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Sourcing in America: Tangible Issues — As Seen By The Japanese

*Tetsuo Kasuya**

It is a great honor to be invited here today to comment on “Sourcing in Canada-U.S. as seen by a Japanese Multinational.” Today, I have chosen to pinpoint several tangible issues concerning sourcing from the United States because these are issues that Americans and Japanese *can* do something about, unlike the more abstract issues in macroeconomic policy such as the yen-dollar exchange rate and interest rates.

I. HISTORY OF JAPAN

Looking back on Japanese history, one finds substantial changes almost every forty years. In 1868 Japan moved into the modern age with the Meiji Restoration; in 1905 Japan sailed proudly in triumph over the Russians; and in 1945 it hoisted the white flag in the Pacific, marking the culmination of its military expansion. From war-induced poverty just forty years ago, Japan has matured into the second largest economy in the world. A paucity of natural resources has caused Japan to rely on exports as a principal means of economic growth, and as a vehicle for recovery from the ruins of war.

On September 22, 1985, Japan was one of five industrial powers assembled in New York for the purpose of creating a balance in international trade by devaluing the U.S. dollar. The resulting G5 Plaza Agreement has proven to be a powerful blow to the Japanese economy. Over the last two and one-half years since the New York meeting the Japanese yen has almost doubled its strength against the U.S. dollar. This has significantly changed world trade by annihilating the competitiveness of many Japanese export items.

II. JAPAN'S TRANSFORMATION EFFORTS

Japan is attempting to transform from a predominantly export-oriented economy to a more domestic consumption-oriented economy. Documents reveal that exports have declined as a primary reason for Japan's economic growth relative to domestic consumption. However, one cannot expect domestic consumption to easily displace a national inclination for exporting that has existed for over forty years. The cur-

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rent transformation of the industrial structure is both drastic and dramatic.

Japan's transformation efforts have produced positive results in two areas. First, Japan has undergone about a 7.0% economic expansion in the last quarter of 1987. Second, as a result of the strength of the yen Japan has experienced a substantial increase in its import of manufactured goods since the latter part of 1986, as well as receiving commensurately low-cost imports of raw material and raw products.

III. AMERICA'S TRANSFORMATION EFFORTS

America's transformation efforts after the substantial adjustment of the over-valued dollar merits analysis. The export boom is a popular topic these days, a topic which has been long dormant in the U.S. media.¹ But in spite of the surge in the export of American products, Japanese import figures from the United States are not impressive. Since 1986, Japan has imported almost 50% more goods from Asian newly industrialized countries (NICs) and almost 20% more from Europe, but unfortunately only 10% from the United States. This defies predictions that Japan's import figure from the United States would show an encouraging increase because of the precipitous decline of the U.S. dollar.²

With the devaluation of the dollar, U.S. manufacturers expected to regain market strength. For example, before the G5 Plaza Agreement, Detroit boasted that since the disproportionately over-valued dollar was advantaging the Japanese, American auto manufacturers would drive Japanese cars out of the U.S. market once the dollar value was adjusted to 200 yen per dollar. Today the yen is valued at 125 per dollar and Japanese cars continue to maintain a strong presence in the United States. Furthermore, the U.S. auto manufacturers have not substantially increased their exports to Japan. In 1987 Japan imported only 4,000 American cars, compared to 100,000 cars from Europe. Of the 18.2% overall increase in automobile imports, the U.S. imports accounted for a mere 8.2% of the total.

Executives of several American companies cite a variety of reasons for the lackluster increase in sales of U.S. goods in Japan and for the higher-than-expected prices of these goods.³ They assert that many subsidiaries of American companies in Japan are not free to set their own prices, but that in Japan, quality and close relationships with customers are more important than product price in gaining market share. They also cite the fact that the products of NICs remain much less expensive

¹ The recent efforts of American business to adjust to the over-valued dollar has been followed by the media. See *How Bad? Will Wall Street Take the Economy Down?*, BUS. WK., Nov. 2, 1987; *Wake up America?*, BUS. WK., Nov. 16, 1987; *Made in the USA*, BUS. WK., Feb. 29, 1988.

² Chira, *Weaker Dollar Fails to Bring a Jump in U.S. Sales to Japan*, N.Y. Times, Mar. 2, 1988, at A1.

³ *Id.*

than American products. Some may expect these executives to have listed tariff barriers as a major hindrance to exporting but they have not since Japanese tariffs are on par with — or even lower than — the U.S. tariffs.

In addition to the problems American executives recognize, the Japanese see two additional factors. The Japanese believe that American companies need to give an extra effort to their selling initiatives in Japan. This need for extra initiative is due to: the labyrinthine distribution system in Japan, the especially keen competition with Japanese companies who are satisfied with a much lower percentage of profit than are American companies, the existing close relationships between suppliers and customers, and other cultural gaps affecting consumer preferences.

A second factor as seen by the Japanese is that American manufacturers have been spoiled by both industrial and individual American consumers who have become accustomed to mediocrity, to chaos, and to compromise. In response, some American manufacturers continue to offer mediocre products and service.

“On average, consumers have problems with one in four purchases they make. . . .”⁴ I will use my own experience with the problems of defective products as an example. My washing machine recently broke, and I waited not only many days for a repairer just to arrive, but also several weeks for the machine actually to be fixed. On the first visit the repairer was not authorized to repair the machine; on the second, the repairer was not carrying the necessary part. In addition, the repair office staff was impolite and indifferent to my plight. In Japan a company with poor service like this does not survive since the Japanese consumer demands near perfection.

IV. AMERICAN INDUSTRIAL STRUCTURE

Several reasons behind America's less-than-spectacular exportations to Japan hinge upon the American industrial structure. Where Japan's foundation was exportation, America's foundation was domestic consumption. America is twenty-five times bigger than Japan and has twice Japan's population. Sufficiently rich in resources to be self-contained, American manufacturers' survival was not contingent on exports; thus many of them produced solely for domestic supply and only exported surplus goods. America's market is so vast that it has become the target market for developing and under-developed countries. According to one report, competition in the United States from both industrial countries and NICs increased from 17% in 1960 to 70% in 1970.

Also, in the era after World War II of *Pax Americana*, the inherent superiority of American products and technologies induced other countries to buy from America; thus ironically, the United States was actually

⁴ Hinds, *Seeking Profits in Consumer Complaints*, N.Y. Times, Mar. 26, 1988, at A40.

exporting without any concerted intent or effort to export. With the industrial development of many newcomers, including Japan and Asian NICs, America became the destination of these countries' promotion of exports. The tremendous attraction of the American market has encouraged and continues to encourage foreign competition within America and with American manufacturers. Unfortunately and unrealistically, American manufacturers, the hares in the race of technological superiority, continue to sell their products predominantly in the domestic market, while the tortoises of the world continue to build their shares in foreign markets.

Furthermore, in the 1970s, American manufacturers began establishing factories outside the United States in order to take advantage of the reasonably skilled, inexpensive labor located in Asia. They then began exporting these products to sell in the United States rather than in other countries. In addition, by moving many of their plants abroad, America's production power was decreased.

In the unparalleled vastness of the U.S. market a domestic focus would *seem* appropriate and natural, but paradoxically, the increasing global orientation of today's marketplace makes this focus very unnatural. In an era of a borderless world economy, American manufacturers must not be passive; they must seek markets abroad. It has been advocated that "every firm over \$25 million should be alarmed if it is not doing 25 percent of its business overseas, including some in Japan."⁵

Too often the executives that lead American companies are focused on next quarter's earnings and what the stock is doing today. Robert C. Goizueta, CEO of the Coca-Cola Company agreed that "[t]he only 'given' in capitalism is that a company's objective is to increase the value of its shareholders' investment." Japanese executives hold a different belief; that market share takes top priority while stock price ranks far down the list. America's corporate management cannot afford to pursue initiatives oblivious to profit or to wait patiently for a new investment to yield profits. Compared with the goals of the U.S. system, Japanese investments usually take longer to break even or to be profitable.

V. THE JAPANESE V. AMERICAN SYSTEM

Now that the weaknesses within American manufacturers' control has been analyzed, an examination of the *de facto* Japanese barriers to American exports are in order. This requires a focus on microeconomic issues as they function in the Japanese marketplace.

A. *Bond Between Vendor and Customer*

One of the most significant non-tariff barriers to entering the Japanese market or to dealing with the Japanese is the pre-existing bonds

⁵ T. PETERS, *THRIVING ON CHAOS: HANDBOOK FOR A MANAGEMENT REVOLUTION* (1987).

between the Japanese vendor and customer or seller and buyer. This is a bond that is established and reinforced over many years and is analogous to the bond between atoms in a molecule. It represents not only interdependence, but also mutual trust, reliability, and business adaptability. Japanese companies desire security and stability in a business relationship more than American companies do and the root of the Japanese fragile feelings toward newcomers or strangers stems from this cultural propensity.

B. Mergers and Acquisitions

An important aspect of this cultural inclination is the Japanese skepticism of the surge in mergers and acquisitions in the United States which often results in dramatically abrupt changes in management style, business ethos, and employee sentiment within a company. The Japanese are adverse to such change. Buyers need security and stability of supply; mergers and acquisitions undercut that need. When a supplier company is merged with or acquired by another, there is a fear that the perpetuity and smoothness of transactions will dissolve. If the supplier terminates production, the recipient manufacturer is then forced to cut off supply to its customers.

The Japanese are also faced with similar problems when a merger or acquisition occurs, but the uncertainty is minimized. Representatives of the new company will visit the manufacturer to offer goodwill and suggest other supply sources. In America the relationship has less structure and coordination.

C. Long-Term Relationships

A second de facto barrier may be that the Japanese place paramount importance on the long-term accumulation of mutual give-and-take exchanges. These exchanges are incorporeal rather than materialistic and so only under exceptional circumstances will buyers change their supply source or their sales source. In contrast, American companies often change their sources, sometimes with each subsequent deal or project.

President Nixon's embargo of soybeans to Japan in 1973 is still vivid in the memory of the Japanese. It is a fear of such "no supply" situations that is making the present agricultural negotiations more difficult and complicated than they should be. The Japanese are wary of such situations and look to the security of supply before investing in an industry. One crucial reason for the success of Japan's steel industry is that the source of iron ore and coal remains secure.

D. Responsibility: Total v. Contractual

A third barrier rests with the difference in Japanese and American companies' definition of "responsibility." A Japanese company usually assumes responsibility and moral liability for the total process: from

product development to customer satisfaction. It will fix or replace a defective product with minimal cost to the customer. An American manufacturer believes itself to be responsible only for specifications stipulated in the contract. The effect of this belief is that the customer may incur substantial repair bills should a product be defective.

Generally speaking, relying heavily on contextual rather than contractual obligations is one of many practices to which the Japanese society subscribes. Cultivating reciprocal trust and commitment takes time; in a sense, a relationship with a Japanese company is analogous to a human relationship in that it will be treasured for years. Therefore, if a company is successful in building up a good business relationship with a Japanese customer, that relationship will long continue, resulting in good returns.

VI. SOURCING: ASSURANCE AND STABILITY OF SUPPLY

Three major factors that initiate procurement of industrial products are *price*, *quality* and *delivery*. The Japanese also consider two additional criteria: the stability of supply and the assurance of supply.

An incident that occurred almost twenty years ago exemplifies the difference in American and Japanese attitudes toward the stability and assurance of supply. Upon the receipt of a new specialty steel in our Los Angeles office, I perused the industrial directories and compiled a list of potential customers in America. First I telephoned each one; next, I sent brochures and samples to those who showed interest; then, I sent price quotations to those who inquired. One day, I received a letter from a customer in Milwaukee; in this letter he placed a one year order for this new steel. I was pleasantly shocked by his decision to depend on me for a material crucial to his production without having a personal meeting.

In contrast, among the Japanese, fostering confidence with a supplier takes much time. In a situation when production depends on a long-term continuous supply, Japanese companies doubt American companies' commitment to pursue a stable, long-term relationship and to guarantee assurance and stability of supply. In general, the Japanese are more comfortable doing business within well-established relationships and are wary of firms outside of that relationship, whether Japanese or American. Consequently, changes in supplier or buyer are infrequent.

While Americans view this mindset as an unjustifiable barrier, the Japanese consider it a precautionary measure for economic well-being and a safeguard of their system. For example, once both parties establish confidence in each other, they are inclined to pursue an amicable and constructive settlement if any mishap arises instead of resorting to litigation.

This mutual benefit relationship can be taken a step further. A supplier, in making every effort to meet a buyer's meticulous demands, may raise the quality level of the supplied products. This will enhance the

technical level that the buyer's manufacturing process itself can achieve. For example, the supplier of auto parts to Honda produces parts with greater precision. These parts will enable Honda to use more industrial robots and automated machinery since these machines can best use parts with severe tolerances. These robotics increase Honda's productivity, so the relationship means that Honda's prosperity promotes that of the part supplier.

In a time of increasing competition in the international business arena, American companies need to understand the intricacies of foreign markets and the cultural values which make them tick. They need to demonstrate their willingness and capability to develop secure, responsible footholds overseas — be it by joint ventures, investments, direct sales, ownership, or by changing basic mindsets or policies.

VII. A MESSAGE FROM THE FIELD: SUMITOMO STEEL DIVISION SUMMIT

Just this past month in New York, Sumitomo's annual Steel Division Summit convened. Approximately twenty executives shared their knowledge of the field and discussed tangible grassroots issues. We analyzed a wide range of issues covering an extensive variety of activities such as: running steel mini-mills of an annual 300,000 ton capacity, operating steel service distribution centers, running pre-stressed concrete wire and strand factories, supplying material to Mazda, and importing and exporting steel products.

From this meeting we were able to compile salient reports on sourcing in the United States by the Japanese, pertaining to many sectors of the marketplace. According to one report, Japanese car manufacturers in the United States have set a 70% strategic target figure for indigenously supplied components, specifically: 60% for Nissan, 65% for Toyota, 70-75% for Mazda, and 75% for Honda. These manufacturers are anxiously seeking to establish stable relationships with local manufacturers.

One colleague emphasized that a first priority is procurement of U.S. made parts. Firms want to buy more parts, components, material, and equipment from American vendors and minimize the amount and number from Japan; however, these products must be of high quality and severe tolerances. If local procurement proves insufficient or unavailable, Japanese parts manufacturers will be urged to form a joint venture with an U.S. manufacturer. If such a joint venture proves to be unmanageable, then the Japanese car manufacturers will attempt to produce in-house. If this scheme also proves to be impractical, they will urge Japanese parts manufacturers to establish an independent company in the United States. If all else fails, the car manufacturers will import Japanese made parts.

In truth, Japanese standards are outrageously meticulous. But such

excess does not dismiss the fact that the Japanese do constitute a nation and a market. American products are by no means inferior, but when sourcing to Japan, American manufacturers need to conform their products to the market. There has been a recent movement within America to tailor products according to customers' needs. "In recent years American companies have changed their ways, and esthetic and consumer-research skills that had atrophied are now blossoming."⁶ They are "trying to find out just what it is that consumers want."⁷ By meeting the consumers' demands the manufacturers' sales will increase and technological advancement will result. The Japanese computer industry responded to consumers' needs by undertaking the formidable task of creating a Chinese character, Japanese language word processing software containing over 10,000 characters. In developing this new product, these companies improved the quality of their technology. American computer companies avoided committing themselves to this task, thus giving Japanese companies wider technical dimensions to conquer.

The summit meeting report concluded that in daily terms American companies operate "geocentrically" (Ptolemaic Theory: the earth is the center of the universe) and Japanese companies, "heliocentrically" (Copernican Theory: the earth moves). In reality it is the earth, not the sun, that moves. In lay terms, American companies live by the philosophy: "You buy what we make," while Japanese companies live by the philosophy: "We make what you can buy." The meeting participants noted that in America a "product-out" attitude took precedent over a "market-in" attitude.

VIII. THE JAPANESE INITIATIVE TO BUY AMERICAN

It is fair to mention that with the Japanese government's strong commitment to import American products, the majority of Japanese people have joined the "Buy American" initiative. As a result of such efforts, Japan is importing more American finished products than are France and the United Kingdom combined. This is reflected by agricultural imports also, as America sells over 75% of its beef to Japan.

Sumitomo Corporation has actively joined in this effort. Last year we cosponsored *The American Fair* at one of the major department stores in Tokyo. In preparation, we deployed a mission in search of excellent products "Made in the United States." Recently, a Sumitomo task force visited the state of South Carolina to meet with suppliers and manufacturers. Sourcing delegations for product lines such as construction and building materials are presently visiting potential suppliers in the United States.

⁶ Glabason, *Listening to the Consumer Again*, N.Y. Times, Apr. 6, 1988, at D1.

⁷ *Id.*

IX. CONCLUSION

The issues I have presented today are relative rather than absolute. Most things are relative, and generalization in absolute terms is misleading. Furthermore, I am not making value judgments about the American or the Japanese culture, but rather offering an analysis of the current economic status of both and the interactions therewithin. I truly hope that in my discussion I have touched upon some truths that have added to your knowledge and understanding of U.S. competitiveness in the world context, especially regarding sourcing in the United States. It is unfortunate that “in both [Japan and America] a perception is spreading that one’s own country is the victim, and the other nation is the aggressor.”⁸ No country is completely free and open; not even America is an exception.

We need to generate better understanding between our two countries by reducing some of these tangible obstacles to sourcing in the United States. One must also realize the difference between access and result; free access to the market does not automatically produce good results. In other words, access is not synonymous with success. Some Americans believe that American products which are sold in the United States also should be sold in Japan. Japan can offer access to its markets, but great results cannot be guaranteed. The Japanese consumer, after all, has “freedom of choice to buy or not to buy.” In addition, the Japanese market is excessively demanding and works by different standards. Access is the *door*; result is a product of *effort* and *performance*. When in Japan, American manufacturers must compete and prove the quality of their products and services. In any country, market share does not automatically exist.

Mr. Kenichi Ohmae, the Director of McKinsey & Company, Tokyo, brings depth to this issue:

The other side of the equation is that once our market is open, the Americans must make real efforts. Americans have been good at opening up our markets, but poor at the follow-through needed to win long-term shares of our markets. . . .

I hope the Americans will be committed to serving our markets, otherwise they will be opening them for everyone else. American companies are too risk adverse and impatient to become real ‘insiders’.

Let me add that there is a great lesson hidden in the proverbial ham and eggs breakfast. While the hens are only involved, the pigs are committed.

I would like to close by quoting Mr. Mansfield:

[The interdependence between the U.S. and Japan] is a fact that we deny at our own peril. . . with patience and a clear sense of our mutual

⁸ Mike Mansfield, U.S. Ambassador to Japan, quoted in *A Troubled Partnership: Perseverance, Not Passion, Is What We Need Now*, FORBES, Jan. 11, 1988, at 2.

interests and priorities, I believe that the U.S.-Japan partnership that has been forged with so much effort over the past 40 years will not falter. It will remain the force that assures the peace and prosperity of the Pacific region.

Thank you for your interest and attention.