Japan's Changing Automotive Industry

By Shibata Yasuhiko

Japan's automotive industry, which has led the world in annual production volume for the last 14 years in a row, now faces an unprecedented crisis. With the double punch from declining international competitiveness brought on the yen's rapid surge and the structural recession that began with the collapse of the bubble economy, corporate earnings have trended downward since their 1989 peak. The close of the financial term in mid-September witnessed a succession of car companies reporting current deficits. This is why automakers, starting with Japan's largest, Toyota Motor Corp., are studying ways of streamlining overcapacity and high cost structures, speeding the shift to overseas manufacturing, primarily in Southeast Asia, and hastening the restructuring on which they have wagered their survival.

However, in the only foreseeable future scenario, factories will be transplanted overseas, leading to a hollowing out that will cause domestic production of new vehicles to fall below 10 million, or a conversion to business dependent upon continually flat domestic demand. In 1994 the U.S. recaptured the lead in new vehicle production for the first time in 15 years, making a solid comeback as the "land where the car is king." Now Japanese manufacturers stand at the crossroads leading to decline or rebirth.

Toyota's metamorphosis

"We want to achieve ¥10 trillion in sales and a 4% operating profit ratio by 1996." Reporting financial results in Nagoya at the end of August, Toyota's president, Toyoda Tatsuro, announced the company's "comeback" despite the first declines in income and profits in seven years. This was supported by an assurance of self confidence that thorough cost cuts would soon be achieved.

During four consecutive quarters of declining profits the company has attacked its ballooning corporate structure head-on through drastic manufacturing process reforms, referred to as value analysis (VA) and value engineering (VE). VA is a methodology for achieving cost cuts by reviewing the parts materials and forms used in mass-produced models to promote interchangeability among various models. VE, on the other hand, involves the consideration of functions and production costs from the design stage in an effort to achieve profitability in car manufacturing even when a model is not mass produced.

Through these two new methodologies Toyota has begun on the one hand to strive for 15% cost reductions in parts procurement within three years, and also to try to broadly cut development costs by reducing the time required to develop new models in half, from 36 to 18 months. By also taking steps to reengineer its business by reorganizing the ranks of white collar management that swelled during the bubble period, having eight people handle work formerly done by 10, and, moreover, moving ahead with a compulsory 10% reduction in total working hours, a system under which seven people can accomplish the work of 10 has been put in place.

Photo: Kyodo News Service

Car makers all plan joint production, concentrating on fully-assembled passenger vehicles, and a steady stream of executives have been visiting China. Toyota has been quickest off the mark and plans passenger vehicle production in Tianjin. President Toyoda Tatsuro being welcomed in China.

At Toyota, which has a reputation for slow decision-making but moving quickly once a decision is reached, it appears that even more restructuring designed to return ordinary profits to the ¥500 billion level, based upon ¥103 to the dollar, is on the way. Toyoda says, "We want to sell 6 million Toyotas around the world by the year 2000." Total combined domestic and overseas sales of new vehicles in 1993 came to 4.5 million, so to boost this by 1.5 million in the next six years the company will need to sell 250,000 more vehicles per year. There is a high possibility that thorough cost cuts and production of low-cost vehicles will spark industry reorganization and consolidation among Japan's 11 domestic manufacturers and Mr. Toyoda's dream could easily lead to the onset of a war in which only the fittest will survive.

Liquidating overcapacity

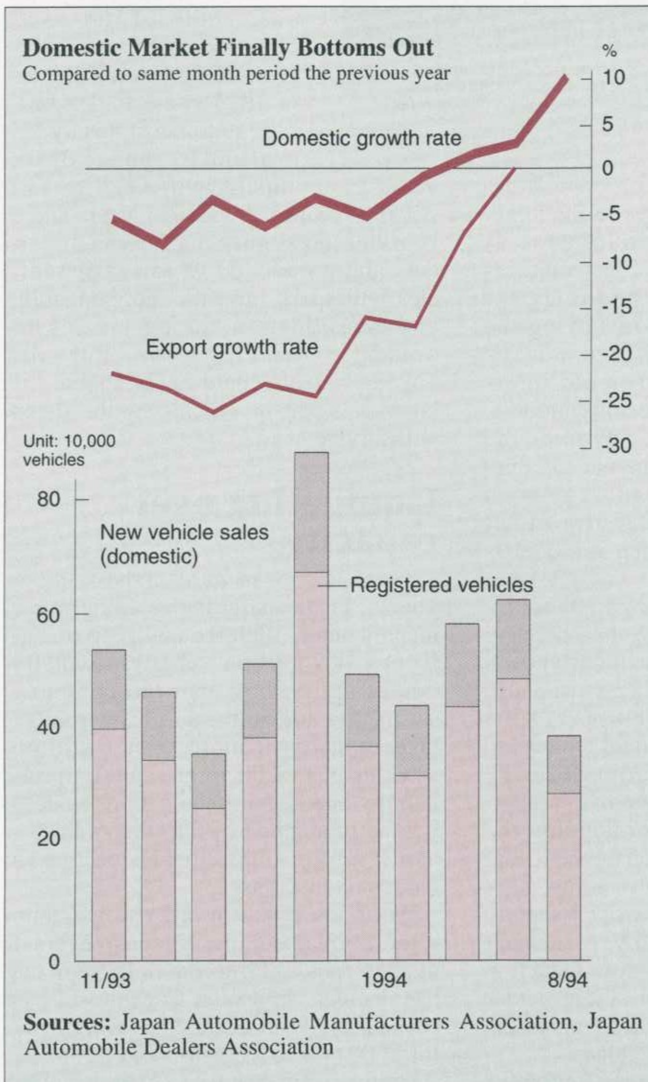
There is still an unresolved issue at Toyota, Japan's largest and strongest car manufacturer: With the ability to manufacture 4.5 million vehicles annually domestically, how can the company shrink and streamline surplus capacity? Overcapacity of more than 1 million vehicles is a factor in pressure on profitability and, leaving the goal of achieving the production of 6 million vehicles aside, Toyota has no choice but to reduce fixed assets.

Word has it that in order to maintain international competitiveness even if the yen falls to 80 to the dollar, Toyota has decided on a plan to achieve 30% cost cuts and sell a strategic "world car" for ¥600,000 to ¥1 million by 1998. As such, the overcapacity problem is not as

bad as at the other car firms, where it is still a headache for Nissan and the other lower-ranked companies. Excess capacity of 800,000 units at Nissan, 400,000 at Mazda, and 300,000 at Honda stands in the way of profitability and Mitsubishi Motors, which grabbed a larger share of the domestic market with recreational vehicles (RV) that proved to be a hit, is the only one with production capacity that matches vehicles sold.

Toyota appears set for an earnings recovery in the period ending March 1995. In contrast, number two Nissan has been unable to halt its skidding business results and has been adversely affected by flat sales of the updated Sunny compact it released in January 1994. This resulted from a marketing mistake—raising prices when they should instead have been lowered. As a result, although their sales plan calls for sales of 1.05 million vehicles during the current term, the forecast is that continuing flat sales will inevitably lead to an operating deficit of around ¥30 billion at the March 1995 close.

Similar to Nissan, Honda is in danger of reduced income and profits due to increased inventory and flat sales because the company was late in tackling low-priced models and RVs. Mazda appears set for a current deficit of ¥35 billion for the March 1995 term following upon the ¥44 billion loss in March 1994.



Sources: Japan Automobile Manufacturers Association, Japan Automobile Dealers Association

Survival

Regardless of appearances, the above shows that Toyota is not the only one struggling to reduce costs through restructuring. Nissan has implemented temporary closings at some of its luxury model plants and has seconded excess personnel who could not be kept on due to continually shrinking production to both Fuji Heavy Industries within the same keiretsu and, to general surprise, Isuzu Motors outside of the group.

In the sales arena as well, two sales firms, Sunny Chubu and Prince Nagoya, have merged and begun rationalization measures in Aichi Prefecture, by far the strongest region for Toyota. "We have no choice but to move ahead with sweeping re-engineering throughout the company," says Nissan president Tsuji Yoshifumi, pointing out cost cuts of ¥200 billion. These break down as follows: cost reviews of ¥100 billion across all sectors, ¥30 billion from cuts in model types and parts interchangeability, and ¥25 billion from layoffs of 5,000 people, accompanied by reviews of overseas manufacturing systems.

Honda is also scurrying to boost profitability through ¥46 billion in cost reductions in both manufacturing and sales along with ¥25 billion in write-offs, for a total of just over ¥70 billion, as is Mazda, by slashing over ¥80 billion in fixed costs. Along with these individual corporate efforts the industry as a whole is heading for a shake-up.

The parts used by various companies are being made interchangeable and original equipment manufacturing (OEM) under other companies' brands has begun. Toyota, Nissan, and Isuzu have decided to plunge ahead with joint manufacturing of engine parts for the small trucks they all produce overseas (in Thailand).

Fuji Heavy and Suzuki have also reached an OEM agreement under which Suzuki will supply the compacts it manufactures in Europe under the Fuji Heavy brand. Overseas versions of domestic OEM alliances, in which companies withdraw from unprofitable sectors and supplement each other in their areas of proficiency appear set to spread in the future, which is also to say that Japanese manufacturers will continue to suffer from flat domestic demand and the strong yen, but also face risks in overseas manufacturing.

Rethinking overseas strategies

Japanese car manufacturers' overseas investments shot up at the beginning of the 1980s when friction in Europe and the U.S. over cars began to heat up with Japan. Honda first decided to begin local production in the U.S. in 1982, after which Nissan, Toyota, Mazda, and Mitsubishi all branched overseas. Nissan, Toyota, and Honda expanded

into Europe as well and Mitsubishi will commence joint production in Holland next year. These overseas transplants have now spread to various Asian countries as well and overseas investments have skyrocketed in conjunction with these moves. For example, seen by affiliated firms' shareholdings alone, Nissan has invested more than ¥900 billion and Toyota over ¥800 billion, followed by Honda with ¥300 billion, Mitsubishi with ¥200 billion, and Mazda with ¥130 billion.

Naturally, this would not be a problem at all if overseas subsidiaries and affiliates were showing profits, but Honda's American plant is about the only one in the black. The profit balance has also improved at Nissan's U.S. operation, but Europe and Mexico are in the red, and losses are piling up in Spain, too. Mitsubishi Motors needs to produce 200,000 vehicles annually at its U.S. manufacturing base, Diamond Star Motors, to break even and inability to achieve this has hampered consolidated profits.

Seen in this light, and with a different aspect from domestic production, Japanese manufacturers have reached a crucial turning point in their overseas expansion. For one, the strong yen has led to reduced competitiveness in terms of price and, regardless of whether the economy is good or bad in the countries where they are located, sales promotion costs are rising because they cannot make a profit without maintaining certain levels of production and sales. In order to avoid this there is a pressing need to improve productivity by lowering the breakeven point and establishing flexible employment systems adapted to business cycles.

In addition, while in the past, expansion of market share was dependent upon low prices and good mileage, the emphasis has now shifted to quality, reliability, safety, environmental considerations, and other non-price competition investments must be prioritized on fewer models.

Japanese manufacturers and local manufacturers under their sphere of influence have acquired large shares in Southeast Asia (more than 90% of the ASEAN market). Including "knocked-down" (KD) kit exports and licensed manufacturing by local manufacturers, production volume in Asia is expected to reach around 2 million units by 1995, far outdistancing Western manufacturers. However, the reality is that there is too much competition between a plethora of small factories and, except for Thailand, where the consumer market is growing rapidly, the issue is how to consolidate efficiently.

Competition with Western manufacturers, in conjunction with increased imports of fully assembled vehicles, has also ratcheted up and Korean cars are expected to grab market share with their low prices, so the outlook is hardly optimistic.

Delayed expansion into China

Under these circumstances the way that Japanese manufacturers handle China, a huge, sleeping market, has become a matter of life or death. Said to be lagging Western manufacturers by three to four years as they study Chinese investments, manufacturers and their affiliated parts makers are all simultaneously starting to move.

In addition to Daihatsu, which furnishes Tianjin Automotive Industry Corp. with technology for compacts, Japanese manufacturers' investments in China since the beginning of the 1990s have amounted to no more than a minicar joint venture between Suzuki and Chengan Railway Co. and Fuji Heavy's licensing of minicar technology to China Guizhou Aviation Industry Corp. The delay has been considerable compared to the sedan manufacturing joint ventures set up by Germany's Volkswagen and France's Citroën and the compact car joint ventures established by Chrysler of the U.S. and France's Peugeot.

However, in July of 1994 the Chinese government decided to move ahead and permit new joint ventures and other foreign investments from 1996 if certain conditions are met, such as entry by parts makers. As a result, the top leaders of the parts companies in the Toyota group, led by Toyoda Tatsuro, visited China in September and formally announced collaboration in the form of investments. Toyota's strategy will take the form of a tie-up with Tianjin Automotive Industry Corp., a joint venture with Shanghai Automotive Industry Corp. to produce engines, and the provision of commercial vehicle technology to Jinlin Motors.

Further, Nissan is planning a partnership with Nanjing Auto Works, while Honda has decided on a link-up for completely locally produced motorcycle engines on the one hand and is also planning a joint venture with Dongfeng Motor Corp. to manufacture passenger vehicles. In other developments Mitsubishi Motors, backed by the strength of the 31 firms in the Mitsubishi group, will start developing low-priced compacts designed especially for the Chinese market and is moving toward local production through a joint venture with China North Industrial Group from 1996. Mazda has also signed a three-company joint venture agreement to produce 10,000 vehicles annually with a leading Chinese commercial vehicle manufacturer, Fuzhou Solid Motors Corp. Ltd., and Indonesia's Salim Group.

However, in addition to hurried attempts by Ford and GM from the U.S. to regain ground with parts partnerships and other new investments, Germany's Mercedes-Benz has embarked upon a manufacturing link-up to produce buses. Without a doubt, the struggle between Japan, Europe, and the U.S. for the Chinese market, with its low-cost labor force and huge consumer markets, is finally beginning to gather steam. Now that imports make up a ratio of more than 10% of Japan's domestic vehicle sales and the strong yen has left overseas investment as the only escape route, how many of the 11 Japanese manufacturers will survive? It is no exaggeration to say that the success or failure of investments in China is the key. ■

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