The U.S.-Japanese negotiations on cars and car parts ended with the Americans claiming victory, and cheering that they forced Japan's automakers to buy an extra $12 billion of U.S. parts by 1998. But the agreement contained some useful axle grease for Japanese companies as well. In fact, if they use it to smooth the political path at home, Toyota, Nissan and every manufacturer in Japan may finally learn what the rest of the world knows about making money buying foreign parts in a marketplace without borders.

This is a particularly good time for Japanese companies to take the plunge. They all are reeling from the impact of the rising yen, or endaka. Toyota claims it loses 10 billion yen on its annual profits for every one yen rise in the dollar exchange rate -- with the recent appreciation of the yen from 100 to 80 per dollar this year's loss would be about $2 billion. Electronics giant Toshiba complains that it loses 6 billion yen yearly for every one yen rise in the dollar exchange rate.

The solution, of course, is to leverage the value of the strong yen to procure parts from overseas. Right now, for instance, an automobile muffler selling in the U.S. for under $30 costs more than 20,000 yen -- or about $230 - in Japan. Imported circuit boards are about 35% cheaper than comparable Japanese products, and the list goes on and on.

In years past, Japanese companies had some legitimate excuses for not outsourcing. Parts suppliers generally were not reliable. Their product quality was bad or uneven, and the suppliers themselves were not responsive to cost cutting measures. None of that is true anymore. There are multiple, reliable suppliers for almost any product or component in demand. If you can't find a good, cheap supplier in Japan, you can go to Korea, Taiwan, Indonesia, the United States, wherever. All you need is a good "global outsourcing" strategy: to pick and choose reliable suppliers who have quality parts and to make the cost of the final product competitive under any exchange rate.

Sadly, this is precisely what many Japanese manufacturers lack. They do have intricate and sophisticated international sales networks. But most do not have well connected global outsourcing information networks. Until now, who needed them? The Japanese language is also a formidable barrier, especially for relatively small-time manufacturers who need or want to talk to overseas suppliers. Language compatibility is one reason why PC makers in the U.S. have have turned to Korea, Taiwan, and Hong Kong for most parts.

The end result, though, is that the Americans are selling notebook PCs at prices that Japanese PC makers can't beat. Or can they? Consider the small manufacturer in Japan selling in a dollar-denominated market. In a typical case, the imported components needed to make the product are 17% to 50% cheaper than similar components available in Japan at 100 yen to the dollar.

Naturally, the manufacturer's profit margin decreases as the yen appreciates. But if the percentage of imported content of the product is increased accordingly, this not only compensates for any loss, but can actually increase the margin of profit.

During the recent row with the United States, we all heard complaints from the American side about the small fraction of imported parts in Japanese automobiles. The percentages of imported components for all Japanese corporations range between about 5% to 15%. For example, at Toshiba Corporation, imported parts account for only about 10% of the total procurement expenses. For Toyota, Nissan and Mitsubishi, the top three in Japan, the parts purchases from the U.S. as a percentage of cost of sales ranged between 6% and 7.7% in 1994.

This is good news because it means Japanese companies still have a lot of room to increase the percentage of imported parts in the products they manufacture. Even with small purchases from the U.S., Toyota made a handsome profit of more than $1 billion in 1994, when the exchange rate was about 100 yen to the dollar.
Computer models indicate that even when the exchange rate goes below 80 yen to the dollar, Toyota or any other Japanese manufacturer can achieve 20% to 30% profit margins by managing -- and in this case increasing -- the percentage of imported components.

The bottom line is that the strategic control of globally outsourced parts will lead to higher Japanese corporate profits. This will boost the stock market, which the Japanese government is desperate to invigorate, and help the ailing financial sector as well. In the process, of course, using a strong yen to buy up parts in the U.S. would reduce the trade imbalance.

Of course, parts importation will always have social implications, like the industrial hollowing that occurs when outsourcing reduces the need for local factory and other workers. But America’s experience shows that it need not end badly. When the dollar was high, many U.S. companies looked overseas, particularly in Southeast Asia, for parts. Some American jobs were lost. Yet many new jobs were created in the U.S, mostly in the service sector supporting the big corporations’ global outsourcing operations. The phenomenal growth of carrier services like Federal Express is a good example.

And did global outsourcing damage the competitive position of the U.S.? No. Look at the U.S. computer industry, where the leader in outsourcing is making the least expensive and most competitive computers in the world. Or at automobile manufacturing where, for all the complaints, America is a world leader in terms of units produced and Chrysler, using imported parts, builds cars cheaper than Toyota. Or at aircraft manufacturing and Boeing, procuring parts from all over the world (including Japan) and a world leader.

Japan can do the same. There is no reason to avoid it any longer. Japanese consumers are demanding affordable products. The recent car and car parts flap did provide a kind of political cover. And endaka is the most attractive inducement of all for Japanese companies to get into global outsourcing -- and get competitive.

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