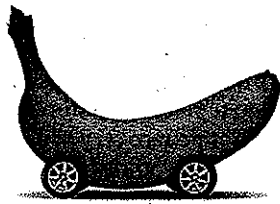


# Toyota slips up

What the world's biggest carmaker can learn from other corporate turnarounds



spiral of decline. Toyota is still a hugely formidable company, and some within the industry (and inside Toyota itself) believe that Mr Toyoda may be overstating the case. Yet there is no shortage of signs that all is not well (see pages 75-77).

Toyota's story has implications beyond the motor industry, for it is not just a car company; it is the model for manufacturing excellence whose "lean" techniques have been copied by countless firms. How it slipped up—and how it may right itself—carries lessons for others.

## Falling giants

Although some of its rivals, notably Volkswagen of Germany and Hyundai of South Korea, have come through the terrible past year relatively unscathed, Toyota's market-share has either fallen or been flat in every region in which it operates except Japan—a market that was shrinking well before the crisis struck. In America, its biggest and normally most profitable market, Toyota has been plagued by highly publicised recalls that have raised embarrassing questions about the safety of its vehicles. In China, India and Brazil, the big emerging markets that will provide nearly all the industry's future growth, Toyota has been slow off the mark. Its lead in hybrid technology is under threat as other big carmakers scramble to bring low- and zero-emission vehicles to market before low-carbon legislation bites. Astonishingly, in the first three months of 2009 it made an even bigger loss than GM, which was then on the verge of bankruptcy. Underlying all these problems is an uncomfortable truth: Toyota's rivals have now caught up. They now offer cars that are just as reliable but far more exciting than the rather dull vehicles Toyota has concentrated on producing in ever-larger numbers.

Mr Toyoda's alarm call last month appears partly to have been prompted by reading "How the Mighty Fall", a book by Jim Collins, an American management writer, which identifies five stages of corporate decline. Mr Toyoda reckons that Toyota may already be at the fourth stage. Companies at this point, says Mr Collins, frequently still have their destinies in their own hands, but often flit from one supposed "silver bullet" strategy to another, thus accelerating towards the fate they are trying to avoid.

Those mistakes include: seeking a big acquisition to transform the business at a single stroke; embarking on a programme of such radical change that underlying strengths are forgotten or abandoned; destroying momentum by constant restructuring; pinning hopes on unproven strategies, such as dramatic leaps into new technologies or businesses; and hiring a visionary leader from outside with little understanding of what made the company great in the first place. Instead, Mr

Collins advocates old-fashioned management virtues such as determination, discipline, calmness under pressure and strategic decision-making based on careful sifting of the evidence. Often, the leader best able to halt a downward spiral will be an insider who knows how to build on proven strengths while simultaneously identifying and eradicating weaknesses.

There are plenty of examples. In the late 1990s both Hewlett-Packard and Motorola found themselves in deep trouble, and IBM, long the most admired firm in America, went through similar agonies earlier in the decade. All three faced the problem of having to adapt their businesses to the rise of the internet. HP and Motorola, in their efforts to remake themselves, hired bosses in from outside and reorganised themselves repeatedly. Luckily for HP, it pulled itself together in the nick of time under Mark Hurd, a very different kind of boss from his predecessor, Carly Fiorina, who was fired in 2005 after a wild five-year ride. Eschewing her game-changing acquisitions and grand strategies, Mr Hurd concentrated on operating efficiency, execution, financial performance and customers. Motorola, by contrast, has never recovered from the aftermath of the telecoms bubble that burst in 2000-01: its share price today is one-sixth of what it was at its peak.

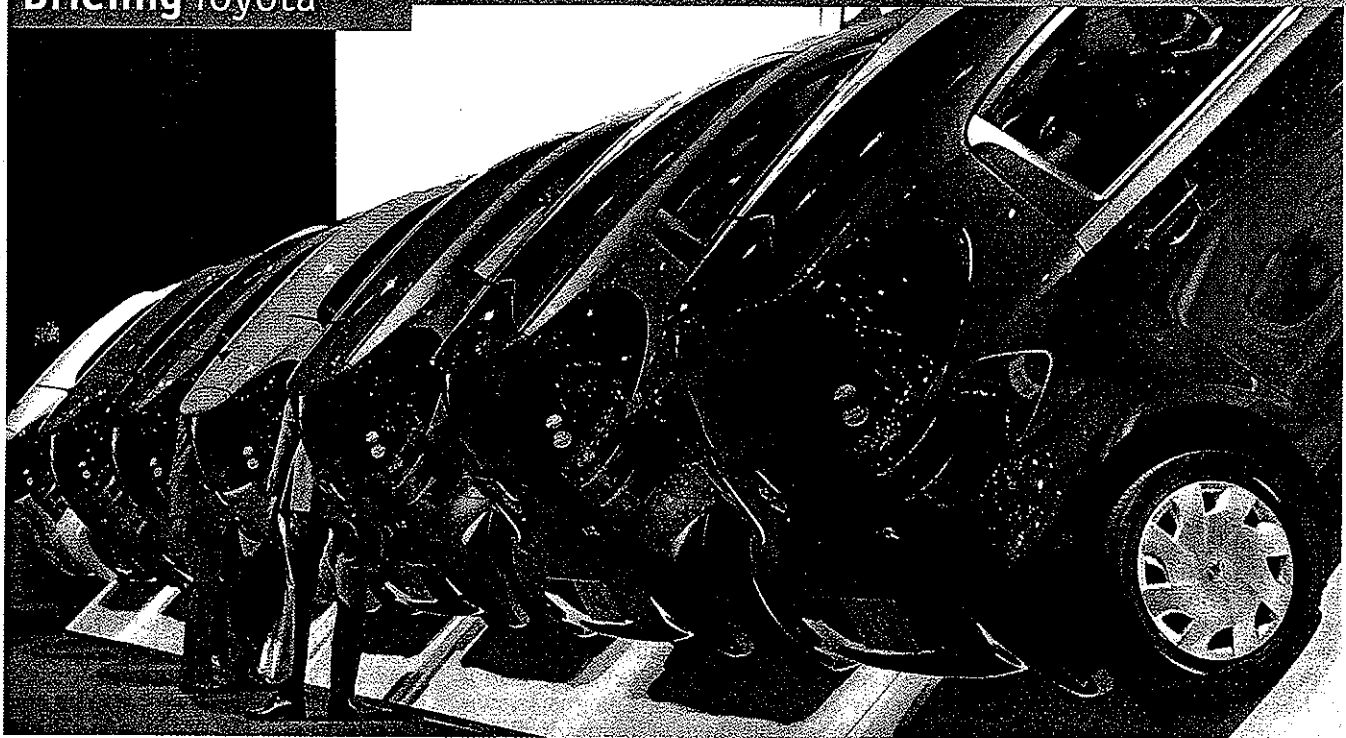
As for IBM, it found new and vibrant life after near-death thanks to Lou Gerstner's refusal to be panicked into breaking up the company—the game-changing solution advocated by Wall Street analysts, investment bankers scenting fees and a good few of IBM's own senior managers. Instead, Mr Gerstner opted for doggedly building on the strengths that had made IBM great in the first place (not least the exceptional quality of many of the people who worked for Big Blue) to make it a leader in the lucrative computer-services market.

## A bit of vroom needed

Toyota can also learn from the woes of other carmakers. A decade ago Ford thought it had found a saviour in the dynamic Jac Nasser, who declared his intention to transform the firm from an old-economy carmaker into a nimble, internet-savvy, consumer powerhouse that managed brands and sold services. He also went on a wild acquisition spree, paying huge sums for Volvo and Land Rover. Unfortunately, amid Mr Nasser's cultural revolution, Ford lost sight of its main purpose: building decent vehicles as efficiently and profitably as possible. That is what Ford is reaping the reward for doing now, under the less exciting but steadier leadership of Alan Mulally.

Toyota, too, has a good chance of putting things right. It is no GM, which had far deeper structural problems before it used bankruptcy to offload some of them. It has a boss who understands what has gone wrong—namely, that it has jeopardised its formerly stellar reputation for quality by pursuing volume at all costs and by failing to put the needs of its customers first. It has started to sort out some of its problems. Quality and reliability are getting back up to the mark. Now it needs to make more exciting and innovative cars.

Mr Toyoda's approach is not visionary. It is simple, incremental and requires painstaking attention to what the customers want. That is its virtue. ■



## Losing its shine

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

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 has-

ten 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

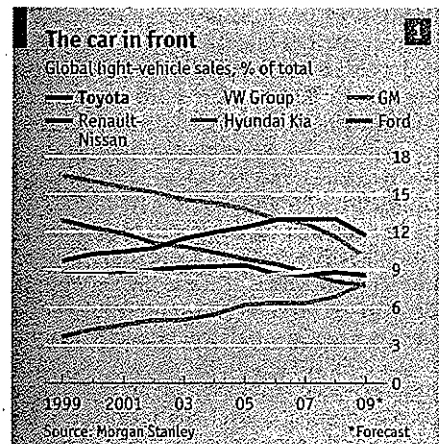
In many ways, Mr Toyoda is right to sound the alarm. Toyota could not have been expected to shrug off the storm that swept through the car industry after the collapse of Lehman Brothers in September last year; but rivals, notably Volkswagen (vw) of Germany and Hyundai Kia of South Korea, have weathered 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 on the previous page). 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 Toyoda. 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 Toyoda 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.

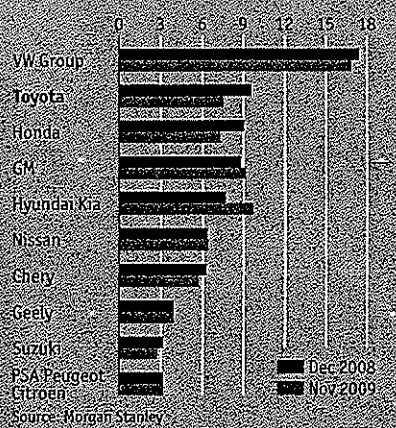
America's ever-eager plaintiff lawyers already have Toyota in their sights. A Californian law firm specialising in customer class-action suits, McCuneWright, filed a suit on November 5th. Citing 16 known deaths and hundreds of injuries, it alleged that "neither driver error nor floor mats can explain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

#### Losing ground

China's light-vehicle sales, % of total



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".

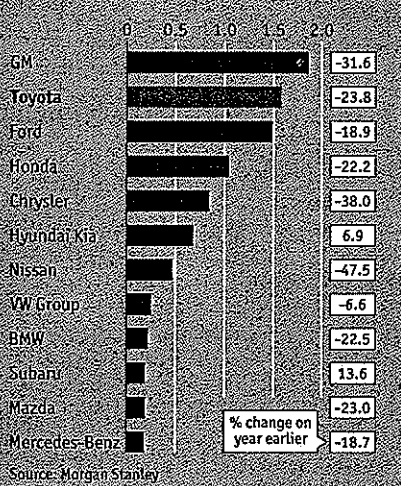
The danger in all of this for Toyota is that its loyal (and mostly satisfied) customers in America have long believed that the firm was different from others and thus hold it to a higher standard. The moment that Toyota is seen as just another big carmaker, a vital part of the mystique that has surrounded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

#### Trouble on the freeway

US light-vehicle sales, Jan-Nov 2009, units, m



► 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 succes-

sion 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 page 72).

#### 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

Toyota's overstretched supply chain

## The machine that ran too hot

The woes of the world's biggest carmaker are a warning for rivals

AS EXECUTIVES from Toyota, including the firm's boss, Akio Toyoda, squirmed before their tormentors in America's Congress this week, there was little public gloating from rival carmakers. Although it is Toyota that is currently in the dock after a crushing series of safety-related recalls across the world, competitors are only too aware that it could be their turn next. After all, there is not a single big carmaker that has not modelled its manufacturing and supply-chain management on Toyota's "lean production" system.

That said, there is a widespread belief within the automotive industry that Toyota is the author of most of its own misfortunes. In his testimony to the House oversight committee on February 24th, Mr Toyoda acknowledged that in its pursuit of growth his firm stretched its lean philosophy close to breaking point and in so doing became "confused" about some of the principles that first made it great: its focus on putting customer satisfaction above all else, and its ability "to stop, think and make improvements".

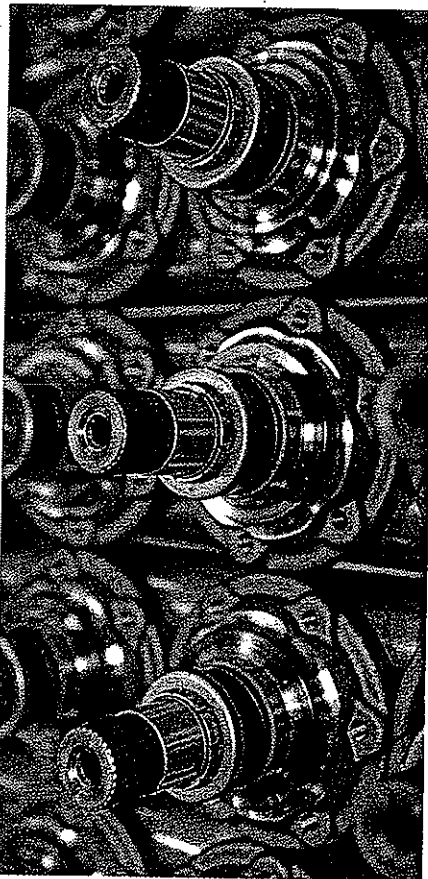
James Womack, one of the authors of "The Machine that Changed the World", a book about Toyota's innovations in manufacturing, dates the origin of its present woes to 2002, when it set itself the goal of raising its global market share from 11% to 15%. The target was "totally irrelevant to any customer" and was "just driven by ego", he says. The rapid expansion, he believes, "meant working with a lot of unfamiliar suppliers who didn't have a deep understanding of Toyota culture."

By the middle of the decade recalls of Toyota vehicles were increasing at a sufficiently alarming rate for Mr Toyoda's predecessor, Katsuaki Watanabe, to demand a renewed emphasis on quality control. But nothing was allowed to get in the way of another (albeit undeclared) goal: overtaking General Motors to become the world's biggest carmaker. Even as Toyota swept past GM in 2008, the quality problems and recalls were mounting.

The majority of those problems almost certainly originated not in Toyota's own factories, but in those of its suppliers. The automotive industry operates as a complex web. The carmakers (known as original equipment manufacturers, or OEMs) sit at its centre. Next come the tier-one suppliers, such as Bosch, Delphi, Denso, Continental, Valeo and Tenneco, who deliver big integrated systems directly to the OEMs.

Fanning out from them are the tier-two suppliers who provide individual parts or assembled components either directly to the OEM or to tier-one suppliers. (CTS Corp, the maker of the throttle-pedal assemblies that Toyota has identified as one of the causes of "unintended acceleration" in some of its vehicles, is a tier-two supplier whose automotive business accounts for about a third of its sales.)

On the outer ring of the web are the tier-three suppliers who often make just a single component for several tier-two suppliers. Although there are literally thousands of tier-two and tier-three suppliers around the world, their numbers have been culled over the last decade as the OEMs and the tier-one firms have worked



A vale of tiers

to consolidate their supply chains by concentrating business with a smaller number of stronger companies.

Toyota revolutionised automotive supply-chain management by anointing certain suppliers as the sole source of particular components, leading to intimate collaboration with long-term partners and a sense of mutual benefit. In contrast, Western carmakers tended either to source in-house or award short contracts to the lowest bidders. The quality Toyota and its suppliers achieved made possible the "just in time" approach to delivering components to the assembly plant. In his book,

Mr Womack quotes a Toyota supplier: "We work without a safety net, so we can't afford to fall off the high wire. We don't."

Most big car firms now operate in a similar way. Ford, for example, will often work with a tier-one supplier for up to three years before a new model comes off the production line to ensure that the design and manufacturing of important components is sound. So-called cross-functional teams from both firms strive to eliminate defects. Rather than always going for the low bid, carmakers now look at the total cost of a component, including potential interruptions to production and, further down the line, customer warranty claims if quality is not up to scratch.

By and large, the relationships between the OEMs and the tier-one suppliers run smoothly. When problems do crop up, it is usually with the tier-two and tier-three firms. A senior purchasing executive at one carmaker says that consolidation, the need to trim capacity and the shock to demand that began in mid-2008 have put the weaker parts of the supply chain under great strain: "Some of these are quite fragile businesses. There's a need for visibility, but we don't always have it. If something goes wrong, we need transparency and speed of communication to make sure it doesn't get to the customer."

A consequence of Toyota's breakneck expansion was that it became increasingly dependent on suppliers outside Japan with whom it did not have decades of working experience. Nor did Toyota have enough of the senior engineers, known as *sensei*, to keep an eye on how new suppliers were shaping up. Yet Toyota not only continued to trust in its sole-sourcing approach, it went even further, gaining unprecedented economies of scale by using single suppliers for entire ranges of its cars across multiple markets.

A senior executive at a big tier-one supplier argues that although Toyota's single-supplier philosophy served it well in the past, it took it to potentially risky extremes, especially when combined with highly centralised decision-making in Japan. "There's a trade-off," he says. "If you don't want duplication of supply you have to have very close monitoring, you have to listen to your supply base and you have to have transparency. That means delegating to local managers. With Toyota, it works well at the shop-floor level, but things break down higher up."

In the aftermath of Toyota's crisis, the industry is now asking itself whether sole-sourcing has gone too far. "It may be safer not to have all your eggs in one basket, but to have maybe three suppliers for major components who can benchmark each other," says another purchasing manager. Until very recently, Toyota was the peerless exemplar. For now, at least, it is seen as an awful warning. ■