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OPINION

Toyota

Losing its shine

Dec 10th 2009

From The Economist print edition

Unless Akio Toyoda can find an answer to Toyota's problems, the Japanese company's reign as the world's biggest carmaker may be brief

Bloomberg



IT IS not unusual in Japan for corporate leaders to make semi-ritualised displays of humility. But when Akio Toyoda, president of Toyota Motor Corporation since June and grandson of the firm's founder, addressed an audience of Japanese journalists in October his words shocked the world's car industry.

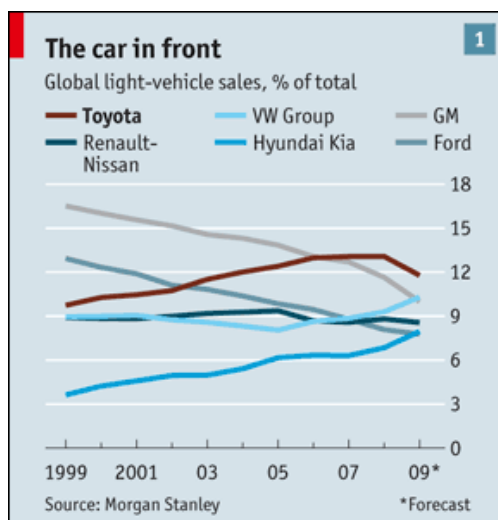
Mr Toyoda had been reading "How the Mighty Fall", a book by Jim Collins, an American management guru. In it, Mr Collins (best known for an earlier, more upbeat work, "Good to Great") describes the five stages through which a proud and thriving company passes on its way to becoming a basket-case. First comes hubris born of success; second, the undisciplined pursuit of more; third, denial of risk and peril; fourth, grasping for salvation; and last, capitulation to irrelevance or death.

Only 18 months ago Toyota displaced General Motors (GM), a fallen icon if ever there was one, as the world's biggest carmaker. But Mr Toyoda claimed that the book described his own company's position. Toyota, he reckoned, had already passed through the first three stages of corporate decline and had reached the critical fourth. According to Mr Collins, fourth-stage companies that react frantically to their plight in the belief that salvation lies in revolutionary change usually only hasten their demise. Instead they need calmness, focus and deliberate action.

Is Toyota really in such dire straits? And if it is, can a company that for decades has been the yardstick for manufacturing excellence turn itself around in time?

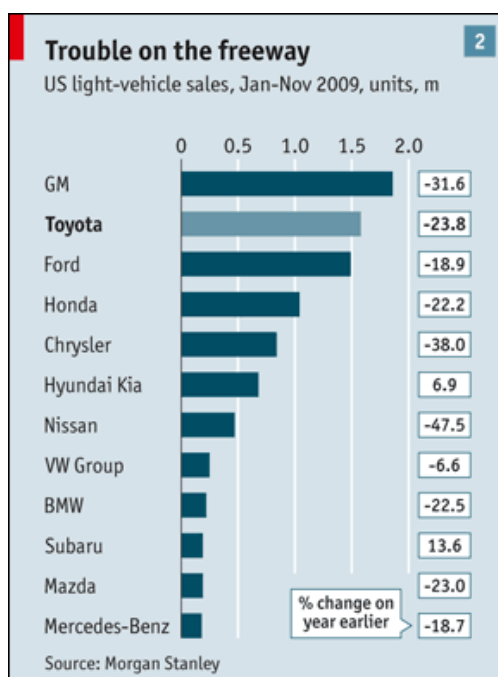
A reliable engine stalls

In many ways, Mr Toyoda is right to sound the alarm. Toyota could not have been expected to shrug off the storm that swept through the car industry after the collapse of Lehman Brothers in September last year; but rivals, notably Volkswagen (VW) of Germany and Hyundai Kia of South Korea, have weathered it far better. In the past Toyota went on racking up profits in booms and recessions alike. Not this time.



In the financial year that ended in March, amid admittedly the worst sales slump in the industry's modern history, Toyota made a net loss of ¥437 billion (\$4.3 billion), its first since 1950. Even more startling, the former cash machine (it had rung up a record profit of ¥1.7 trillion the year before) managed to lose ¥766 billion in the three months to March alone—the equivalent of \$2.5 billion more than GM did in the same period as it hurtled towards bankruptcy. Toyota expects to lose ¥200 billion this year. But for belated cost-cutting measures and falls in raw-material prices, the forecast would be worse.

Some analysts think that is conservative, because sales in America and Japan appear to be recovering slowly and costs are being slashed further (the company says it is shooting for "emergency profit improvements" of around ¥1.25 trillion). In the most recent quarter Toyota made a surprise net profit of ¥58 billion. It also raised its sales forecast for the year from 6.6m units to 7m. Much, however, depends on the yen-dollar exchange rate. The yen has been climbing, and a rise of ¥1 can subtract ¥30 billion from Toyota's bottom line.



What should be worrying Mr Toyoda more than the firm's short-term financial position—its cash pile is an enviable ¥2.65 trillion—is the loss of its once seemingly unstoppable market-share momentum. In 2002 the then president, Fujio Cho, declared that Toyota was aiming for 15% of the global market by 2010. It chased volume at almost any price. By 2007 Toyota's sales had reached nearly 9m cars, 13.1% of the world total. Last year that share was stable, but this year it seems likely to fall to 11.8% (see chart 1). It has been flat or falling in every important region except Japan, where it has benefited from generous tax breaks on hybrid vehicles, in which it is stronger than its domestic rivals.

In America, Toyota's largest and hitherto most profitable market, its share has stayed at around 16.5%, hardly a brilliant performance given Detroit's long, dark night of the soul. So far this year its sales are down by nearly

a quarter—a figure not as dreadful as GM's, but much worse than VW's and worse even than Ford's. Hyundai's sales went up (see chart 2).

In Europe, Toyota's share was the lowest since 2005. Most worrying, after several good years it fell back in China, not only the world's fastest-growing car market but now also its biggest. Toyota lost more than two points of market share, the worst performance of the 24 brands on sale in the country (see chart 3). In Brazil and India, Toyota scraped along with little more than 2% of either market.

Toyota's to-do list

There is plenty here to concern Mr Toyota. The first is that for a global carmaker Toyota has been slow off the mark in several emerging markets that are likely to provide nearly all the growth in sales when the mature markets of America, western Europe and Japan have recovered to something like normality. VW is far ahead of Toyota in China and out of sight in Brazil. GM, for all its difficulties, is still doing better than Toyota in China and sells nearly ten times as many vehicles in Brazil. Hyundai almost overtook Toyota in China this year and is the biggest foreign car brand in India. Toyota's first low-cost car designed especially for the price-sensitive Indian market is still a year away.



The second thing that Mr Toyota should reflect upon is that Toyota is sluggish for different reasons in different markets. This may make answers harder to find. In China, it took longer than rivals to respond to tax breaks for vehicles with smaller engines and it has made less effort to develop cars specifically for the Chinese market. In Europe, the solid but ageing Yaris and the dull Auris left it poorly placed to exploit the scrappage schemes that boosted sales, and its lack of a full range of competitive diesels continues to hinder it.

In America, Toyota is still hugely powerful. It sells more cars there than anyone (the Detroit Three remain highly dependent on big pickups and sport-utility vehicles), it leads in small trucks and it has the bestselling luxury brand in Lexus. But it has also been clobbered by an avalanche of bad publicity, after the recall of 3.8m Toyota and Lexus vehicles. The recall was prompted by the crash of a Lexus saloon in which a California Highway Patrol officer and his family were killed. The apparent cause was "unintended acceleration".

At first the National Highway Traffic Safety Administration (NHTSA) and Toyota thought that a badly fitting floor mat could have jammed the accelerator open. Both still think that probable. But the NHTSA is continuing its investigation, having received more than 400 complaints about acceleration problems that appear to have been responsible for several fatal accidents. It is now focusing on possible problems with the design of the throttle pedal and the vehicles' electronics. On November 25th Toyota announced that it would reshape the suspect pedals or fit redesigned ones in 4.26m vehicles. Some will also get reshaped floor-pans and a brake-override system.

America's ever-eager plaintiff lawyers already have Toyota in their sights. A Californian law firm specialising in customer class-action suits, McCuneWright, filed a suit on November 5th. Citing 16 known deaths and hundreds of injuries, it alleged that "neither driver error nor floor mats can explain away many other frightening instances of runaway Toyotas."

Almost every carmaker has had to contend with recalls and ambulance-chasing lawyers, but in a place as litigious as America the reputational damage can be severe. Audi (part of the VW Group) has taken more than 20 years to recover from reports of unintended-acceleration allegations that ultimately proved to be groundless.

In another class-action suit, triggered by a former employee, a corporate lawyer named Dimitrios Biller, Toyota is accused of trying to cover up evidence that it knew some of its vehicles could be deadly in rollover accidents. These were not high-sided SUVs, which are prone to rolling over, but its bestselling Camry and Corolla saloons. The company has raised questions about Mr Biller's veracity and employment record, but the allegations have not gone away. The suggestion that squeaky-clean Toyota's behaviour may have resembled that of Ford and GM, which in the distant past covered up problems with the Pinto and the Corvair, is especially wounding.

Last month Toyota's standing was dealt a further blow. The Insurance Institute for Highway Safety, a car-safety research group funded by insurers, announced its highest-rated cars and SUVs for 2010, having added a rollover roof-strength test this year. Not one of the 27 vehicles it chose was a Toyota. The company called this finding "extreme and misleading".

The danger in all of this for Toyota is that its loyal (and mostly satisfied) customers in America have long believed that the firm was different from others and thus hold it to a higher standard. The moment that Toyota is seen as just another big carmaker, a vital part of the mystique that has surrounded the brand will have been rubbed away.

Another part of that mystique has also suffered some scratches. Just as Cadillac used to be synonymous with luxury and BMW with sportiness, Toyota was a byword for quality and reliability. A few years ago its crown slipped when a number of quality problems surfaced. In July 2006, after a spate of well-publicised recalls, Katsuaki Watanabe, Mr Toyoda's immediate predecessor, bowed in apology and promised to fix things with a "customer first" programme that would redirect engineering resources and, if necessary, lengthen development times.

However, the recalls continued and Toyota started slipping in consumer-quality surveys. A year later *Consumer Reports*, an influential magazine, dropped three Toyota models from its recommended list. The magazine added that it would "no longer recommend any new or redesigned Toyota-built models without reliability data on a specific design".

People within the company believe these quality problems were caused by the strain put on the fabled Toyota Production System by the headlong pursuit of growth. Toyota now looks as though it has been largely successful in solving them. In the latest annual reliability study published by *Consumer Reports*, Toyota boasted 18 of the 48 leading vehicles. Honda, the next best, had only eight.

The report, however, also contained less welcome news. Ford vehicles, long among the also-rans, are now showing "world-class reliability". To back up the claim, Ford's highly praised new Fusion beat not only the Camry but also its main rival, the Honda Accord, as the best in the hugely important mid-size segment. In an annual study of the dependability of three-year-old vehicles, J.D. Power, an automotive consultancy, placed Buick (a GM brand) and Jaguar joint first, ahead of both Lexus and Toyota.

For years Toyota has been the quality benchmark for every carmaker, but at the very moment it faltered, others were finally catching up. The truth is that although a few fail to make the grade—Chrysler still has a lot of catching-up to do—most cars these days are extraordinarily well-made. The quality surveys by which buyers used to set such store are now based on minute differences. This is the main reason why the manufacturers' positions in the league tables have become increasingly volatile.

If Toyota can no longer rely on its superior quality to give it an edge, its vehicles will inevitably be judged increasingly on more emotional criteria, such as styling, ride, handling and cabin design. In America, Toyota is likely to face much more consistent competition from at least two of Detroit's Big Three, while both Hyundai and VW are starting to snap at its heels. The South Korean company has put on an astonishing spurt this year, adding about two points of market share to take it to 7.2%. Its Lexus-rivalling Genesis saloon was named North American car of the year. In 2010 it will start selling the new Sonata, which looks like being a great improvement over the old model, aiming it squarely at the Camry.

And whereas Toyota's sales have fallen by 23.8% in America so far this year, VW's sales have dropped by only 6.6%. In 2011 VW will start making cars in America after a break of more than 20 years. The first car out of the factory in Chattanooga, Tennessee, will be a saloon specially designed for the American market. It too will take on the Camry. VW is planning to double its sales in America by 2018, to around 800,000. Though far short of the record 2.6m vehicles Toyota sold in America in 2007, this is a sign of the German group's intent.

The relentless pace at which VW continues to churn out an unending succession of new models across its

unmatched stable of brands, each one keenly priced and brimming with showroom appeal, has shaken the rest of the industry, Toyota included. VW is laying plans that it believes will sweep it past Toyota to become the world's biggest carmaker within a decade. Even now, it is not far behind, although this year it has been helped by its geographic sales pattern compared with Toyota's. This week VW said it would buy a stake of 19.9% in Suzuki, a Japanese car- and motorcycle-maker that dominates the Indian market through Maruti, its local subsidiary (see [article](#)).

Pizzazz, please

How will Toyota respond? Publicity-shy Toyota executives hate announcing detailed strategies to the outside world. Nor have many of them yet come to terms with Mr Toyoda's urgency and appalling frankness. Uniformly they spout that his words about the firm "grasping for salvation" were widely misunderstood. But for all that, there is plenty going on behind the scenes beyond ferocious cost-cutting. Upon seizing the reins in June, Mr Toyoda immediately ordered a back-to-basics overhaul of product development across the firm's global operations.

One conclusion was that Toyota should be more ruthless in exploiting its early leadership in commercialising hybrid systems and electric-vehicle technology. Although every other big carmaker is launching new hybrids (including plug-ins) and purely battery-powered vehicles, or is preparing to, Toyota is convinced that it is still ahead of the pack. Within a few years there will be a hybrid version of every car Toyota makes and there are plans to extend the Prius brand to cover a range of innovative low- and zero-emission vehicles.

Another conclusion—and possibly a more radical notion—was that Toyota must stop making so many dull cars with all the appeal of household appliances. Importantly, Mr Toyoda is what is known as a "car guy", a part-time racer and an enthusiast for cars that are designed with passion to engage the right-side as much as the left-side of the customer's brain. At the Tokyo motor show in October he said pointedly: "I want to see Toyota build cars that are fun and exciting to drive."

As Morizo, the alter ego under which he blogs, Mr Toyoda went further. He said of the cars at the show: "It was all green. But I wonder how many inspired people to get excited. Eco-friendly cars are a prerequisite for the future, but there must be more than that." After trying VW's hot Scirocco coupé in July, he blogged: "I'm jealous! Morizo cannot afford to lose. I will tackle the challenge of creating a car with even more splendid flavour than the Scirocco." His favourite metaphor is that Toyota's engineers should be like chefs, seasoning their cars with tantalising flavours.

He still has some way to go. As *Car* magazine observed recently: "Excepting the small cars and the Prius, Toyota's European range is as appetising as an all-you-can eat tofu buffet." Strategic Vision, a market-research firm based in San Diego that studies the factors that drive both the choices car-buyers make and subsequent owner satisfaction, publishes an annual "Total Value Index" covering 23 different categories of vehicle. In this year's study, which was based on feedback from 48,000 buyers, for the first time Toyota had no winners at all. The authors of the study concluded that other carmakers had caught up with Toyota on quality while offering products that inspired greater "love".

There is also only so much that one man can do to shift the culture of a vast organisation. But there is nothing engineers like more than to be challenged, and Toyota employs many of the world's finest. The latest, third-generation Prius and the brilliant little iQ city car show what they are capable of. So, in a very different way, does the 202mph (325kph) Lexus LFA. *Kaizen*, the pursuit of continuous improvement, is, after all, embedded deep in Toyota's DNA and only needs prodding.

The test will be to keep the ingredients that have made Toyota great—the dependability and affordability—while adding the spice and the flavours that customers now demand. It will not be easy, and the competition has never looked more formidable. But by recognising the scale of Toyota's problems, by proclaiming their urgency and then by drawing on the firm's strengths to fix them, Mr Toyoda has already taken the first, vitally important, step towards salvation.



Morizo in a suit