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## **Japanese Auto Giants Accelerate Shift to U.S.**

As Their Home Market Continues to Shrink, Japan's Car Makers Look to American Drivers

By Norihiko Shirouzu and Todd Zaun

The latest sport-utility vehicle to hit the American market is bigger than its predecessor on the outside, bigger on legroom, bigger in the cargo area and beefier under the hood. In short, it's American in every imaginable way but one: It's the new Lexus RX330 SUV, from Toyota Motor Corp.

Making the old RX300 more American and less Japanese is exactly the point. For Toyota, as well as Honda Motor Co. and Nissan Motor Co., what American consumers want is becoming more important than the wishlists of consumers in Japan's shrinking market.

Vehicles such as the new Lexus SUV, a hulking Mississippi-made pickup truck Nissan plans to launch later this year, and Honda's new Ohio-built Element SUV, mark an important turn in the long-running battle between the auto titans of Japan and Detroit.

The Japanese are accelerating their shift away from their home market, which they see headed for long-term decline. Flush with cash earned largely in America, Toyota, Honda and Nissan are boosting investment in new factories, engineering labs and vehicles. They plan to storm the American car-and-truck market with an intensity that will rival their early-1980s assaults.

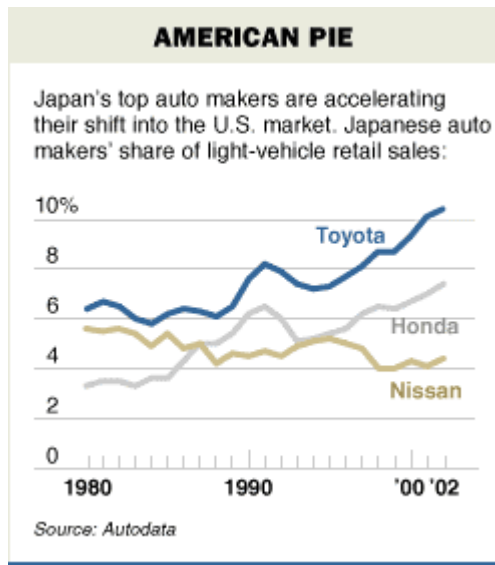
Gone are the days when Japan's top car makers would tread lightly in markets such as big pickups and SUVs for fear of a trade backlash and tough competition from Detroit. Almost nothing is sacred anymore, as Nissan executives will show this week when they come to Detroit's annual auto show to pocket the "Automobile of the Year" award from Automobile magazine for the new Nissan 350Z sports car.

Nissan Chief Executive Carlos Ghosn also is expected to unveil the new large pickup made in Mississippi and designed to compete head-on with Detroit cash cows such as the Chevy Silverado and Ford's redesigned F-150. Detroit executives are bracing for Toyota's rollout of a larger replacement for its Tundra V-8-powered pickup.

The result of Japan's picking on the pickup? A segment that supplies a huge chunk of annual revenue and profits for General Motors Corp., Ford Motor Co. and the Chrysler unit of DaimlerChrysler AG will suddenly become much more competitive, and potentially less profitable. For the Japanese giants, the math has become simple. With the market shrinking back home, even boosting your share of the pie might not mean higher sales and profit, notes Norio Matsumura, a Nissan executive vice president. "We have to look to America or to China -- the markets with potential," he says.

Toyota is leading the charge. About 60% of its vehicles sold in the U.S. are made in North America, and Toyota is about to unveil plans to build its sixth plant, probably in the Southern U.S. The company will increase capacity to 1.48 million vehicles this year from 1.25 million in 2002 as it completes expansion of plants in Indiana and Ontario.

## Ambitious Goal



Toyota's aim is to boost its share of the American car market to 15% by 2010 from about 10% today -- an ambitious goal in a brutally competitive market where executives are grateful to gain a tenth of a point over the course of a year. As it expands in America and other overseas markets, it is slowly scaling back production in Japan. The company expects to build 3.39 million vehicles in Japan this year, down 3% from 3.48 million vehicles in 2002. The company plans to increase overseas production by 15% this year to 2.48 million vehicles from 2.16 million last year.

The auto industry world-wide is heading into a period of expanded production -- particularly for vehicles aimed at North America -- while short-term sales growth in many major markets other than China appears to be stagnating.

This is worrisome news for Detroit's Big Three, which have been losing market share steadily to foreign rivals for years. Despite billions spent on discounts in 2002, Ford and Chrysler continued to lose market share, while GM needed a 36% increase in December sales to deliver a 0.4-point gain in share last year over the year before.

Even more ominous for Detroit: So far, the Japanese appear to be more profitable in America than Detroit. Toyota's pretax profit margin is running at 9.4% for the six months ended Sept. 30, compared with GM's 3% for the same period. And the weak yen helps Japanese car makers because dollars go a lot farther in buying major parts back home, where many still are made.

Toyota, Honda and Nissan have more going for them than just the yen. Their North American factories are more efficient than their U.S. rivals' plants, despite Detroit's efforts for more than 10 years to narrow the gap. The three Japanese companies also don't have to carry the same burden of pension and health-care costs either at home or in their overseas operations that Detroit's heavily unionized Big Three do. Analysts estimate that those expenses add about \$1,000 a vehicle to the cost of a Detroit model. Toyota and Honda still outscore GM, Ford and Chrysler on quality in the U.S., although there are signs that the lead is vulnerable. Honda and Toyota still have a lead on GM in product-development speed and manufacturing flexibility -- despite the No. 1 U.S. auto maker's impressive improvements in recent years.

Toyota engineers in Japan have begun developing vehicles without prototypes. They rely solely on past engineering knowledge and model new parts with computer-aided engineering tools. Toyota executives say the system, which will be used at its Ann Arbor, Mich., engineering center, allows the company to save 30% in development costs per vehicle.

## Attention to Detail

The obsession with America extends to the smallest details. Michigan-based Toyota engineer Dana Hargitt thought the "meep-meep" sound of the Japanese-designed horn in the previous-generation Camry sedan sounded too much like a synthesized Roadrunner. In Japan, auto horns

are blown to alert nearby pedestrians or show gratitude to another driver for letting you pass. Americans often use auto horns to vent their anger or to jolt other drivers and so avoid an accident. Mr. Hargitt says the new Camry horn sounds "powerful" and "aggressive," more like a trumpet.

More than a decade ago, Toyota's top executives commissioned detailed demographic studies that confirmed their fears: Japan was aging rapidly -- the population is now expected to begin shrinking in 2007. The U.S. market, on the other hand, was young and growing, thanks to a steady flow of Hispanic and Asian immigrants. The U.S. population is expected to grow through 2030, creating a massive market of some 400 million people.

The long-range demographic trends were reinforced by shorter-term concerns about trade tensions. In the mid-1990s, the Clinton administration came within hours of imposing sanctions that would have in effect barred Japanese auto makers from selling in the U.S. luxury cars such as Toyota's Lexus line. Japanese manufacturers, led by Toyota, avoided the sanctions by setting clear goals for increasing production in the U.S. Toyota said it would raise its North American production capacity to 900,000 in 1996 and to 1.1 million by 1998.

To be sure, Toyota, Honda and Nissan can make mistakes. In particular, surging sales of Detroit's SUVs in the early 1990s set the Japanese companies back on their heels for part of that decade. Today, some Toyota and Honda executives worry that the styling of their U.S. models is too bland and, more important, that quality is slipping as sales rise.

Toyota's reputation as the global industry's quality leader has suffered some dents. Shortly after its launch in the fall of 2001, the redesigned Toyota Camry, one of America's best-selling cars, became the target of complaints about "spongy" brakes and peeling roof trims, among other things. Art Niimi, head of Toyota's North American manufacturing operations, points to sporadic failures by Toyota's plant in Georgetown, Ky., where a majority of Camrys sold in North America are produced, to perform highly standardized assembly work precisely as prescribed. He also says more defective parts are appearing, although the overall ratio has fallen to 300 rejects per million parts from 3,000 rejects 15 years ago when the Kentucky plant opened.

So far the concerns about quality haven't undermined Toyota's U.S. sales, nor slowed the auto maker's drive to boost sales -- particularly with luxury vehicles such as the Lexus RX. Still, the latest RX will face far more competition than the old one. Honda, which responded in 2000 with its own car-based SUV, the Acura MDX, last year rolled out an MDX derivative called the Honda Pilot. Nissan just launched a jazzy crossover called the Murano, which will be followed within a few months by the sporty Infiniti FX45 crossover, while Volkswagen AG also is about to launch a crossover called the Touareg. Toyota itself offers a Lexus version of the Toyota 4Runner called the GX470.

The RX300, the first high-volume midsize SUV to be developed on a passenger-car platform, was a sensation when it was launched in 1998. With a smoother ride and higher fuel efficiency than many of Detroit's SUVs, which are based on pickup truck designs, it ignited the fastest-growing new automotive segment since the mass-market SUV emerged in the early 1990s. It helped boost Toyota's Lexus brand to the No. 1 spot in luxury-brand sales, past GM's Cadillac and Ford's Lincoln.

The idea to develop such an SUV came out of Toyota's success in Japan with the youth-oriented RAV4, a compact SUV based on the Corolla. Hideaki Miyahara, the father of the RAV4 and a product-planning chief at Toyota in Japan in the early-1990s, subsequently noted how many women in American suburbs were climbing into Ford Broncos and Chevrolet Suburbans to taxi kids to soccer practice or go grocery shopping. Toyota decided to create another crossover based on the Camry, which went on to become a smash hit, selling more than 75,000 vehicles each year, even though some U.S. executives felt the new vehicle, dubbed the RX300, would be handicapped by its smaller size, weaker engine and skimpier legroom than what Detroit was offering.

With the RX330, the U.S. executives got the bigger, beefier vehicle they were looking for. They fought to boost room for second-row passengers and the vehicle's cargo space. It was a battle since the time when Toyota designed the original RX300, says Chris Hostetter, vice president of advanced product strategy, because the Japanese designers, with their smaller physiques, generally aren't sympathetic to many Americans' need for leg and elbow room. When Japanese product planners and designers came to the U.S., Mr. Hostetter always tried to pair them up with "people who are 6'7" and weigh about 250 pounds."

The new RX, when it arrives at Lexus dealers this spring with a base price of about \$35,000, will be six inches longer, giving more room for both its driver and four passengers. The vehicle's cargo space with its second-row seats folded down will grow to 85 cubic feet from 75 cubic feet. With the stretched body length, the RX330 will likely be too big for the Japanese market. But company executives say its greater potential in a much bigger American auto market outweighs any loss of sales at home.