Genesis of divisional management and accounting systems in the House of Mitsui, 1710-1730

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GENESIS OF DIVISIONAL MANAGEMENT
AND ACCOUNTING SYSTEMS IN THE
HOUSE OF MITSUI, 1710-1730

Abstract: Early in the 18th century the House of Mitsui created a divisionalized administrative structure with a general office known as Omotokata in order to control many operating shops. This paper examines the divisional administrative structure and accounting systems that the House of Mitsui developed between 1710 and 1730.

Introduction

Mitsui is known as one of the largest business enterprises in Japan. "Mitsui family opened its first shop five years before the Pilgrims landed in New England, and established a bank—still operating in the same location—in 1683, a decade before the Bank of England was founded." After the Meiji Restoration (1868), the House of Mitsui was a leader of Japan's industrialization, and by the early 20th century it developed into a huge economic empire known as the Mitsui Zaibatsu.

This paper will focus on the House of Mitsui in the early 18th century, when it established the foundation for its subsequent development. Newly-rising merchants, including the House of Mitsui, grew rapidly in the surge of commodity markets during the late 17th century. Faced with a national economic recession after the mid-1710s, they rearranged their administrative structures. The objective of this paper is to examine the divisional administrative structure and accounting systems that the House of Mitsui developed between 1710 and 1730.

The research for this paper is based on the many business documents that have survived and are preserved in the House of Mitsui Archives Collection at the Mitsui Research Institute for Social and Economic History (Mitsui Bunko), Tokyo. Existing financial records
include ledgers (daifuku-chō), accounting reports (mokuroku, Omotokata kanjō-mokuroku), duplicates of reports (mokuroku-todome), summaries of reports (tairoku), etc. These records help us understand both the accounting system of the House of Mitsui’s general office, called Omotokata, and the accounting systems of two different types of operating divisions.

**Divisional Administrative Structure under Omotokata**

The House of Mitsui, founded by Mitsui Takatoshi (1622-1694), grew rapidly in the third quarter of the 17th century. In 1710, a central body known as Omotokata was formed to control sixteen operating shops located in Kyoto, Edo (present Tokyo) and Osaka. (Note that O in O-motokata means great or general and motokata means proprietor or controller.) Legally, Omotokata was a general partnership composed of the heads of nine families of Takatoshi’s descendants.² It was not in charge of actual operations but held the investments in operating shops like a pure holding company of today.* Each of the shops carried on business under its own firm name. Administratively, Omotokata resembled “a general office” in the multidivisional organization, which “plans, coordinates, and appraises the work of a number of operating divisions and allocates to them the necessary personnel, facilities, funds, and other resources.”³

Since almost all the premises of the House of Mitsui belonged to Omotokata, operating shops, therefore, leased the shop premises and paid their rent semiannually—to Omotokata. Omotokata held the investments in operating shops (their amounts sometimes changed) and received their fixed interest semiannually (its rate differed among operating shops). Beside the investments, Omotokata also gave temporary loans to operating shops. Employees in the upper two-thirds of the job-ranks were allocated by Omotokata.⁴

The arrangement of the operating shops under Omotokata took a long time. The original structure of 1710 illustrated in Figure 1 was

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*Mitsui’s investment-holding general family partnership was rather unique, while a decentralized administrative structure was common among the new wealthy merchants.

In order to unite a decentralized structure, the new wealthy merchant formed an institutional confederation composed of one main family and its branch families: a main family held a main shop and branch families held a branch shop. However, the solidarity in such a family group was not so strong. Some branch families could compete with a main family and other branch families. To counter the trend toward dispersion of family capital through independence of branch families, the House of Mitsui organized Omotokata as a central body to consolidate the family capital and to control a divisionalized administrative structure.
gradually changed by trial and error. By 1729, as shown in Figure 2, Mitsui's divisional structure came to consist of two major operating divisions and one original shop. (Matsusaka was the birthplace of Takatoshi.) The textile fabric division (the chain of silk fabric shops and cotton fabric shops) may be characterized as a "scaled down, specialized U[unitary]-form structure," while the banking division (the chain of banking shops) as a scaled down multidivisional structure. The difference will be discussed later in connection with their accounting systems.

The residual profit generated by the division over and above the cost of capital was employed as a measure of divisional performance. In the operating shops, reserves for bad debts and for employees' retirement allowances were set aside semiannually. Then, every three years, 10 percent of the residual profit was paid for bonuses to managers and other employees, and 90 percent was treated as liabilities of the operating shops to Omotokata. After such "every three years settlements" the latter amount was transferred to Omotokata through annual installments spread over several years.6

The Accounting System and the Financial Structure of Omotokata7

The House of Mitsui established accounting systems in accordance with Omotokata and its underlying divisional structure. Separate accounting systems were set up for Omotokata and for the operating shops. There was no consolidated accounting of Omotokata and the operating shops.

Omotokata calculated net income semiannually (dated July 14 and December 31), using the double profit measurement in property calculation and income calculation:8

\[
\text{ASSETS} - (\text{LIABILITIES} + \text{OPENING CAPITAL}) = \text{NET INCOME}
\]

\[
\text{REVENUES} - \text{EXPENSES} = \text{NET INCOME}
\]

They also compiled the capital calculation:

\[
\text{OPENING CAPITAL} + \text{NET INCOME} = \text{CAPITAL}
\]

This amount was carried forward to the next period.

The property calculation did not include the premises, since all capital expenditures on the premises were treated as expenses and all proceeds on sale of premises were treated as revenues. Therefore, in addition to the capital calculation, the net worth was calculated as follows:
Figure 1
Structure under Omotokata in 1710

Partners
(Heads of 9 Families)

(1) transferred to one of Mitsui's top managers in 1724.

Figure 2
Structure under Omotokata in 1729

(1) absorbed the Kyoto Purveyor Office in 1718 and the Kyoto Cotton Shop in 1729.
(2) absorbed the Edo Purveyor Office in 1718.
(3) absorbed the Osaka Cotton Fabric Shop in 1729.
(4) affiliated with the Kyoto Silk Fabric Shop in 1729.
(5) affiliated with the Kyoto Banking Shop in 1719.
(6) affiliated with the Kyoto Banking Shop in 1729.
CAPITAL + APPRAISED VALUE OF PREMISES = NET WORTH

Accounting reports prepared according to these procedures give us certain information about the financial structure of Omotokata. The total assets of Omotokata increased from 10,607 kan at the beginning of 1710 to 23,712 kan at the end of 1730. Partners’ equity constituted about 90 percent of total equities, except the year of its organization, 1710, when the debts from the Kyoto Banking Shop for the initial financing formed about 20 percent of the total equities. The appraised value of premises constituted nearly 40 percent of the total assets of Omotokata at the beginning of 1710 and then gradually dropped to 14 percent at the end of 1730 as the total assets increased. Assets other than the premises included the investments and loans to operating shops and the claims to the residual profit retained in operating shops. The component ratio of investments gradually dropped from 67 percent of all the assets except the premises (42 percent of the total assets) at the beginning of 1710 to comparable figures of 34 percent (28 percent) at the end of 1720, and 13 percent (11 percent) at the end of 1730. The loans to the operating shops, with considerable fluctuations, formed 20 to 40 percent of all the assets except the premises. The claims to the residual profit retained in the operating shops comprised 25 to 49 percent of all the assets except the premises. Other assets involved cash and loans to heads of families, to managers, to daimyos (feudal lords), and to others.

The ordinary revenues of Omotokata consisted of fixed interest received on investments in operating shops, interest received on loans, rental received on shop premises, and gains from money exchange. About one half to three quarters of the ordinary revenues consisted of fixed interest received on the investments. The amount of rental received was about one quarter of the amount of the fixed interest. It should be stressed that the ordinary revenues nearly balanced with all expenses and that the main source of net profit (increase of capital) was the special revenues on the “every three years settlements.”

The expenses of Omotokata consisted of fixed fees for family living costs, ceremonial occasions expenses, donations to daimyos, and general administrative expenses, including the partners’ salaries and traveling expenses of family-heads, top managers’ salaries, and office supplies expenses. It is notable that the fees for family living costs were paid to non-partners as well as to partners. The amount of these fees rose slightly with an increase in the number of children. It is also notable that top managers’ bonuses paid
by divisions on the "every three years settlements" were sometimes much higher than their salaries paid by Omotokata.

The Accounting Systems and the Financial Structures of Operating Shops

The Chain of Banking Shops

Three banking shops and the Yarn Shop had independent accounting systems, although the Kyoto Banking Shop collected and distributed the residual profit of its affiliated shops.

The Kyoto Banking Shop and its two affiliated banking shops calculated net income semiannually, using the double profit measurement in property calculation and income calculation.

A part of the semiannual net income of the affiliates was set aside as a reserve for their bad debts. The residual profit of the affiliates was then transferred to the Kyoto Banking Shop and added to its net income. A part of the Kyoto Banking Shop's total profit was set aside as a reserve for its bad debts and for employees' retirement allowances. Ten percent of the residual profit was set aside as a reserve for bonuses to managers and other employees. Further, on the "every three years settlements," the reserve for bonuses was charged when bonuses were paid, and 90 percent was treated as liabilities to Omotokata (to be transferred through annual installments).

Most of the total equities of the Kyoto Banking Shop consisted of investments and loans from Omotokata, liabilities to pay the residual profit to Omotokata, and reserves. Considerable amounts of the assets comprised investments and loans to the affiliates. Other assets were bills of exchange receivable, loans to daimyos, etc.

Most of the total equities of two affiliated banking shops consisted of investments and loans from the Kyoto Banking Shop, and the reserve for bad debts. Their main assets were composed of direct loans to merchants.

Almost all the revenues of three banking shops were interest received. The majority of their expenses consisted of interest paid. Other expenses included salaries to middle managers, charges for board of resident employees, donations to daimyos, etc.

The Chain of Silk Fabric Shops

In contrast with the banking shops, each shop in the chain of silk fabric shops did not operate its own double profit measurement in property calculation and income calculation. The Kyoto Silk Fabric
Shop combined the figures in its books and the books of its affiliated shops and calculated semiannually the double profit measurement for the chain of silk fabric shops. The entire chain of silk fabric shops was treated as one profit center, because virtually all business activities in the silk fabric shops were closely interrelated with activities in the Kyoto Silk Fabric Shop. For example, in 1711, about 80 percent of the goods purchased by the Kyoto Silk Fabric Shop were shipped to the Edo Silk Fabric Shop, and about 80 percent of sales of the Edo Silk Fabric Shop and about 50 percent of sales of the Osaka Silk Fabric Shop depended on the goods shipped from the Kyoto Silk Fabric Shop. Since the Kyoto Silk Fabric Shop fixed the selling prices, which included profit, of the goods shipped to the Edo and Osaka shops, they could not calculate profit on sales of the goods received from the Kyoto Silk Fabric Shop. But they recorded profit on sales of self-purchased goods and interest received.

The semiannual profit measurement in property calculation and income calculation for the Kyoto Silk Fabric Shop was different from those for Omotokata and for the banking shops. The property calculation of the Kyoto Silk Fabric Shop measured net income by adding up the net assets (total assets minus all liabilities except the residual profit to be transferred to Omotokata) of itself and of the affiliated shops, and subtracting the investments from Omotokata and retained profit (including the residual profit to be transferred to Omotokata). The income calculation measured net income by adding up profit on sales recorded at the Kyoto Silk Fabric Shop (actual sales were done by each shop and some profit recorded at each shop) and then subtracting the rental and interest to Omotokata, donations to daimyos, middle managers' salaries, reserves for managers' and other employees' bonuses paid on the "every three years settlements," and other items. It is notable that the chain of silk fabric shops was vague about the distinction between expense and profit appropriation.

**Conclusion**

Early in the 18th century the House of Mitsui created a divisionalized administrative structure with the general office known as Omotokata in order to control many operating shops. To help achieve this objective, the House of Mitsui also formulated hierarchical accounting systems for Omotokata and divisions. Since the banking division was subdivided into geographic subdivisions, each banking shop was treated as a separate profit center. In the textile
fabric division, by contrast, all the shops formed one profit center as a whole, because this division was subdivided along functional lines.

The House of Mitsui, with its unique structure under Omotokata, continued to earn a comfortable profit until the 1740s and became one of the largest business enterprises in Japan. However, Omotokata and its underlying structure began to stagger. Because of the friction among heads of the Mitsui families and the overall financial difficulties, Omotokata was divided in 1774, in a way like a spin-off of today. The Mitsui families were separated into three groups: one family group directly held the chain of textile fabric shops, another group the chain of banking shops, and the other group the original shop. Omotokata returned to the original form through reconsolidation in 1797, though each division now accumulated its own residual profit. After several attempts to put old wine into new bottles in the Meiji era, Omotokata finally became the incorporated Mitsui Gomei Kaisha, the stock-holding company of the Mitsui Zaibatsu, in 1909.

FOOTNOTES

1 Roberts, p. 3.
2 Nakada, pp. 258-260.
3 Chandler, p. 2.
5 Williamson, p. 136.
6 See House of Mitsui Archives Collection—Omotokata kanjo-mokuroku, san-kan-nen daikanjo jibu-ichi-wari, and san-nen kanjo jibu-ichi-warikata no no ukagai-cho.
7 This section is based on Omotokata kanjo-mokuroku in House of Mitsui Archives Collection.
8 For an analytical interpretation on “double profit measurement in property calculation and income calculation” diffused among the wealthy merchants, see Takatera.
9 The following subsection is based on mokuroku-cho, dailuku-cho, mokuroku-todome, and Edo-dana mokuroku-todome in House of Mitsui Archives Collection.
Instead of inter-shop transfer prices, standard amounts in sales, inventories, and some expenses were set for remote control of shop operations. Mitsui jigyo-shi, Vol. I, pp. 200, 201.
12 Mokuroku and tairoku in House of Mitsui Archives Collection.
14 Roberts, chaps. 8-14.

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House of Mitsui Archives Collection (of primary source materials) at the Mitsui Research Institute for Social and Economic History (Mitsui Bunko), Tokyo. The collection includes daifuku-cho, 1728 (material number Zoku 855); Edo-dana mokuroku-todome, 1786-1790 (Hon 1778); mokuroku, from the second half of 1710 to the second half of 1711 (Hon 1354-3, 1360-1, 1360-2, 2023-17, 2026-7, 2027-1); mokuroku-cho, 1728-1737 (Hon 1748); mokuroku-todome, 1786-1797 (Hon 1763); Omotokata kanjo-mokuroku, from the first half of 1710 to the second half of 1730 (Zoku 2855 to Zoku 2889); san-ka-nen daikanjo jibu-ichi-wari, 1725-1727 (Betsu 690-6); san-nen kanjo jibu-ichi-wari-kata no ukagai-cho, 1722-1724 (Zoku 6370); tairoku, the first half of 1719 to the second half of 1730 (Zoku 3135 to Zoku 3163).


