

An Analysis of the Economical Performance on L. S. R. S. Law in Japan

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Abstract

The structure of the retail sector in Japan has been the subject of considerable research interest. For such a developed country, Japan has a large number of independently owned, physically small retail outlets, a situation that has been promoted historically by legislation designed to protect small-scale business. The legislative environment changed in the late 1980s in a way that should have promoted both a growth in the number of larger stores and an increase in retail concentration. The purpose of this paper is to test the impact of the legislative changes. Using a model of legislative effect and data on retail concentration, the change in legislation can be seen to be associated with a change in the Japanese retail structure. However, the change is small when compared with what could have been expected from trends in a comparable market. Further change will be needed to promote any rapid shift towards the retail structures existing in other developed markets. An analysis is made of the pattern of new store development by leading retailers to explain in part why the change in retail structure has been slower than might have been expected.

Legislation and Retail Structure

The retail sector is often subject to legislation that affects its structure. The direct or indirect effects of legislation, such as Robinson-Patman in America (Hollander and Omura, 1989), the Baunutzungsverordnung in Germany and the "Piano Regolatore" in Italy (CNW, 1990, 1991a), the padlock Law in Belgium (Leunis and Francois, 1988), the Loi Royer in France (Treadgold and Sanghavi, 1990) and Resale Price Maintenance in Britain (Davies and Harris, 1990), have been claimed to share a common feature : to restrict the activities of large scale retailing. Planning legislation often restricts the ability of retailers to build larger outlets (as in Germany, Belgium and Italy). Pricing legislation often affects the ability of large retail businesses to use their purchasing power to gain competitive advantage by offering lower prices, as, historically, has been the case in both the UK and USA. Such legislative effects serve to favour the smaller scale operator by restricting the power of the large-scale retailer to use any economies of scope or scale that may be derived from the nature of its operation. Small-scale retailers tend to operate from physically small premises. They tend to offer a narrower range and, therefore, forgo economy of scope. They tend to purchase via wholesalers somewhat more than their larger rivals who can, in an unconstrained market, negotiate preferential discounts in direct negotiation with suppliers.

Large-scale retailers are not always disadvantaged by planning legislation designed to constrain the building of larger stores. Hence the German retailer Aldi, whose trading format is that of a relatively small store, was unaffected by the restrictions on shop size in that country. Legislation is also only one of a number of factors that can affect retail structure (Treadgold,

1990, Kacker, 1983, Sybrandy et al, 1991). The purpose of this paper is to assess the effect of a change in legislation in Japan, legislation that has, historically, been specifically intended to restrict large store, and therefore large-scale, retailing and to promote small-scale retail business. The new legislation was designed to affect the retail structure in that country. A change in legislation designed to reverse previous policy should therefore have had an observable effect on retail structure.

Measures of Retail Structure

A number of measures exist of market structure ; those normally associated with the retail sector are measures of concentration, after the market share of the largest five or ten organisations. A similar measure is the Herfindahl Index, Kwoka (1985) which is the sum of the squares of the percentage market shares of all competitors. However, while a Herfindahl Index is calculated for Japanese retailing, the calculation is made on data only for larger, self-service retail businesses (0.8% of all outlets) and not on the sector as a whole. Its value as a measure of the structure of the Japanese retail sector is useful but limited.

Examining changes in concentration is itself a narrow view of change in retail structure. An alternative is to assess the trend in the total number of fixed shops, or the ratio of this to that of the population. It has been argued that such a measure is influenced by both retail concentration and the average size of a retail store (Davies and Whitehead, 1995). The measure reflects both retail concentration and store size, the two targets of the change in legislation of interest here.

In a market unrestricted by regulation, the number of fixed shops can be expected to fall over time, as larger shops are more economical to operate (NEDO, 1979, CNW, 1991b). Expansionist retailers will, if they can, tend to build such shops, if they can obtain planning permission. Such retailers can also use their market power to become more profitable if they are not constrained in their negotiations with suppliers (Hollander and Omura (1989). Building more shops (and, if possible, larger ones) increases market power. Economies of scope and scale combine to promote the growth of larger stores operated by larger retailers, and small-scale retailers exit from the market. The total number of stores falls. If expenditure rises due to increased wealth or an increase in population the number of stores may not fall as rapidly. When comparing the retail sectors of two countries the more important issue is that of population size. Two similar economies with similar populations will have comparable numbers of retail outlets. This is, in essence, the argument used by Davies and Whitehead (1995) to support the use of the ratio of population to store numbers as a measure of market structure when comparing retail market structures or in monitoring retail markets over time.

Legislation and Retail Structure in Japan

The very different nature of the distribution system in Japan has received considerable attention (Goldman, 1990a, 1990b ; Larke, 1994 ; Taga and Uehara, 1994 ; Turumi, 1982 ; Watanabe, 1994 ; Kakeda, 1994). It is multi-layered, with as many as three different layers between a manufacturer and a retailer. With some exceptions, as with milk products, there is little direct negotiation between manufacturer and retailer. Retail concentration is low (Kuwahara, 1997). There are a great many small, independently owned re-

tail outlets. Personal service rather than self-service is still the norm (MITI, 1994). Large-scale retailers have been seen traditionally as a major threat to the small scale, independent retailer in Japan (Dawson and Sato, 1995 ; Tajima and Miyashita, 1985 ; Tajima, 1984 ; Uno, 1985 ; Akiyama, 1977 ; Iwashita, 1997).

Legislation affecting the retail sector in Japan during the latter half of the 20th century involved two phases, the first up until the late 1980s and the second from the late 1980s until the present day. Up until the 1980's, legislation had been enacted to develop and to protect small-scale retail business. The Law for the Promotion of Small and Medium Retail Business (the PSMRB law) in 1959, and the subsequent Law for the Promotion of Private Enterprise (the PPE law) in 1959, were specifically designed to promote growth among small and medium sized retailers (Tajima, 1982). The Large Scale Retail Store Law (the LSRS Law) was first introduced in 1973 to restrict competition from larger stores, inter alia, by limiting opening hours (Larke, 1994).

The LSRS law was amended in 1979 to apply to stores below the earlier limit of 1500 square metres in size (variations in the size threshold also applied in different regions). Thereafter it applied to any stores above 500 square metres in size. Critics of the LSRS law claim that it served to reduce competition among large retailers (Goldman, 1990a, 199b) while having little effect on retail structure (Flath, 1990). This argument is based on the rapid expansion of chains of stores of a size below the 500 square meter threshold and especially of convenience store chains operated by larger businesses. Convenience stores are defined as having 'sales space between 50 and 499 square metres and where the style of shopping is self-service.'

The opening hours are more than 12 per day and closing time is after 2100 hours (MITI, 1985). (The Japanese Franchise Chain Association has a slightly different definition of the convenience store : sales space between 60 and 230 square metres, trading more than 1500 items opening more than 14 hours a day, more than 340 days a year). The number of convenience stores doubled between 1982 and 1994, but even by then still only represented 3% of all stores, albeit a higher percentage of food sales. The feature dominating Japanese retailing by the end of this period was still the large number of small (independently owned) shops by comparison with the situation in other developed countries, and the high ratio of stores to population, (Table 1).

Table 1 : Population per Retail Outlet, Selected Countries

Country	No. of Retail Outlets 1994	Population 1994 (000)	Population per Outlet 1994
France	326,142	57,900	177.5
UK	306,600	58,395	190.5
USA	977,400	260,660	266.7
Japan	1,499,948	124,960	83.3

Sources : European Marketing Data and Statistics 1999, 34th Edition, Euromonitor plc, London, from national sources.

International Marketing Data and Statistics 1999, 23rd Edition, Euromonitor plc, London, from national sources

In the late 1980s negotiations between the Japanese and American Governments on a wide range of trade issues resulted in the publication in 1990 of a Structural Impediments Initiative (the SII report), providing a 'momentum for a sweeping transformation in public policies' (Watanabe, 1994). The negotiations were about more than just the retail sector. Change in legislation was argued for here to promote the growth of large-scale retailing, so as

to promote easier access to the consumer market for American suppliers. Under the new legislation small stores were still to be allowed to retain certain advantages including greater flexibility in their opening hours. Planning permission for large stores had previously needed the consent of local retailers and the planning process could last up to 10 years (Dawson and Sato, 1995). The LSRS law was amended in 1992 and was to be abolished to ease the planning process. The PSMRB law was also amended in 1992 but a new law, for the Development of Specific Shopping Centres (the DSSC law) was introduced to promote retail business in general and smaller retailers in particular. Nevertheless, a very different legislative environment had been introduced. The new planning application process differed somewhat by size of city but there had been a general loosening of the restrictions on the building of larger stores. Planning applications for larger outlets increased rapidly in the 1980s (Larke, 1994), in anticipation of the introduction of formal legislation.

Hypotheses

The purpose of our analysis is to appraise the effect on the Japanese retail structure of legislation since 1973. It would be expected that such a significant change in the legislative environment would provide a significant change in any established trend in the evolution of the retail sector, as this was one of the aims of the change in legislation. It is possible, therefore, to propose two hypotheses, on the assumption that other factors affecting the retail sector remain the same.

H1 (a and b) test whether retail structure, measured by the trend in store numbers and concentration, was affected by the change in legislative emphasis :

H1 (a) The decline in the ratio of retail store numbers to population in Japan in the 1980s / 1990s is significantly different from the trend in the 1970s / 1980s.

(d) The direction of the trends differs in the same periods, with the second phase showing a greater reduction in the ratio.

If both hypotheses fail, then there is no evidence that the change in legislative environment have, thus far, affected the retail structure in Japan. The null hypothesis in both cases is that the change in legislation has had no effect on retail structure.

The second hypothesis, **H2**, is used to test whether any new trend demonstrates that the new legislation has created as significant an effect as would be expected. Given Japan's unusually high number of retail outlets, a rapid fall in the outlet to population ratio as well as a rise in concentration would be expected, one significantly higher than in countries where the ratio is already low.

H2 The decline in retail store numbers in Japan in the 1980s / 1990s is lower than that which would be expected from international comparison.

If this fails, then even though the legislation may have influenced the retail structure in the direction expected, the change is smaller than might have been expected. The null hypothesis here would be that the legislation had not been as effective as might have been expected.

Analysis

The country chosen for comparison for the purpose of testing H2 is the United Kingdom. Japan and the UK have some similarities that are relevant to any comparison of distribution. They occupy a similar latitude and climate. They have similar population densities and car ownership. They differ slightly in the percentage of women working outside of the home (Table 2).

Table 2 : UK and Japanese Comparative Statistics

	UK	Japan
Population (000)	58,276	125,768
Urbanisation (%)	89.9	78.0
Land Area (Km ²)	244,755	369,700
Population / Km ²	238	339
% economically active females	43.9	40.5
Passenger Cars in Use (m)	26.1	41.3

Sources : European Marketing Data and Statistics 1999, 34th Edition, Euromonitor, London, from national statistics for 1997. International Marketing Data and Statistics 1999, 23rd Edition, Euromonitor, London, from national statistics for 1997. International Marketing Data and Statistics 1998, 22nd Edition, Euromonitor, London, from national statistics for 1997.

However, the structure of their retail sectors differs markedly when the key statistics for this paper, the ratio of population to shop numbers are compared (Table 3). The trend in concentration is also presented for Japan using the available Herfindahl Index for the same period. The method of obtaining the British data changed significantly after 1994 and so more recent British data is not shown. No Herfindahl data is available for the British market.

Table 3 Trends in Retail Structure in Japan and the UK

Year	Population per Outlet : Japan	Herfindahl Index : Japan	Population per Outlet : UK
1997	88.94		
1996			
1995			
1994	83.36	795	201.36
1993		675	190.17
1992		709	182.41
1991	77.97	728	169.03
1990		678	165.41
1989		707	163.88
1988	75.77	666	169.11
1987		629	165.24
1986		609	165.75
1985	74.31	590	161.96
1984		556	
1983		561	
1982	68.99	591	
1981		630	
1980		670	
1979	69.39	662	
1978		660	
1977		679	
1976	70.07		
1975			
1974	71.93		
1973			
1972	71.93		

Sources : MITI, Census of Commerce, Ministry of Finance, Tokyo, various dates
 CSO, UK Annual Abstract of Statistics, Central Statistics Office, London, various dates

The British data shows a steady and accelerating increase in the ratio of population numbers to retail outlet numbers, caused by a decline in the number of outlets. The Japanese data shows two trends ; a decrease in the same ratio for the years 1972 up until the middle 1980s and an increase from that time until 1997 (Figure 1 and Table 3). The differences between the British and Japanese ratios in the same year are large. During this time period Japan had more than twice the number of retail outlets compared with the number one might expect by examining the British data. The data series were analysed using correlation and regression (Table 4).

Although the trend in the Japanese data is one of overall significant growth in the ratio of population to outlet numbers from 1972 to 1997, dividing the data into two subsets reveals a steeper growth in the later years and a decline from 1972 to 1982. Japan would have been unique among developed economies in having a decrease in the ratio of population to shops between 1972 and 1982. The same pattern emerges from the Herfindahl data. Concentration decreased from 1977 up to 1985, from when it rose. The effect of

Table 4 : Trend Analysis of UK and Japanese Data

Population per Outlet	Correlation			Regression	
	R	R ²	Sig R	Sig F	Beta
UK 1985-1994	0.845	0.714	0.001	0.002	3.71
Japan 1972-1997	0.858	0.736	0.003	0.002	0.649
Japna 1982-1997	0.980	0.956	0.001	0.001	1.23
Japan 1972-1982	-0.944	0.880	0.009	0.017	-2.68
Uk 1988-1994	0.897	0.805	0.003	0.006	5.94
Herfindahl Index					
Japan 1977-1994	0.494	0.244	0.014	0.037	5.63
Japan 1985-1994	0.819	0.671	0.00	0.001	17.36
Japan 1977-1985	-0.895	-0.801	0.016	0.001	-15.81

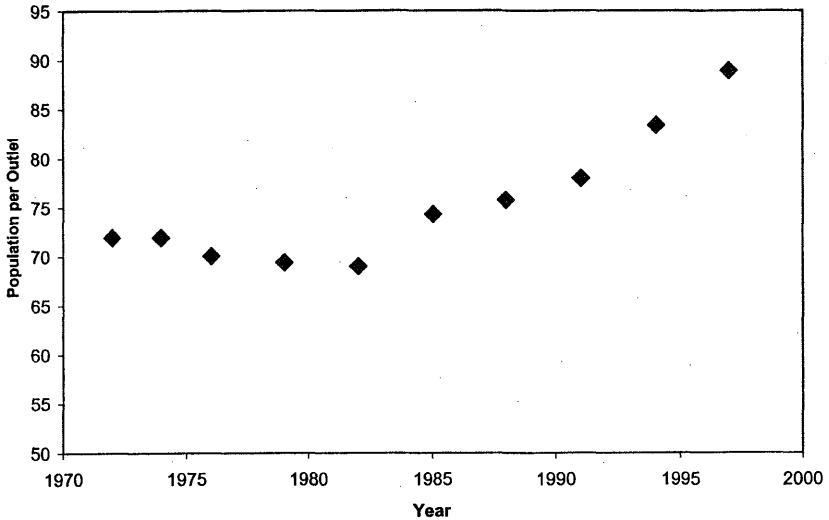


Fig (1) Population per Outlet in Japan

a change in legislative approach during and following the negotiations with the USA could explain these changes. Whether the change in trend is statistically significant can be tested using piecewise linear multiple regression, as in Equation 1.

$$\text{Japanese Population / Shop} = B_1 + B_2 (\text{Year}) + B_3 (\text{Year} - \text{Year}_t) + e \quad (1)$$

In Equation (1) B_1 B_2 B_3 are constants, Year is the year in question, Year is the year of the suspected change in trend (1982) and e is the residual error. If B_3 is significantly different from zero, the trends either side of 1982 are different (Pindyek and Rubinfeld, 1991). B_3 has a value of 1.55, giving a probability of better than 0.0001 than the two trends differ. The slope of the data set prior to 1982 is negative, and after 1982, positive (Table 4). Both parts of Hypothesis 1 are supported.

This finding cannot be used to argue that the change in legislation was the *cause* of the change in retail structure, merely that the change in legislation is contemporary with the change in structure. However from the null hypothesis, the proposition that no effect occurred as a result of change in legislation can be rejected.

The second hypothesis, that the recent trend of a decline in store numbers is higher than would be expected from international comparison, can be tested by comparing the analyses from the Japanese data with that from the British data in Table 4. The gradients for the 1982-1994 Japanese data and the 1985-1994 British data are both positive. The number of stores in both countries was declining, but the rate of change in the British market was higher. The collection method for the British data changed slightly in 1988, but the gradient from 1988 to 1994 is even steeper and it is even less likely to be similar to that for the Japanese data. The slopes of the two lines from 1985 to 1994 were compared using Equation 2.

$$\text{Population / Outlet} = B_1 + B_2 (\text{Year}) + B_3(D) + B_4 (D * \text{Year}) + e \quad (2)$$

Here B_1 , B_2 , B_3 and B_4 are constants, Year is the in question, D is a dummy variable of value 0 for Japan and 1 for the UK, and e is the residual error. B_4 is significantly different from zero at better than 0.001 probability. The two data sets do not share the same slope. The regression values show that the increase in population per outlet in the UK is higher than in Japan. H2 is supported.

Given that the retail structure in Japan had been constrained by legislation designed to promote the independent sector, the change in legislative en-

vironment should have produced a more rapid change in the population to store ratio than in the UK, where planning legislation had been more liberal. The opposite is true. One explanation for the more rapid change in the British ratio was the further liberalisation of the planning process in the 1980s, when the maxim of 'existing adequate provision' was suddenly withdrawn as a criterion by which local planning authorities could refuse to sanction new developments. There followed a substantial growth in out-of-town retail development. The change in the British figures still provides a useful guide as to the rate of change that is possible under liberalised legislation. The Japanese context cannot be said to compare. The change in legislative environment in Japan has probably had a significant effect on the trend in retail structure but by no means as high as might have been possible. To try to understand why the effect has been so muted, we analysed the approaches being used towards new building by the six largest Japanese retailers, those who should have been affected most by the change in legislation.

Store Development by Individual Retailers

During the period 1985 to 1997, the six largest retailers in Japan were Ito Yokado, Jusco, Uni, Seiyu, Daie and Mycal, MITI (1994). The total number of stores they operated grew from 872 to over 1,250 in this period. (Some of this growth come from the consolidation of subsidiary companies into the accounts of the parent, making direct comparison of store numbers difficult). The average size of the stores they operated increased, from 4,680 square metres in 1985 to 6,474 square metres in 1997, MITI (1994-7). The picture this data provides is one of slow growth in store numbers but a faster growth in average store size. A somewhat clearer picture of the retailers'

strategies emerges when the data on the value of new stores opened and old stores shut are analysed (Table 5, Figure 2). Retailers have been building new stores but have also been closing stores at high rate.

Figure 2 takes the total value of closed and opened stores for the top six retailers in Table 5 and compares these two figures over time, identifying the net gain in the value of new stores for these retailers. Between 1985 and 1993 the policy among larger retailers was to increase their sales potential mainly by 'scrap and rebuild'. Instead of building more stores the focus has been on the sale of older smaller stores and investment in newer, larger outlets in better locations. Two peaks in investment occurred, one in 1989, the other in 1992. The first coincides with the agreement between the Japanese and American governments to liberalise trade, the second with the various amendments to existing legislation and new legislation in 1992.

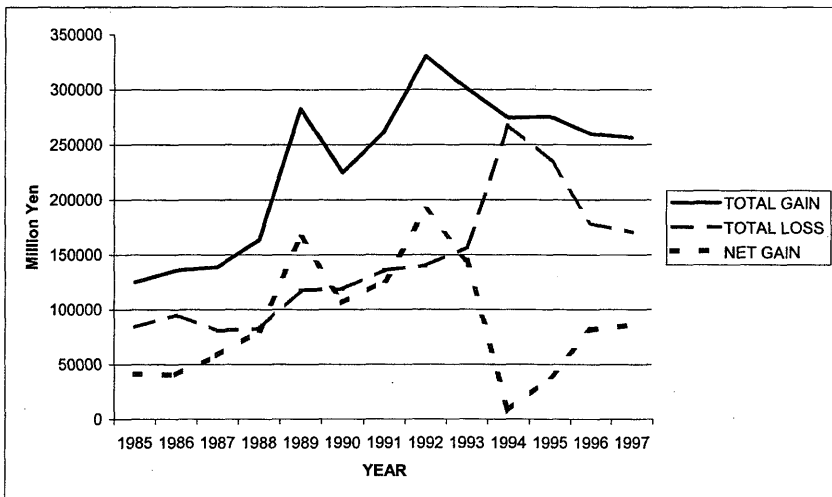


Figure 2 : Changes in the Values of Stores Opened and Closed by the Six Largest Japanese Retailers

Table 5 : Trends in Japanese Store Investment by Value 1985-1997

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997
RETAILER													
Ito-Yokado	35538	19669	24334	21862	36765	37193	43155	66932	33987	34613	41612	71494	19040
Jusco	28985	29798	40431	38563	46458	69401	57831	61079	89563	119791	109152	54298	90495
Uni	17316	30138	17826	29178	30098	34978	35151	40745	34436	28629	54327	46407	73726
Seiyu	14153	7940	17217	20043	84119	23657	25689	36909	35439	16447	17268	17538	20782
Daie	14629	18111	12470	22388	18569	15600	26050	39056	36505	25591	31834	51450	32245
Mycal	14359	30283	26654	31498	66626	43895	74196	85326	70984	49307	21150	18632	20043
TOTAL GAIN	124980	135939	138932	163532	282635	224724	262072	330047	300914	274378	275343	259819	256331
TOTAL LOSS													
Ito-Yokado	18718	10743	13647	10844	18838	16995	15532	32293	19777	18546	20870	47473	11943
Jusco	18784	19024	23394	27473	29892	42817	40925	36790	62466	89259	78440	40154	60148
Uni	8811	13717	9646	17670	18257	22347	21932	24863	22381	22963	36445	35361	46717
Seiyu	6407	3215	3341	7925	24767	9147	29718	12364	20646	8974	13214	23116	19225
Daie	21075	29648	12134	10700	5871	7426	6682	18795	5274	5620	38912	19384	9321
Mycal	10323	18920	18441	7836	19847	20047	20912	14816	25824	122063	48122	13041	23252
NET GAIN	40862	40672	58329	81084	165163	105945	126371	190126	14546	6953	39340	81290	85725

Source : MITI (1994-7), Units : Million Yen

However, in the later 1990s there was a sharp fall in the net gain figures. The increase in closures in 1995 was a precursor to an imminent phase of new building but this has been at a relatively low level.

The strategies being followed by individual retailers differed. Jusco, Uni and Mycal opened some stores in new locations as might have been expected following an easing of planning legislation, but they concentrated on rebuilding or relocating existing stores. Ito Yokado reacted more slowly, but then focused on relocating or rebuilding existing stores. Daie (until

1996) chose only to refurbish its existing stores, upgrading its rather utilitarian hypermarkets rather than building new stores or relocating existing stores. The Kobe earthquake also affected it financially. Seiyu has had more serious financial problems, due to an investment failure in its subsidiary, Tokyo City Finance. It has been restructuring, reducing its workforce and has been unable to take advantage of the change in legislation. The combined effect of the different strategies created a virtual standstill in total net gain in 1994, Figure 2. The overall trend to 'scrap and rebuild' then continued, although at lower levels than in 1992. Matters were not helped by the recent poor performance of the Japanese economy and the pressure this has placed on even the largest of retailers.

The change in legislation has not produced a totally free market. Land prices, the need to protect green belt land and other planning issues are still constraints on retailers wishing to expend. The planning process is now much faster, albeit still taking one and half year from application to permission. That said, only certain of the largest retailers have chosen to or have been able to take advantage of the new environment by opening large number of new stores. Four of the largest retailers have chosen to rebuild or to relocate existing stores rather than to concentrate on building new stores. There has been an increase in the average size of the stores operated by the larger retailers but less of an increase in the total number of large stores. Retailers appear to be seeking to benefit from increased scope economy (wider range on the same site by increasing store size) rather than on scale economy (more purchasing power from greater sales of the same goods by increasing store numbers).

Conclusions

Using two measures of retail structure, the ratio population to stores and a modified Herfindahl Index, the changes in legislative environment in Japan can be seen to be associated with a change in that country's unusual retail structure. Correlation is no guarantee of causality, and many things can affect retail structure. Nevertheless, the null hypotheses that no change in structure occurred at the time of the easing of Japan's legislation in favour of large-scale retailing can be rejected. However, the rate of change in structure has been comparatively slow. The structure of the retail sector is changing faster in countries such as the UK, and so further legislation or other changes may be needed if Japanese retailing is to develop along western lines. The political power of the small business sector in Japan and the possible effects on transportation demand and unemployment if further changes in legislation were to be introduced, are factors that may constrain the introduction of more radical legislation. The strategy of some larger multiples to increase the number and size of their stores is already a feature of the market. They had been already been increasing their investment in new stores and this accelerated after the changes in legislation. Other has been more conservative, constrained by either lack of funds or by following different policies.

Two other factors have inhibited any recent growth by large-scale retailers. First the Japanese economy has been in recession. Second, some retailers have taken the view that a further easing of planning law is possible, following pressure from the American Government at the World Trade Organisation. New legislation has been proposed, to be introduced in June 2000. The current LSRS law is to be replaced by legislation with a focus on the

environmental impact of proposed new building. Two other initiatives would be introduced, one concerning city planning, the other concerned with the promotion of small-scale retailing. However the reported positions of the American government and the Japanese Chain Store Association are that the new thinking could add considerably to the costs of operating larger stores and, further, that the new legislation and associated guidelines appear ambiguous and therefore open to interpretation at local level, where smaller retailers have more power to influence planning decisions. The reaction of one retailer, Ito Yokado, has even been to accelerate its new store opening plans ahead of what is seen as a possible return to a more restrictive planning regime after 2001.

One implication of our analysis is that a rapid opening up of the Japanese market to ease access to the major channel for the distribution of consumer goods has not occurred. The slow growth in the numbers of larger retail stores and large-scale retail businesses in Japan implies that the retail sector there will not become as powerful as its counterparts in other countries, at least not in the short to medium term. While it is not possible at the time of writing to be clear about the likely impact of the next phase of proposed changes in legislation, the status quo could well prevail. This has implications for suppliers. Manufacturers will not experience the same pressures as in countries where retailing is highly concentrated. At the same time, access to the Japanese market for foreign suppliers and retailers will continue to be an issue.

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