd.
Projected Development of OPEC Refining Capacity and Crude Oil Production



Source: Fereidun Fesharaki and David T. Isaak, "OPEC Downstream Processing-A New Phase of the World Oil Market," Resource Systems Insitute, East-West Center, October 1981, p. 8.

stock to be distributed to third parties. The number of shares to be issued was 100 million, or 12.4% of the then outstanding 807,999,051 shares. The per share price was set at 240 yen against its face value of 50 yen and the marked price of 295 yen(as of April 30, 1983). The parties that assumed the new shares were Zuito Kaiun, a subsidiary of Sanko Steamship(88 million shares), Hitachi Engineering and Shipbuilding(5 million), Onomichi Dockyard(3 million), Japan Radio Co., Ltd.(2 million), and Japan Oils and Fats Co., Ltd. (2 million). They were expected to pay a total of 24 billion yen in exchange for the new shares by May 30. Chairman Okaniwa made it clear that this fund would be used for the acquisition of newly built ships and secondhand ships. By this capital increase, Sanko's capital was boosted to almost 52.4 billion yen, thereby outstripping Nippon Yusen Kaisha in capitalization and becoming the largest shipping company in Japan in this respect.

The industry observers were shocked to hear the news, because Sanko was challenging the securities industry's traditionally held taboo that a company with a big loss and no paid dividend could not dare to issue new shares at a premium price. But the price of Sanko shares had been rising steadily since the outbreak of the news that the company was ordering a large number of bulk carriers (see *Exhibit* 6). Furthermore, the moment the company declared its intent to issue new shares, the price started to climb. Although it temporarily fell to 280 yen during the morning session of May 2 in reaction to the news, Sanko's share was posted at 343 on May 12, the highest since June 1980.

Beginning in July, however, various rumors started to percolate. One was that the general trading companies involved in the project started quietly to sell off the ships they had been ordering, out of fear that the bulker-transport market in the mid-1980s would be saturated with a flood of the newly built Sanko bulkers. Another rumor was that the companies who recently assumed the newly issued Sanko shares had started to sell their portions on the market.[4] As a result of such rumors, the price of Sanko shares began to fall, reaching 222 yen on July 22, 18 yen below the price at which the third parties assumed their shares.

In spite of the rumors, Sanko was said to be preparing a second round of new buiding orders, this time with oil product carriers. With a number of gigantic refining facilities under construction in the OPEC nations, it was expected that 18 percent of their oil would be exported in the form of refined products in 1985; by 1990 this share might rise to 30 percent (see *Exhibit* 7). Given such a trend in the oil-producing countries, sea transportation of oil products instead of crude was believed by Sanko management to be the brightest market in the foreseeable future.

4) *Mainichi Shinbun*, July 23, 1983, p. 8.