GRINDING GEARS:

THE JAPANESE AUTO DEALER NETWORK AND AMERICAN TRADE COMPLAINTS

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INTRODUCTION

Last October, we published a study of the Japanese auto distribution network that analyzed claims by U.S. industry executives and American trade officials that General Motors, Ford and Chrysler were being systematically denied access to a sufficient number of car outlets to sell their products in Japan. The paper examined the history of Big Three and Japanese makers' marketing efforts in the respective countries, reviewed the trade and business literature, and made what we believe was the first detailed effort to get behind the numbers and dissect the conflicting statistical evidence about the actual structure of the Big Three's distribution systems in Japan.[1]

The work revealed some striking contradictions between American trade complaints and actual Big Three business practices. Rather than significantly adding to their total number of direct franchise outlets,[2] Ford and Chrysler were instead engaged in a process of "churning" dealerships – shedding some franchises that were unprofitable and signing up new ones for which they had higher hopes. While to varying extents the two companies still envision a hypothetical future in which they might significantly expand their sales facilities, it is clear from low sales volume that this day has not yet arrived. Moreover, the study noted that – precisely in order to avoid this turmoil – General Motors' Saturn Japan subsidiary began operations in April 1997 with a sales strategy specifically designed to *limit* the number of outlets in the country (the same approach, incidentally, that Saturn took in the U.S.).

After the smoke cleared from all the Big Three maneuvering, about as many direct franchise outlets were terminated over the past several years as were added to the networks. In fact, this study showed that the Big Three actually ended the year 1997 with slightly fewer direct franchise outlets than they had in either 1996 or in 1995. The full extent of this churning, revealed here for the first time, means that the fate of a large number of dealerships – what we call the "missing in action" – has been deliberately left out of the trade calculations of American policy makers and industry representatives. The reasons for this stratagem were, as we shall see, both simple and complex. But the net effect was to maximize pressure on Japan to yield to "results-oriented" trade policies – highly specific demands for guaranteed sales levels – while at the same time maintaining at least some form of safety valve on escalating protectionist sentiment in the U.S.

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[1] See Scott Latham, *"Dealers, Dealers Everywhere… But Nobody Stops to Think: An Analysis of the Auto Dealer Network in Japan,"* Scott Latham Associates, Philadelphia, October 2, 1997.

[2] A direct franchise outlet implies a much more serious commitment on the part of both the dealer and the manufacturer than a so-called "dual" showroom, where the models of more than one manufacturer are sold side by side. Direct franchise outlets are most often exclusive to one brand, either simply by practice or because the contract explicitly prohibits sales of other makes. As part of the franchise agreement, the manufacturer provides the dealer with a range of help in the form of sales incentives, an after-sales parts and service system, advertising and promotional assistance, and a product warranty.

In addition to uncovering the large turnover in direct franchise outlets, the first study examined Chrysler Japan's decision to terminate its "indirect" distribution agreement for Jeep products with the Honda Motor Co. The action, announced unexpectedly in September 1997 in the midst of a chorus of growing complaints about the *lack* of Big Three showrooms in Japan,[3] had the effect of removing a total of 1,877 outlets from Chrysler's sales network. In 1996, these Honda dealers sold 10,368 Jeeps in Japan, while Chrysler's own independent franchise dealers accounted for only about 5,100 sales. Robert E. Bowen, president of Chrysler Japan Sales, explained the business rationale by saying the strategy would "attract many new [independent and exclusive] dealers who wish to sell our products and, long term, increase our sales volume in Japan."[4] This study will dig much more deeply into the dynamics of that decision.

The first paper also identified and analyzed another serious contradiction in U.S. trade policy – the American position that it was perfectly acceptable for U.S. and European importers to conclude exclusive franchise agreements with their dealers in Japan, but that Japanese auto makers not only did not have this business right, but were expected to write periodic letters to *their* dealers reminding them of their freedom to sell other brands.[5] That situation continues to this day.

Another key area examined in the first paper involved the severe and chronic problems of Big Three product quality and after-sales service in Japan – especially when compared to their more aggressive and successful European competitors. It also explored the critical issue of "over-dealering," a disease that afflicts not just Japan, but America and Europe as well, and examined the prospects for consolidation in an industry that virtually all analysts agree has a corresponding – and parallel – problem of over-capacity.

The current study was designed to test the potential impact of these findings through a series of in-depth interviews with a substantial cross-section of auto dealers and leading

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[3] The American Automobile Manufacturers Association (AAMA) in particular issued frequent press releases that purported to keep a running total of "new" outlets and invariably blamed Japan's government and auto makers for insufficient progress. To add to the pressure earlier in the summer, virtually all of the leading figures in the Clinton administration, including the president himself, made statements in various forms that Japan's auto makers were "exporting" unemployment to the U.S.

[4] Chrysler Press Release, Auburn Hills, MI, September 12, 1997.

[5] One of the major arguments of the U.S. auto manufacturers during the 1995 auto negotiations – and one that seemed to have the most "legs" among lay observers in the U.S. – was the charge that Japanese dealers were somehow barred, either by practice or regulation, from carrying a line of foreign cars. It is interesting from a historical perspective to see that this complaint had already been dismissed in 1991-92 by the MOSS Motor Vehicle Study, a joint consulting project commissioned by the two governments. Specifically, the report found that no such "exclusivity" clause had been a part of Japanese vehicle manufacturer franchise agreements since 1980, although up to 1990 some domestic makers required advance consultations before dealers could sell other brands. See *MOSS Motor Vehicle Study*, Revised December 1993, by Booz-Allen & Hamilton Inc., Bethesda Md., and Nomura Research Institute, Tokyo, Japan, "Executive Summary," p. 4. The acronym MOSS, which stands for Market Opening Sector Specific, was the name given to a series of trade negotiations between the U.S. and Japan.

industry executives who represent both domestic and foreign manufacturers in Japan.[6] In the process, we received dramatic confirmation of the basic conclusions reached in the first paper, and uncovered a great deal of new and detailed information about the competitive positions and marketing strategies of many of the players in the market. The open-ended nature of the interviews served to put this in very concrete and often graphic terms.

One significant exception to the theme of "dramatic confirmation" was our discussion with Konen Suzuki, the former president of Ford Japan who announced his retirement on March 17, six weeks after we met in Tokyo. Mr. Suzuki, who agreed to meet with us only in his capacity as chairman of the Market Committee of the Japan Automobile Importers Association (JAIA) and not as president of Ford Japan, presented some strongly held opposing arguments regarding dealer productivity and sales issues, which are discussed in detail in one of the later sections of the paper. It should be noted that criticisms of Mr. Suzuki's policies voiced by some of the other participants in the study were expressed prior to the announcement of his retirement. Nevertheless, it was felt that these comments had to be included here in order to clarify the issues and give the reader a better opportunity to make his own judgments about the auto business in Japan.

In any event, it seems clear from the evidence gathered in the interviews that the Japanese automobile market will be undergoing a shake-out over the next five to 10 years. For many companies – both domestic and foreign – it will be "make or break" time. In the process, the American manufacturers will be severely tested, and none more so than Ford. Of the Big Three, Ford has made by far the biggest dollar investment and commitment in the Japanese market. But precisely because of that, it has by far the most to lose if it doesn't find a winning strategy. The company suffered nearly a 40 percent drop in its import sales in 1997, and many of its dealers are openly angry about the lack of consumer appeal of current models, the paucity of financial support from the manufacturer, and the apparent dearth of exciting new products in the pipeline. Moreover, Ford has yet to find a way to make its controlling interest in Mazda pay off.

However, potentially dramatic changes are afoot. Newly appointed Japan president Eiji Iwakuni spoke recently (mid-April 1998) of a 'Ford Japan that can say no' – not to the Government of Japan, but to the head office in Detroit! In the process, he announced some radical changes that will drastically re-shape his company's overall marketing strategy in the country and, hopefully, place it on the road to long-term recovery. For purposes of clarity and continuity, a fuller discussion of the particulars of this attempted transformation comes toward the end of the study. Suffice it to say for now that Iwakuni's fresh approach calls into question years of American assumptions regarding the

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[6] As part of the study, we conducted interviews with 27 Japanese dealers and auto industry executives between January 24 and February 17, 1998. The interviews typically lasted 1 ½ to 2 ½ hours each and were open-ended, meaning that no pre-determined questionnaire was used. We tried to divide the sessions roughly equally between questions involving general day-to-day business operations, and questions involving Big Three strategies and U.S. trade complaints.

Japanese automobile market – both in terms of trade politics and practical business opportunities.

For its part, Chrysler has also crossed the Rubicon. In addition to its decision to terminate the Honda distribution agreement and build its own network of independent dealers, Chrysler announced in late March that it had raised its stake in its Japanese subsidiary, Chrysler Japan Sales, to 100% from 70% by buying out the shares of its joint venture partner, J. Osawa & Co.[7] While most analysts applaud this action and think it long overdue because it gives the company more control over its own destiny, the short to medium term impact on sales will be painful. Up to now, Chrysler has found a niche market with its Jeep products, and the right-hand drive Voyager minivan introduced last year has also met with some limited success. But the Neon – unfortunately nicknamed the "Japan car killer" – has been a very big disappointment, and the prospects for growth in the sport utility vehicle market seem to be heavily weighted in favor of station wagons and vans, not the off-road four-by-four that is Chrysler's trademark. In any case, Jeep sales in Japan fell sharply last year. As part of this study, we will hear from two very different – and very independent – Chrysler dealers. In addition, some perspectives on past practices and current strategy were graciously provided by Keisuke Egashira, chairman of Chrysler Japan Sales.

Quite apart from its business activities in Japan, of course, Chrysler recently crossed yet another and much larger Rubicon – announcing a $38 billion merger with Germany's Daimler-Benz AG on May 7, 1998. While the significance of this huge industrial combination will be felt around the world and may stimulate still more consolidation among auto makers, for a variety of reasons that will become apparent, the merger will probably have little immediate impact in the Japanese market.

General Motors, meanwhile, continues to sell most of its products through Yanase & Co., which for 83 years has been Japan's leading independent importer and distributor of foreign automobiles. This conservative strategy, while safe, is not likely to make GM one of the big winners in the Japanese import market and could seriously jeopardize its ability to expand its sales efforts in the rest of Asia. For all of the Big Three, success in Japan will be the benchmark that Asian consumers use to make their future buying decisions. Moreover, GM's Saturn Japan division is off to a very slow start, and the GM Cavalier – although re-badged and aggressively marketed as a Toyota – is also not winning many converts.

In fact, for all but a few car companies doing business in Japan – domestic as well as foreign – the year 1997 did not go down in history as one of the better ones. The first quarter of 1998 was even more distressing, with little short-term relief in sight. Domestic vehicle sales for all of 1997 fell nearly 5% to 6.73 million, while in the first two months of this year they were down 22.8% from the corresponding period last year.[8] Total

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[7] See, for example, "Chrysler Lifts Stake in Japan Sales Unit to Increase Leverage," *The Asian Wall Street Journal*, March 26, 1998.
[8] Japanese Auto Dealers Association (JADA) statistics.

passenger car imports fell 13.2% overall, although this was largely the reflection of a huge 44% drop in so-called "reverse imports" by Japanese makers with plants based in North America. Meanwhile, total American-built Big Three imports to Japan fell nearly18% in 1997, and 33% in the first two months of this year.[9] Those trends continued into March, when the import segment overall fell 34.6% compared to the same month the previous year. Ford sales slumped 50% for the month, Chrysler dropped 43.5%, and GM sales fell 34.9% for the period.[10]

Significantly, many of the European manufacturers registered gains in Japan last year, even in the face of a generally slow economy. But because of the Big Three's weak performance, complaints have been raised once again by Congressmen, administration officials and U.S. industry executives blaming our trading partner for the sales decline.[11] It would be a shame if these rumblings were given a great deal of credence. Nearly three years ago, Japan and America almost landed in an economically and politically devastating trade war, in part because of fundamental – and sometimes even willful – misunderstandings about the actual workings of the Japanese auto market. For example, the erroneous and misplaced demands for more and more Big Three outlets seemed to take on a life of their own.

The complexity and huge human diversity of the Japanese dealer network needs to be seen first-hand to be appreciated. Just as in the U.S., there are tremendous debates under way between advocates of traditional ways of selling and ardent promoters of all kinds of new systems and marketing tools, from the Internet, to direct mail, to computerized showrooms and "auction" networks, to complete restructurings of dealer channels. The competition is intense, and there are many views and opinions on almost every facet of the business.

The purpose of this study is not just to analyze Japan's distribution system in light of Big Three trade complaints, but to delve into the dynamics of dealers' day-to-day business decisions so that they might come alive for Americans unfamiliar with the situation in Japan. In the first paper, we included a section called "On the Ground in America" – based on a series of interviews with U.S. dealers of both domestic and imported cars. This second paper will take a closer look at dealers "on the ground in Japan."

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[9] "New Car Registrations by Country, Manufacturer and Type," Ministry of Transportation, JAIA.

[10] James B. Treece, "Makers End Grim Fiscal Year with 20% Tumble in March," *Automotive News*, April 20, 1998.

[11] "The Japanese [auto] market is closed," asserted Andy Card, the president of the American Automobile Manufacturers Association (AAMA), at a news conference on March 17, 1998. Comments of this sort are reported on an almost daily basis. For some other recent examples, see: "Asia's Troubles Start to Slow U.S. Exports," *The Washington Post*, March 20, 1998; "US Carmakers See Setback in Asia," *Journal of Commerce*, March 18, 1998; "Fisher to Travel to Japan on Autos, Deregulation Initiative," *Inside U.S. Trade*, February 27, 1998; "Japan Warned About Imports – Visiting Lawmakers Foresee a Backlash," *The Washington Times*, January 21, 1998; "U.S. Tells Japan to Open its Markets," Reuters, December 4, 1997; "U.S. Auto Exports to Japan Slide; Data May Fuel Anger at Policies," *The Wall Street Journal*, December 5, 1997.

HISTORICAL OVERVIEW and MARKET DYNAMICS

The Failure of the U.S. Auto Makers to Re-Enter the Japanese Market

Because it is important to present the substance of the dealer interviews in as “natural” a form as possible so the reader can appreciate the full flavor, tone and atmosphere of the various encounters, a short digression might be helpful for relative newcomers to U.S.-Japan trade debates. Knowing something about the basic market dynamics and the history of the Big Three in Japan should make it easier to navigate these discussions and avoid the need to stop too often for explanations along the way.

Because of years of high-profile complaints about Japanese trade barriers – both real and perceived – many Americans are unaware of the very conscious decisions of the U.S. auto makers not to re-enter the market after the end of World War II. Before the war, both Ford and General Motors had held not only substantial but dominant positions in Japan. By 1930, their combined market share topped 95% before the rising power of the military gradually began to reverse the Japanese government’s policy of open foreign investment and whittle away at sales.[12]

In the post-war devastation that was Japan, of course, there was no auto industry, and government economic planners were at first sharply divided over whether they should even encourage domestic efforts to rebuild one. In consideration of their huge pre-war presence in Japan, Ford and GM were both invited back into the market before the Occupation came to a close in 1952. The offer was conditioned on the understanding that the companies would not export finished vehicles, but instead establish local manufacturing facilities in Japan to create jobs in the domestic economy – a framework quite similar to requirements imposed on U.S. auto makers by European governments at the time.

But both Ford and GM declined. An internal memorandum from Arthur J. Wieland, vice president of Ford International, to Henry Ford II, set the tone for many years of neglect. "I presently cannot foresee any major competition from the Japanese automobile industry anywhere in the world outside Japan, with the exception of China, Manchuria and Korea," Wieland wrote. GM's assessment was equally bleak.[13]

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[12] For a more complete discussion of the pre- and post-war history, see James C. Abegglen, *Sea Change: Pacific Asia as the New World Industrial Center*, New York, The Free Press, 1994; Mark Mason, *American Multinationals and Japan*, Harvard University, Cambridge, 1992; *My Life With Toyota*, Shotaro Kamiya, Tokyo, 1976; Seisi Kato, *My Years With Toyota*, Tokyo, 1981; Doron P. Levin, *Behind the Wheel at Chrysler*, Harcourt Brace & Company, New York, 1995; John B. Rae, *Nissan/Datsun: A History of the Nissan Motor Corporation in U.S.A, 1960-1980*, New York, McGraw Hill, 1982; James C. Abegglen and George Stalk, Jr., *Kaisha: The Japanese Corporation*, Basic Books, Inc., 1985; Eiji Toyoda, *Fifty Years in Motion, Kodansha International*, Tokyo, 1985; and Anne O. Krueger, *American Trade Policy: A Tragedy in the Making*, The AEI Press, Washington, D.C., 1995.
[13] Mason, p. 147.

As events unfolded, it seemed the Americans were almost determined to stay out of the market. By 1960, it was Toyota – not Detroit – that proposed an international alliance. Even as late as 1938, Toyota had tried to forge a joint venture with Ford and Nissan, and then with Ford alone in the early 1950s, but this time the Japanese firm seriously piqued the American company's interest. Ford engineers and officials made repeated trips to Japan, and negotiations went on for about a year on a joint production deal that would have given Toyota and Ford each a 40% equity stake, with 20% to be held by the Japanese distributor. This was later sweetened to allow Ford 50 percent, but suddenly Ford dropped the idea with no explanation offered.[14]

In his autobiography, former Toyota chairman Eiji Toyoda complained that "Ford's method of turning us down left a lot to be desired." But still, he said, his company gave it one more shot in 1980, shortly before the Reagan administration imposed so-called "voluntary restraint agreements" – quotas – on Japanese car imports to America. This time, Toyota proposed joint production of *their* vehicle, in the U.S. "We attempted to form ties with Ford on a total of four occasions before and after the war," Toyoda wrote. "I suppose that we were never meant to become partners."[15]

Donald Frey, a senior engineer at Ford in 1960, explained his company's position on the aborted 1960 deal in an interview published in 1995. "By not giving [Toyota] an answer," he said, "we were not being rude, but civil. The first Toyotas we saw were junk… terribly underpowered…"

But, Frey conceded, "We looked at small cars as money losers. Henry Ford II believed the finance guys who told him that. He was preoccupied with building up our European operations. At home in America, we had a big booming market. Japan was a non-factor in our thinking. It never occurred to us that we might learn something from that deal. America was king of the hill; who the hell ever expected a little company called Toyota to be a world class competitor?"[16]

Limited Engagement: The Evolution of the Big Three Japan Strategies

There were other lost opportunities for the Americans,[17] especially during what might be called the "modern era" of U.S.-Japan trade – the years after 1964 when the yen became convertible in international markets and Japan's restrictions on investment were slowly but gradually liberalized. In 1969, Mitsubishi defied the Japanese government and announced a venture with Chrysler that eventually grew to a 24 percent stake for the American

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[14] *Ibid*, p. 333.
[15] Eiji Toyoda, *Toyota: Fifty Years in Motion*, p. 130.
[16] Michael Berger, "Detroit's Deception: What U.S. Carmakers Don't Tell You"; *Japan Scope*, Spring 1995, p. 49.
[17] For additional candid industry views, see James Bennet, "Big 3 and Japan: U.S. Talks of Closed Markets for Cars, But Detroit Concedes It Wasn't Trying," The New York *Times*, May 27, 1995.

company before Chairman Lee Iacocca started selling off shares in the late 1980s because of a cash crunch – much to the chagrin of his Japanese counterparts, who had hoped to have a reliable long-term partner in the U.S.

In 1971, Isuzu agreed to sell a 34.2 percent share to GM, which has since expanded to a 37.5% stake by the American company. And in 1979, Ford took a 25 percent interest in Mazda. But for many years, none of these investments led to either a substantial marketing or manufacturing presence in Japan for the Big Three, and there was therefore little in the way of product to attract dealer interest. The key point is that even during the period of maximum market protection in Japan (1955-1975), there were still a large number of practical ways around the obstacles. If the Big Three had been committed, they could have used their technological edge – when they still had one – to form alliances and ventures that would have allowed them to enter the market in a big way.

While this account might generate a great deal of anger in certain trade circles in Washington and among others who have been weaned on stories of alleged Japanese economic perfidy, it should be noted that in the academic community and among Japan business specialists, this history is essentially non-controversial. Even the 1992 MOSS report, which was jointly commissioned by the governments of the U.S. and Japan, reported the Big Three neglect of the Japanese market in some detail:

> With the start of the 1980s, European vehicle manufacturers such as BMW, Volvo, and Mercedes Benz made large-scale investments for the establishment of import companies and launched full-fledged campaigns to expand their sales in Japan. BMW in particular vigorously invested in the construction of a dealer network beginning in the early 1980s, and this network consisted entirely of exclusive dealerships. In 1982, Ford began constructing the Autorama channel jointly with Mazda. By contrast, GM and Chrysler, the other two "Big Three" U.S. vehicle manufacturers, continued to opt for the conventional strategy of using existing networks of Japanese importers and dealers, which entailed a relatively low level of investment, during the 1980s. Their investment in the Japanese market only began to expand in earnest in the 1990s.[18]

Recent changes in the American makers' portfolios have dramatically altered this landscape, however. While it used to be safe to speak of "Big Three" strategies in one breath, because their Japan sales and investments were so extraordinarily low when compared to their competitors', their paths have continued to diverge. The decision by Ford in 1996 to take a controlling 33.5% interest in Mazda now provides the U.S. maker with future manufacturing and R&D capability in Japan.[19] Chrysler's decision to acquire

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[18] *MOSS Report*, "Executive Summary," Volume 1, p. 12.

[19] A word of caution should be injected here on the use of the term "controlling interest." James C. Abegglen, a leading Japanese business consultant and a former adviser to General Motors on its market entry strategy in the 1970s, notes that Japan's commercial code follows European practice. Thirty-three and one-third plus one provides a blocking vote at a shareholders' meeting – and thus a veto on matters

majority equity in its own import subsidiary in June 1995 (since expanded to 100% ownership) – and then last year to jettison the security blanket of the Honda distribution network – simultaneously raised the stakes for the company and gave them more room for maneuver. They have gone from an office of only about 50 employees in 1995 to an operation of more than 200 today.

Only GM, with the exception of the company's Saturn division, has stuck to the old trodden path, even deepening its relationship with Yanase in a roundabout kind of way. In 1993, the German auto maker Opel (100%-owned by GM) designated Yanase to be both its exclusive importer and distributor in Japan. And last July, GM-affiliate Saab (50% GM-owned) made the same kind of arrangement. GM estimates that because of the Yanase relationship and its heavy emphasis on service and customer loyalty, 70%-80% of its sales in Japan are still made door-to-door.[20]

Down the Up Staircase: Lack of Demand and Great 'Expectations'

With the introduction of right hand drive vehicles for the first time in 1994, sales of American-made vehicles in Japan began to increase dramatically – but from a very low base. Unit sales for 1993 totaled 19,335, soared to 34,250 the next year, and to 52,984 vehicles in 1996. In just three years, Big Three sales had increased by a factor of 2.7 times.

The problem was that this growth rate was completely unsustainable. Worse, the rhetoric in the aftermath of the June 1995 auto agreement was even more unrealistic. U.S. trade officials and industry executives unilaterally announced their "expectation" that the Big Three would open 200 new direct franchise outlets a year in Japan and increase sales to 300,000 vehicles by the year 2000 – nearly eight times the actual 1995 level.[21] Ever since then, the word 'expectation' has been uttered at least as often as the phrase 'level playing field' whenever American trade warriors and aggrieved businessmen gather to discuss U.S.-Japan commerce.

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that must go to the shareholders for vote. On the other hand, controlling equity is sixty-six and two-thirds plus one, with the holder of this share portion able to control all decisions, including those that require shareholder approval. In a real sense, however, control rests with the people who are managing the company. Thus, Abegglen suggests that a distinction be made between legal control and operating control. That Ford is allowed to appoint the Mazda president and key executives does in fact provide a good measure of operating control. That is the "controlling interest" referred to by analysts. However, these executives represent Mazda and have legal responsibility for Mazda, not Ford. Therefore, to the extent that Mazda and Ford might have conflicting interests, their legal positions can become rather tricky.

[20] *Motor Business Japan: The Japanese Motor Industry Worldwide*, Economist Intelligence Unit, 3rd Quarter 1997, p. 84.

[21] For a more detailed analysis of the unsustainability of Big Three vehicle sales growth in Japan, see Latham, "Market Opening or Corporate Welfare? 'Results-Oriented Trade Policy Toward Japan," Cato Institute, April 15, 1996, pp. 12-13.

But with nearly all of the recent Big Three entrants in Japan – the Neon, Taurus, and Cavalier – meeting with less than a lukewarm reception from Japanese consumers, last year's sales decline was predicted well in advance by most industry analysts. With few exciting models in the pipeline, the American makers may find it difficult to dig themselves out of this hole.[22]

Empirically Yours: the European Success Story

In contrast, many of the European manufacturers actually posted sales gains in Japan in 1997. Mercedes Benz Japan (MBJ) was up 2.3%, BMW up 0.3%, Rover up 0.9%, Citroen-Peugeot up 5.6%, Fiat up 16.5%, and Saab up 12.1%. VW/Audi nearly held the line, dropping just 0.3% from its 1996 level. At the end of the year, European manufacturers had sold a total of 245,287 new passengers cars in Japan – nearly 72% of imports totaling 341,495 units. The German makers alone accounted for more than half of this number.

The comparative success of the Europeans is reflected not only in the sales figures and the excitement their products generated among consumers, but also in their distribution systems, which are far more highly developed and efficient than those of the Big Three. For example, to put the debate over the number of outlets in perspective, in 1997 the three leading German auto companies sold more than two and a half times the number of cars as the Americans did – with about the same number of outlets. VW/Audi, BMW and Mercedes Benz sold a combined total of 135,190 new cars last year from 663 showrooms nationwide. The Big Three, meanwhile, had combined sales of 53,403 from 631 outlets.

But perhaps the most telling evidence of the European success is the fact that these auto makers enjoy a higher market share in Japan than they do in the United States 7.2% vs. 5.0%.[23]

The graph on the following page tracks the shifting fortunes of the European auto makers in the two countries and pinpoints the year the market share lines crossed.

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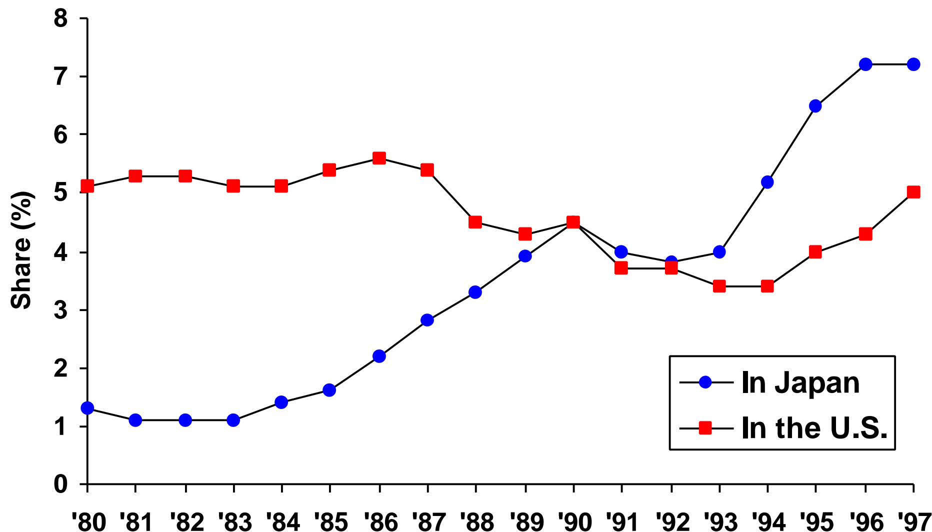
[22] For a complete discussion, see "Dealers, Dealers…," pp. 18-20.

[23] The 1997 Japanese market share is arrived at by dividing the total number of European imports – 256,485 units – by the total number of passenger vehicles sold – 3,574,906 (excluding mini-vehicles). The 1997 European share of the U.S. market is taken from Ward's Communications and does not include models manufactured by BMW or Mercedes Benz in their U.S. plants or Volkswagens produced in Mexico and sold in America.

Market Share of European Cars/Japan and the U.S.



The charts on the following pages have been updated and refined from the original study published last October. They break out sales figures and the number of direct franchise outlets for selected importers as well as domestic manufacturers for the years 1992-1997. The so-called "efficiency ratios" for 1997 have also been computed by dividing sales by the total number of outlets. This gives us the average number of vehicles sold annually or monthly per outlet by each auto maker, which is a key measure of potential profitability for the individual dealers.

As you can see, the Big Three trail far behind both their European and Japanese competitors in this important category. Ford, for example, had an efficiency ratio last year of 116.1, or just under 10 cars a month. Chrysler trailed with a rating of only 60.1 vehicles per outlet – just over 5 units a month, while General Motors sold only 4.5 units a month per outlet.[24]

In stark contrast, VW/Audi had a combined efficiency ratio of 249.5 through two separate and exclusive sales channels, more than twice that of Ford and more than four times that of GM and Chrysler. BMW sold an average of 218.7 cars per outlet, or 18.2 cars a month. Mercedes Benz, meanwhile, averaged 152.0 vehicles per showroom. Volvo sold

[24] Because of a tabulation error in the first study, the 1996 sales and efficiency ratios for both Chrysler and GM were *over*stated. Direct franchise Chrysler dealers were mistakenly given credit for Jeep sales made through the Honda network, and GM was credited with re-badged Cavaliers sold by Toyota. The actual situation on the ground, therefore, is worse than originally portrayed for these two companies. The 1996 sales figures for Ford, on the other hand, were *under*stated because Ford's sales of newly introduced re-badged Mazdas (the Festiva mini-wagon and the Ford Freeda), were inadvertently omitted. While these errors are corrected in this study, they in no way alter the basic conclusions.

NUMBER OF DIRECT FRANCHISE OUTLETS FOR SELECTED MANUFACTURERS IN THE JAPANESE MARKET 1992-1997

Country	Auto Maker	Number of Direct Franchise Outlets				
		1992[1]	**1994**	**1995**	**1996**	**1997**
U.S.	GM	215	185	184	190	192
	Saturn	NA	NA	NA	NA	15
	Ford	355[2]	298	309	320	304
	Chrysler	60	118	129	110	120
	Total	**630**	**601**	**622**	**620**	**631**
Germany	VW/Audi Fahren	230	75[3]	87	84	101
	VW/Audi DUO	33	91	96	106	141
	Mercedes Benz	235	245	250	250	255
	BMW	135	153	154	160	166
	Total	**600**	**473**	**491**	**600**	**663**
U.K.	Rover	NA	86	104	110	124
Sweden	Volvo	76	148	151	151	149
Japan	Toyota	NA	5,659	5,666	5,634	5,627
	Nissan	NA	3,099	3,090	3,060	3,061
	Mazda	NA	2,882	2,688	2,488	2,315
	Mitsubishi	NA	1,389	1,398	1,473	1,400
	Honda	NA	2,311	2,313	2,305	2,300
	Isuzu	NA	587	515	501	498
	Subaru	NA	536	539	541	543
	Daihatsu	NA	720	689	689	700
	Suzuki	NA	690	695	716	767
	Total		**17,873**	**17,593**	**17,407**	**17,211**

Notes:
1. The 1992 figures are from the MOSS Report
2. Includes 335 exclusive Ford 'Autorama' outlets.
3. The large drop in outlets from the previous year for VW/Audi is due to the auto maker's decision in 1992 to terminate its exclusive distribution agreement with Yanase & Co. in order to exercise more direct control over sales and marketing.

Sources: MOSS Report, Ford, Chrysler, GM, JAIA, JADA, JAMA, Nikkei Handbook, and individual Japanese companies.

SALES AND EFFICIENCY RATIOS OF DIRECT FRANCHISE OUTLETS FOR SELECTED MANUFACTURERS IN THE JAPANESE MARKET (1996-1997)

Country	Auto Maker	Number of Outlets 1996	1996 Sales			1996 Efficiency Ratios Yearly/Monthly		Number of Outlets 1997	1997 Sales			1997 Efficiency Ratios Yearly/Monthly	
U.S.	GM	190	9,812[1]			51.6/4.3		192	10,286[1]			53.6/4.5	
	Saturn	NA	NA			NA		15	602			40.1/4.5	
	Ford	320	45,590[2]			142.5/11.9		304	35,299[2]			116.1/9.7	
	Chrysler	110	5,802[3]			52.7/4.4		120	7,216[3]			60.1/5.0	
	Total	**620**	**61,204**			**98.7/8.2**		**631**	**53,403**			**84.6/7.1**	
Germany	VW/Audi Fahren	84	28,498			339.3/28.3		101	26,128			261.3/21.8	
	VW/Audi DUO	106	32,086			302.7/25.2		141	34,002			241.1/20.1	
	Benz	250	36,773			147.1/12.3		255	38,762			152.0/12.7[4]	
	BMW	160	36,317			227.0/18.9		166	36,298			218.7/18.2	
	Total	**600**	**133,674**			**222.8/18.6**		**663**	**135,190**			**204.2/17.0**	
U.K.	Rover	110	27,254			247.8/20.6		124	27,508			**221.8/18.5**	
Sweden	Volvo	151	24,037			159.2/13.3		149	19,875			**133.4/11.1**	
			Excluding Mini	**Mini Sales**	**Including Mini**	**Excluding Mini**	**Including Mini**		**Excluding Mini**	**Mini Sales**	**Including Mini**	**Excluding Mini**	**Including Mini**
Japan	Toyota	5,634	2,124,949	0	2,124,949	377.2/31.4	NA	5,627	1,996,869	0	1,996,869	354.9/29.6	NA
	Nissan	3,060	1,116,679	0	1,116,679	364.9/30.4	NA	3,061	1,042,990	0	1,042,990	340.7/28.4	NA
	Mazda	2,488	285,427	49,178	334,605	114.7/9.6	134.5/11.2	2,315	293,534	43,645	337,179	126.8/10.6	145.6/12.1
	Mitsubishi	1,473	480,684	276,729	757,413	326.3/27.2	514.2/42.9	1,400	426,359	258,338	684,697	304.5/25.4	489.1/40.8
	Honda	2,305	587,466	164,497	751,963	254.9/21.2	326.2/27.2	2,300	585,549	216,227	801,778	254.6/21.2	348.6/29.0
	Isuzu	501	136,645	0	136,645	272.7/22.7	NA	498	123,080	0	123,080	247.1/20.6	NA
	Subaru	541	137,113	211,378	348,491	253.4/21.1	644.2/53.7	543	141,701	163,782	305,483	261.0/21.7	562.6/46.9
	Daihatsu	689	24,340	444,399	468,739	NA	680.3/56.7	700	40,476	407,849	448,325	NA[5]	640.5/53.4
	Suzuki	716	65,899	555,959	621,858	NA	868.5/72.4	767	73,134	522,681	595,815	NA[5]	776.8/64.7
	Total	**17,407**	**4,959,202**	**1,702,140**	**6,661,342**	**248.9/20.7**	**382.7/31.9**	**17,211**	**4,723,692**	**1,612,522**	**6,336,214**	**274.5/22.9**	**368.1/30.7**

Notes:

1 1996 GM sales do not include 11,467 Cavaliers re-badged as Toyotas and sold through 1,267 Toyota outlets. 1997 GM sales do not include 9,406 Cavaliers sold through 1,262 Toyota outlets. GM sales also do not include sales of German-made Opels, which are imported by Yanase and sold exclusively through that channel.

2 This figure represents all of the Fords sold in Japan in 1996, including 14,713 U.S.-made cars, 6,296 vehicles made by Ford in Europe, and 24,581 vehicles manufactured by Mazda in Japan but re-badged and sold as Fords. The 1997 breakdown for Ford is 8,853 U.S.-made vehicles, 5,130 Europe-built, and 21,316 re-badged Mazdas.

3 1996 Chrysler sales do not include 10,368 Jeeps sold indirectly through 1,877 Honda outlets. The 1997 sales figures do not include about 7,200 Jeeps sold through the Honda network.

4 This figure, computed by dividing total sales and total outlets for 1997, significantly understates Mercedes Benz' efficiency through its two most important sales channels.

5 The extremely small number of regular vehicle sales, coupled with insufficient detail regarding the structure of the company's dealer network, makes this calculation meaningless.

Sources: MOSS Report, Ford, Chrysler, GM, JAIA, JADA, JAMA, Japan Mini Vehicle Association, individual Japanese companies.

New Passenger Car Registrations in Japan by Country, Manufacturer and Type 1996-1997

Country of Origin	Manufacturer	1996 Sales	1997 Sales	Percent Change
U.S.A.	General Motors	22,101	19,692	-10.9
	Ford	14,713	8,853	-39.8
	Chrysler	16,170	14,432	-10.7
	Mitsubishi U.S.A.	1,272	672	-47.2
	Honda U.S.A.	47,893	29,968	-37.4
	Nissan U.S.A.	217	167	-23.0
	Toyota U.S.A.	20,152	5,566	-72.4
	Saturn		602	NA
	BMW U.S.A.		3,362	NA
	Others	41	30	-26.8
	Total	122,559	83,344	-32.0
U.K.	Rover Group	27,254	27,508	+0.9
	Rolls-Royce	156	127	-18.6
	Jaguar	2,686	2,529	-5.8
	Lotus	322	364	+13.0
	Morgan	41	23	-43.9
	Nissan U.K.	124	1,188	+858.1
	U.K. Others	250	207	-17.2
	Total	30,833	31,946	+3.6
Germany	VW-Audi Group	60,306	60,130	-0.3
	BMW	36,317	33,127	-8.8
	Mercedes-Benz	40,975	41,905	+2.3
	Porsche	1,900	2,386	+25.6
	Opel	38,339	34,397	-10.3
	Ford	6,296	5,130	-18.5
	Total	184,133	177,075	-3.8
France	PSA Group	7,852	8,295	+5.6
	Renault	2,648	1,964	-25.8
	France Others	2	3	+50.0
	Total	10,502	10,262	-2.3
Italy	FIAT Group	6,739	7,850	+16.5
	Maserati	238	162	-31.9
	Innocenti	20	11	-45.0
	Lamborghini	56	47	-16.3
	Zagato		2	NA
	Italy Others	6	3	-50.0
	Total	7,059	8,075	+14.4
Sweden	Saab	901	1,010	+12.1
	Volvo	24,037	19,072	-10.7
	Total	24,938	20,082	-19.5
Australia	Mitsubishi	1,434	968	-32.5
	Nissan	2		NA
	Total	1,436	968	-32.6
South Korea.	Kia		14	NA
	SsangYong	78	91	+16.7
	Total	78	105	+34.6
Spain	Nissan	9,812	4,453	-54.6
Mexico	Nissan	1	1	0.0
The Netherlands	Mitsubishi	1,423	3,789	+166.3
	Volvo		803	NA
	Total	1,423	4,592	+222.7
Others		618	592	-4.2
IMPORTS TOTAL		**393,392**	**341,495**	**-13.2**
Domestics	Daihatsu	22,316	20,891	-6.3
	Subaru	132,731	138,963	+4.7
	Honda	530,457	546,713	+3.1
	Isuzu	3,145	3,110	-6.1
	Mitsubishi	206,745	207,015	+0.1
	Nissan	813,565	744,386	-8.5
	Suzuki	42,117	55,351	+31.4
	Mazda	162,402	193,103	+18.9
	Toyota	1,404,477	1,323,879	-5.7
DOMESTICS TOTAL		3,317,955	3,233,411	-2.5
IMPORTS & DOMESTICS	**TOTAL**	**3,711,347**	**3,574,906**	**-3.7**

Source: Ministry of Transportation, JAIA

149 vehicles per outlet, and Rover averaged 221.8 vehicles per showroom. The leading Japanese auto makers all averaged over 200 – Toyota and Nissan well over 300 – vehicles per dealership, with the exception of Ford Japan's Mazda, which averaged 145.6 units a year.[25]

A reader studying the charts should be aware of a couple of "apples and oranges" comparisons inherent in some of the figures. The very low efficiency ratio achieved by General Motors – 53.6 vehicles per outlet per year – is due to the fact that GM sells primarily through Yanase showrooms, which by definition are "dual" outlets. This industry term of art means that Yanase sells the products of several different makers side by side in the same outlet, and the dealership's ultimate profitability can only be judged on the basis of total vehicle sales for the entire facility, not just the level of GM sales. In one respect, however, the "apples and oranges" comparison is actually quite useful because it underscores the superior sales efficiency of exclusive outlets over duals – the precise strategy the European makers pursued and the Big Three shunned until recent years .

The only other manufacturer listed on the charts that sells through Yanase is Mercedes Benz, but this is a different situation. By special agreement with Yanase, many of the Benz outlets in this channel are exclusive showrooms that earn revenue only on the sales of Mercedes. Others are duals or so-called "multi-franchise outlets." While the combined efficiency ratio for all 192 Yanase outlets was 157.1 vehicles, at our request Mercedes Benz Japan broke out the ratios for the two different types of Yanase outlets in 1997. By this measure, Yanase sold an average of 181.0 vehicles in its exclusive Mercedes showrooms, and only 149.2 vehicles in its dual outlets. Also included in the total number of outlets for Mercedes is a second – and totally exclusive – Benz channel known as Stern, whose 46 showrooms had an average efficiency ratio of 175.9, and 17 multi-franchise outlets in a third sales channel with Mitsubishi, whose annual sales per showroom were only 17.5 cars. The combined efficiency ratio of 152.0 – the number actually shown in the chart – is the average of all of these channels and therefore significantly understates the selling power of Mercedes in Japan.

All of the other makers' sales channels shown in the chart are made up primarily of exclusive showrooms – including Ford and Chrysler outlets – and therefore the numbers can be compared with a fair degree of accuracy. However, in making comparisons for the purpose of estimating dealer profitability, one other distinction must be drawn. Profit margins on Japanese cars, which sell in huge volume in an intensely competitive environment, are extremely low – especially on the less expensive models. As a result, efficiency ratios in showrooms that sell domestic vehicles must be quite high to generate a profit for a dealer.

At the other end of the spectrum, the leading European manufacturers enjoy very high margins because of their special cachet and appeal as exotic, finely crafted imports. Unfortunately, the American brands do not have this image and – with some obvious

[25] According to the National Automobile Dealers Association (NADA), the average number of sales per showroom in the U.S. for 1996 was 664 vehicles.

exceptions like the slow-selling Cadillac or Lincoln – have to compete head-to-head on price with many of the standard Japanese models. Which leads us to…

The 20/30 Rule

Like most "rules" everywhere, this one was made to be broken. But in general in today's marketplace, a Japanese dealer has to sell between 20 and 30 new cars per outlet every month to make a profit. Dealerships selling higher-margin vehicles such as Mercedes Benz and BMW can be profitable at the low end or even below 20 units per month. Dealerships selling lower-margin vehicles such as Fords or Toyotas can survive only at the high end of the range.

Of course, there are many other factors that can affect this calculation – location, overhead, size of the facility, other sources of income such as used-car sales and service, and internal efficiencies at the individual outlets. This last subject, as we shall see in our discussion with Ford Japan's Konen Suzuki and others, can generate a fair amount of heat and controversy. Clearly, if Ford's 304 outlets are selling on average fewer than 10 new cars a month – and the 20/30 rule is a fair yardstick – the dealers cannot possibly make money because they are all exclusive to Ford. The same applies to Chrysler dealers that are exclusive – and also to the new Saturn Japan, whose 15 exclusive outlets sold a total of only 602 cars since opening their doors for business in April 1997. As a result, Saturn eked out a per-outlet average of only 4.5 units a month, although admittedly this is in a very early stage of the company's development.

Obviously, something has to give in a situation like this. The U.S. manufacturers must either find ways to develop enough new and exciting products to raise demand and sales levels closer to 30 a month, or the outlets themselves must double or – in some cases – even triple their internal sales productivity in order to stay in business. Or some combination of both. The alternative is closing down outlets which, to say the least, is not a particularly attractive option for the dealer – or even for the manufacturer, which is striving to increase sales at every opportunity. Japanese makers and dealers also face this problem, even with their much higher volumes, because of intense competition within distribution networks that also have become bloated with too many outlets.[26]

The careful reader may have already spotted another way out of this conundrum: why not just create more dual outlets so dealers can make money from several different manufacturers at the same time? The answer is that this is not what Ford and Chrysler want, nor – to be fair – is it the best way to market automobiles. While there will always be some dual outlets to handle low-volume specialty cars or to take up the slack in sparsely populated areas, it is a fact that exclusive showrooms are more effective sales

[26] Japan is not a special case in this regard. The phenomenon of "over-dealering" is a problem worldwide, and is being addressed in the U.S. and Europe through major consolidation and restructuring programs. For a more complete discussion, see "Dealers, Dealers…," pp. 16-17.

tools because they build brand image and keep the staff focused on a single product-line.[27] General Motors, for example, is frequently criticized for selling through Yanase rather than creating its own distribution network like Ford and Chrysler. In effect, by choosing Yanase, the argument goes, they are condemning themselves to permanently low sales levels in Japan.

So like it or not, we are back to the productivity issues outlined above.

Trade Math: A Primer

Having updated the sales and outlet chart from the first study, we would be remiss if we failed to take a fresh look at the arithmetic that has dominated U.S.-Japanese trade politics in autos for the last three or four years. The frequent references to this issue by many of the interview participants will be much easier to understand if we spend a moment reviewing the record and examining the new numbers.

As noted earlier, ever since the auto agreement with Japan was concluded in June 1995, the U.S. industry has kept a monthly update on the number of "new" direct franchise outlets established by the Big Three in Japan. These numbers were then announced and – sometimes with great public fanfare – compared unfavorably to the American "expectations" of 200 new showrooms a year. Periodically, these pronouncements were accompanied by calls for unilateral economic sanctions against Japan.[28]

The latest newsletter from the American Automobile Manufacturers Association (AAMA) continues this tradition. "Since the 1995 U.S.-Japan Auto Agreement, AAMA member companies have added a total of 177 new outlets, short of the 400 expected by the end of 1997 under the Agreement," declares the March 1998 *Global Automotive Trade Report*. The report then goes on to document the name and location of most of the new showrooms. But once again, it is what AAMA doesn't say that is far more important and revealing of actual market conditions in Japan. And what it doesn't say is what the actual *current* total of Big Three outlets really is, which makes it difficult to check the net gain or loss.

Fortunately, there is a remedy for this. The Japan Automobile Importers Association (JAIA), which represents all of the importers in that country (including the Big Three), keeps those statistics, as do other government agencies and industry groups. Here is what the numbers tell us: while the Big Three had 622 direct franchise outlets in 1995, they had

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[27] For a discussion of these same dynamics in the U.S. market, see "Dealers, Dealers…," pp. 13-17.
[28] "With each month, Japan's government and auto industry fall further behind in meeting the modest expectations outlined at the time of the trade pact's signing," AAMA president Card said in a typical statement in March 1997. "We expected meaningful deregulation and a sincere effort to encourage Japanese dealers to sell imported cars and trucks. What we've gotten is a lot of lip service and little to back it up." Last July, AAMA asked that Japan be put on the Super 301 "watch list" because of alleged barriers in the auto market, but USTR did not take such action in its report of October 1, 1997.

a total of only 616 at the end of 1997 – *a net loss of six outlets*. Simple arithmetic tells us that if you "add" 177 new outlets (which, remember, are listed in the AAMA reports), and you wind up with six less at the end of the day, then somewhere along the line you have "lost" or closed 183 other showrooms. These MIAs – or "missing in action" – need to be accounted for as well.

This was the situation on the ground as of December 31, 1997, updated to reflect AAMA statistics through the end of February:

	1992	**1994**	**1995**	**1996**	**1997[1]**	**"New"[2] Outlets 6/95-2/98**	**"MIA's"**	**Total Changes**	**% Change From '95**
GM	215	185	184	190	192	?	?	?	?
Ford	355	298	309	320	304	?	?	?	?
Chrysler	60	118	129	110	120	?	?	?	?
'97 Totals	**630**	**601**	**622**	**620**	**616**	**177**	**183**	**360**	**57.9%**

Notes:
1. As of December 31, 1997.
2. As of February 28, 1998.

The key point here is that the Big Three (mostly Ford and Chrysler) have "turned over" or "churned" a total of 360 outlets since the auto agreement was announced – *more than half of their entire distribution network in only two and a half years*. This represents a significant increase in churning – a total of 112 additional showrooms were turned over and 67 more outlets joined the "missing in action" list since we last measured the activity at about the mid-point of 1997.[29] As noted in the original study, shifts of this magnitude do not happen in a closed market. Quite to the contrary, they reflect a dynamism, flexibility and openness that contradicts years of assertions about "invisible" trade barriers. Sometimes, like the emperor's clothes, "invisible" must simply be translated as "non-existent."

A more serious question, which begs an answer in the current environment of rapid change in the Japanese auto industry, is whether or not this churning of dealers will be good for the Big Three or – to be more precise, for Ford and Chrysler – since GM's arrangement with Yanase is rather stable and passive. The answer is, "that depends." In

[29] See "Dealers, Dealers…," p. 25. For the purposes of consistency and comparison with the original study, the 15 new Saturn Japan outlets are omitted from this analysis. Saturn Japan is a completely new operation and functions as its own importer. Any discussion of turnover or "churning," therefore, would be meaningless in this context.

the short run, clearly, it is certainly good for the U.S. auto makers that the marketplace allows them to make swift and dramatic changes. What matters more, however, is whether these changes have improved the overall quality of their dealer networks and – if the answer to that is "yes" – then to what extent can that quality be maintained or improved by the introduction of exciting new products and better market strategies? After all, it is sometimes reasonable to undergo major disruptions in one's distribution system during a building period, but it is not something one wants to live with every day. That kind of unstable and chaotic situation would drive dealers away in droves. These are the really tough questions, and our discussions with industry executives will provide an interesting range of opinion.

But so far, in the world of Washington trade politics, there has been a continued reluctance to confront these realities publicly and acknowledge what most of the players in Japan, including virtually all of the foreign manufacturers themselves, have already 'fessed up to: the Japanese auto market is open. For example, in a statement accompanying the United States Trade Representative's and Department of Commerce's so-called "monitoring report" to President Clinton last December, USTR Charlene Barshefsky said, "We are concerned that the progress achieved under the first year of the agreement clearly has not been sustained. We view the slowdown in new dealership signings… as particularly troubling… It is time that Japan took real action to achieve these goals."[30]

"Oh Yes, We Have No Bananas!"

The USTR report itself essentially dodged the difficulties of the outlet count by ignoring it – or at least writing around the subject in the apparent expectation that no one would notice. In essence, the "missing in action" were brought back to life with the stroke of a pen. The report declared flatly that the Big Three had added 142 new direct franchise outlets since the auto agreement, bringing the current total to 753, instead of the 631 we know to be true.[31] (Actually, when you add 142 to the 622 independently confirmed outlet totals for 1995 shown in the previous chart, you should come up with 764, but let's concede that this is at least in the ballpark.)

The real statistical legerdemain begins with the sub-totals for the individual companies. According to the report, Ford had a total of 307 exclusive sales outlets (again, close enough),[32] Chrysler had 120 (same),[33] and General Motors had – how many? Well, the report forgot to say. But of course, with a little arithmetic, we can figure this out. To make the numbers add up to 753, GM would have had to have amassed 326 outlets (307 + 120 + 326 = 753) – an implied increase of 142 over GM's 1995 total of 184. To make

[30] USTR Press Release, December 4, 1997.
[31] "Report to President William Jefferson Clinton of the Interagency Enforcement Team Regarding the U.S.-Japan Agreement on Autos and Auto Parts," U.S. Department of Commerce and The Office of the U.S. Trade Representative," December 4, 1997, p. 10.
[32] *Ibid*, p. 15.
[33] *Ibid*, p. 17.

matters even more confusing, the report states in another section that GM outlets had only increased by 69 showrooms since the auto agreement.[34]

So, in effect, the report asks the reader to believe that General Motors – the American company that is universally acknowledged to be doing the least to expand its distribution system in Japan – somehow accounted for the entire 142-outlet increase in Big Three dealerships claimed by the American side.[35] But this is gamesmanship. Of course, the main point of the exercise may have been simply to fudge the numbers so badly that the "churning" issue wouldn't surface and no one could get to the bottom of the actual business situation in Japan.

One final word on trade math, and then we'll let the dealers do the talking. American trade officials and AAMA report the foreign share of the Japanese automobile market at 5.4% for 1997. Everyone else in the world says it's 9.6% -- including JAIA. This is because AAMA computes the figure using Japan's *entire* motor vehicle market as a base, including trucks, buses, and so-called "mini-vehicles" with engine displacement under 660cc – none of which the Big Three make for Japan. But since these constitute nearly half of all vehicles sold in the country, the AAMA method makes the foreign share appear much smaller – an important pressure point in the inevitable public relations battle during trade negotiations.[36] JAIA excludes these vehicles from their calculation on the grounds that it makes little sense to compute market share for a product that does not exist. The situation would be analogous to the state of Alaska complaining that its share of the Japanese banana market was too low.

Here is how they do it:

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[34] *Ibid*, p. 10.

[35] Virtually all of the statistics used by the monitoring report come directly from AAMA, whose membership consists of the Big Three companies only. For example, the October *AAMA Japan Report* gives the new-outlet figure of 142 ("…still far short of the 400 new outlets that were expected…") without, as usual, providing any overall totals against which to measure the actual turnover. The last thing U.S.-Japan trade relations needs right now is another government bureaucracy to measure "progress," so a better place to go in the future for these numbers – at least as a double-check – might be JAIA. While this group too is a trade association with an active lobbying agenda, the fact that it has 45 members – literally all of the companies in Japan that import cars – helps insure that no single point of view prevails. As indicated, the outlet totals supplied by JAIA were one of the primary sources of dealership numbers used in this study.

[36] Interestingly, in the *1996 National Trade Estimate Report on Foreign Trade Barriers* (NTE), USTR used the JAIA method and excluded mini-cars [p. 199]. The 1997 NTE reverts to the U.S. industry calculation and therefore computes foreign market share at only 6% of total sales [p. 214]. The 1998 NTE, for the first time in recent memory, omits the calculation entirely. The report does, however, repeat the AAMA claim of 177 "new" outlets and remains true to the position that "foreign access to Japan's automotive distribution network remains a serious problem." [p. 233].

1997 Market Share Calculations

AAMA Method: Divide the total number of imported cars sold (including gray market vehicles, but that's another story that we'll address later) by the total number of vehicles sold in the market, including mini-vehicles, trucks and buses.

$$364,383 \div 6,729,975 = 0.05414 = 5.4\%$$

Rest of World: Divide the total number of imported passenger cars sold by the total number of passenger cars sold.

$$341,495 \div 3,574,906 = 0.09552 = 9.6\%$$

ON THE GROUND IN JAPAN

No Closed Markets Here: JAIA

Given the broad range of companies represented by JAIA, Executive Director Seiichiro Ide was in an understandably delicate position when he agreed to sit for this interview. His membership includes such successful companies as Mercedes Benz, BMW, and Volvo, as well as the less successful – and highly vocal – American car makers. No matter what he said, there was always the potential for offending somebody. Nevertheless, Ide gave an extremely interesting overview of JAIA's extensive activities in Japan, helped put into perspective some of the broader market dynamics and – not infrequently – volunteered some very candid views about trade politics. Put simply, he doesn't like them.

JAIA was founded in 1965 and currently has a total of 45 members – a large roster that in itself says a lot about the competitiveness of the Japanese auto market.[37] The group's annual demand forecast, released just a month before our interview, predicted 1998 import car sales of 360,000 – about the same as in 1997 – with a continued sluggish economy nationwide. The importers' association works closely with various Japanese government agencies, coordinating a series of foreign auto shows and exhibitions in five major and 20 smaller cities in Japan, and it provides support to three permanent exhibition centers for imported vehicles in Tokyo, Osaka and Nagoya. A by-product of U.S.-Japan auto negotiations, these centers were built by the Japanese government and are administered by the Japan External Trade Organization (JETRO).

JAIA's activities also include organizing bi-annual used car sales, conducting test drives for the media, consumers and the employees of importers, holding training sessions and seminars for its own staff members, preparing a lecture series on such issues as inventory control, service, parts supply and assembly plant technology, and publishing the usual assortment of public relations material, pamphlets and guidebooks. The group is also active as a lobbyist for a wide range of industry issues such as safety regulations and the environment, various certification procedures and so-called "homologation" standards – a big word that refers to the process of making sure all cars in the market conform to local regulations.

Like most analysts, Ide attributed 1997's first quarter sales spurt to the fact that consumers were trying to beat the April 1 increase in Japan's sales tax from 3% to 5%. After that shopping spree, new-car buyers stayed home in the face of the country's

[37] The Japanese manufacturers engaged in so-called "reverse imports" from North America (Toyota, Honda, Nissan, Mitsubishi, and Mazda) are actually JAIA members but do not take an active role in the organization because of a political sensitivity that the association should be run by "non-Japanese" members. When addressing trade and industry issues, the domestic manufacturers rely on their own group, the Japanese Automobile Manufacturers Association (JAMA).

continued slow economic recovery and the expiration of the 1996 temporary income tax cut. Ide also cited the yen-dollar exchange rate as a critical factor in lowering foreign car sales, noting that the strong dollar had made exports from North America more expensive in yen terms. This hurt the Big Three, of course, but Japanese car makers with transplant facilities in North America – Toyota, Honda, Nissan and Mitsubishi – made especially large cuts in their "reverse imports" to Japan.

Ide noted that Japan's economic troubles had also created severe problems for the country's domestic manufacturers, many of which experienced sales decreases last year. Several of the leading domestics saw an erosion in profit levels and two – Mitsubishi and Mazda – experienced operating losses.[38]

When asked about the trade debates, Ide was – to our mind – refreshingly blunt. "To put it simply," he said, "the Japanese market is quite open. There are no restrictions [on imports]." He also turned the tables on us near the end of the interview: "Which is more open? The U.S. or Japanese market?"

Before we could respond, he made it clear his vote was with the latter: "For example, Toyota cannot be a member of the American Automobile Manufacturers Association, but this association consists of all importers," Ide said. "There may be some unreasonable commercial practices in Japan, but they apply equally to all competitors. U.S. businesses always think their practices are more universal."[39]

Ide also volunteered that many of Japan's standards for imported cars are more lenient than even for domestic manufacturers. "Because of trade pressure, the Japanese government instituted preferential standards for foreign-made cars and also established a whole series of import promotion programs. As part of this effort, JETRO financed 50% of the expenses of the imported car exhibitions – that means taxpayer money," Ide said.[40]

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[38] See, for example, "Nissan Motor Expects Profit to Plummet 79% for Year," *The New York Times*, April 18, 1998; "Japan's Car Makers Stall," The Economist, March 21, 1998; "Toyota Profit Is Likely to Disappoint as Times Cool Even for Japan's Stars," *The Wall Street Journal*, March 17, 1998; "Mitsubishi See First Loss Since 1974-75," *The New York Times*, March 11, 1998; "Japan's Auto Makers to Slice production Amid Slack Demand," *The Wall Street Journal*, March 4, 1998.

[39] In the late fall of 1992, shortly before the new Clinton administration took office, Honda and Volvo were effectively expelled from the then Motor Vehicle Manufacturers Association (MVMA), leaving the Big Three as the group's only members as they geared up to lobby for increased protectionist measures against their Japanese competitors. The trade coalition – subsequently renamed the American Automobile Manufacturers Association (AAMA) – excluded any auto maker other than GM, Ford and Chrysler, even though the U.S. subsidiaries of foreign auto makers were technically American corporations whose employees also were virtually all American [see, for example, "War of Words Follows MVMA Reconstruction," *Automotive News*, December 7, 1992]. In 1996, after Ford increased its stake in Mazda to 33.5%, *Automotive News* carried a political cartoon depicting AAMA leaders sitting at a desk while a Ford/Mazda representative stands in the doorway to the office. The caption reads: "We kicked out Volvo and Honda. What are we going to do with these guys?" With the merger of Chrysler and Daimler Benz now in the works, the question is once again apt.

[40] The Japan External Trade Organization is an arm of the Japanese Ministry of International Trade and Industry that actively promotes exports and imports between Japan and other countries.

"Of course, JAIA is in a position to demand even more incentives, but the same incentives are not enjoyed by Japanese auto exporters in foreign countries." He also referred us to page 17 of JAIA's official handbook, "The Imported Car Market of Japan – 1997," which describes the so-called "Preferential Handling Procedures for Imported Motor Vehicles (P.H.P.)." This allows importers with sales of fewer than 3,000 vehicles a year to take advantage of vastly simplified documentation requirements. Page 17 also describes the "Type Designation System," which applies to all vehicles sold in large quantities in Japan, as "perhaps the world's simplest certification system." Yet another section on the same page summarizes the inspection requirements for passenger cars in Japan. Given the frequent criticisms of this system as time-consuming and expensive, it is worth noting that in Japan an inspection certificate for a new car is valid for three years (as opposed to only one in most states in the U.S.), and renewal certificates for the second and subsequent inspections are valid for two years.

Ide completely dismissed U.S. government and industry arguments and demands regarding the number of Big Three direct franchise outlets in Japan. "I don't know why they are so concerned with that figure," he said. "If the Japanese government were hindering increases in the number of American car outlets, I could understand that concern. But otherwise, I don't see why the U.S. government sees it as a problem. I don't think there are any restrictions imposed by the Japanese government or domestic manufacturers. It's a business decision whether or not to become a dealer of an imported car. So what's happening to the number of imported sales outlets is the result of such business decisions."

Ide noted that the Japanese market was already crowded with about 2,000 foreign car showrooms, as well as some 20,000 domestic outlets. "Growth of imports has been greater than the growth of domestic models. We hope this trend will continue for a while. Last year's situation [sales declines] was very special. But the increase in the number of imported cars does not necessarily mean an increase in the number of outlets. My general impression is that there are too many outlets, not only for imported cars but for domestic cars as well – especially in this central part of Tokyo."

But Ide felt that future consolidation in the Japanese dealer market was likely to be haphazard. "There is no consensus [in the industry]," he said. "I don't think they ever discuss this issue. Dealers would think it a paradise if there were no competition in their territory. But we are in a free economy – featured by free competition – different from planned economies. But of course, to consumers, more outlets mean better services."

Pressed on the issues of trade politics, Ide showed some impatience with the situation. "It's just my general impression about the number of outlets. It's not limited to the amount of American cars or imported cars. But what the U.S. government is demanding is to increase the outlets of dealers handling *American* cars, and I have no intention of getting involved in a debate. I don't exactly understand the intention of the U.S. government. More frankly speaking, I'm not interested!" Ide said.

Both Ide and Sakae Kobayashi, a fellow director of JAIA, said several of their members disagreed with the conclusions reached in our first study, but we noted that Ide and Kobayashi themselves seemed to be in accord with the three main findings: 1) the Japanese auto market is open; 2) there is an "over-dealering" problem in both the domestic and import distribution systems; and 3) the study's statistics on numbers of outlets and sales figures are essentially in agreement with JAIA's.

THE VIEW FROM EUROPE

Beemers Uber Alles

Kazuo Omori is president of the Toho Motors Corporation, which owns and operates two exclusive BMW outlets in Tokyo. Last year, the two stores sold a combined total of 752 new cars, well above the prestigious auto maker's average "efficiency ratio" of nearly 220 vehicles a year.

Omori and a colleague, Masaaki Mizuno, one of Toho's directors, discussed the many day-to-day details of their business and of the auto market in Japan. They agreed the 20/30 rule was a good benchmark for estimating dealer profitability, but cautioned against facile generalizations because of the many factors that could complicate the calculation.

"Even for BMW, the numbers vary tremendously between downtown Tokyo and rural areas," Omori said. "Downtown, you have to sell 30 a month, while in some parts of the country, a dealer could turn a profit with fewer than 20 cars sold every month. But even with BMW's high margins, I doubt you could make a profit – even in rural areas – with as few as 120 new car sales annually," about the current average for Ford and well above that for Chrysler.

He said the stated strategy of the U.S. car makers puzzled him. "American cars don't have brand recognition and are not competitive. Few Japanese want to buy them, so increasing outlets would be self-defeating. From the dealer's point of view, they simply can't do that."

Omori noted that while BMW and Mercedes Benz enjoyed huge profit margins on their cars throughout the 1980s up to the time of the bubble economy, since then there had been a great deal of increased competition from Japanese and other European makers in the luxury car segment. The result, he said, was shrinking margins and profits even for dealers of the more prestigious brands – although he said BMW had taken up some of the slack with an incentive program.

"American car makers first have to create a situation where the dealer can make a profit," he said. "But the current situation is exactly the opposite – the cars aren't selling and yet they're trying to increase the number of outlets. It's a vicious circle." Not surprisingly,

given their dramatic success in the Japanese market, many of the European makers and dealers show some impatience with Big Three and U.S. Government trade complaints. But usually, their focus tends to be much more on the positive and practical side of the ledger – what can be accomplished, when and how.

Omori said he had no way of estimating how many dealers may have ended their relationship with the Ford and Chrysler sales networks, and shook his head in consternation over the possibility – based on the actual dealership counts reported by JAIA and AAMA – that the two companies combined may have closed nearly 200 outlets since June 1995.

But his colleague Mizuno interjected to recall: "In fact, not far from here in Meguro, there is a dealer – New Empire Motors – which has been a Ford dealer since 1948. When the Ford/Mazda outlets at Autorama [now Ford Japan Sales] started to sell the same models, New Empire was allowed to deal only in Lincoln-Mercury products – the very limited models from Ford. For Mustang and others, they had to get the cars through Mazda. They weren't allowed to deal directly any more. So there was little benefit to the business. I understand that New Empire had to close its outlet in Chiba [the prefecture to the east of Tokyo]. I'm also aware of other Ford dealers that went out of business on a direct franchise basis."

Mizuno was the first of several dealers who – unprompted – mentioned the problems at New Empire, which we later learned was the oldest Ford franchise in Japan, having been established 50 years ago with Douglas MacArthur's blessing during the Occupation. We subsequently arranged a meeting with the dealership's current owner to get his side of the story. But more on that later.

Mizuno said Toho Motors also had a long post-war history, opening for business in 1950 to distribute GM Oldsmobiles. "So we haven't only been dealers in BMWs. We do know how the U.S. cars have been doing in this market. I think what's important for a manufacturer is to convince a dealer that getting in this business will really make a profit for you… Up to now, however, General Motors has been emphasizing its relationship with Yanase. And for Ford and Chrysler, the easiest way for them [in the past] was to use the dealers from the Mazda and Honda networks."

But, Mizuno said, BMW's strategy for building sales in Japan was entirely different. "They deliberately looked for companies that had no prior experience selling Japanese cars and started with a clean slate to establish the brand identity of BMW. And that led to the current success." He added: "As long as the products have a good brand image and are profitable, there will be a lot of people interested in selling them – that was the case for BMW. They could even afford to select from among many candidates. But looking at the current situation for American auto makers, there are very few people who would want to become their dealers."

Omori said, “BMW focused on companies – blue-chip companies – based in rural areas. For example, they looked at companies in the food industry, they looked at the operators of drug stores, they looked at car parts manufacturers and even some wholesalers. In that sense, Toho was the exception. We were already in the car business.”

Omori said that when he signed the deal with BMW in the early 1980s, even though it was an exclusive franchise with a separate sales outlet, “Oldsmobile terminated our contract. There was a time when the Big Three were not very enthusiastic about exporting.”

But the recent increased investment by Ford and Chrysler won high marks from Omori, especially Chrysler’s move to end its indirect distribution agreement for Jeeps with Honda. “I fully agree with the decision,” Omori said. “In the long run, this could be good for them” because it could help them create an enthusiastic and loyal dealer network. “But American companies sometimes look only for the short term. BMW Japan spent a lot of money and put in a lot of effort. Nobody who wants to be successful in this market can avoid these efforts.”

He noted that BMW had made a lot of small design changes to adapt to consumer tastes and fashion, and also singled out Volkswagen, Volvo and Rover as important winners in the import market.

Omori and Mizuno were asked about the internal productivity of Toho Motors salesmen, and the various efforts of other dealers to find ways to modify the standard salaried wage system to bring about improvements. This is a much-discussed subject among dealers in Japan. The president of one very large dealership we interviewed had set up a system to qualify his salesmen for a special bonus program. Depending on sales volume, this could raise their overall compensation significantly, but also reduce the portion earned through wages. We wanted to know if Omori thought this would work in his operation.

“Our life would be much easier if we had the answer to that question,” he laughed, shaking his head no. “We have a salary system, and the sales average is about four new cars per month per salesman, but the veterans need to sell six or more… BMW Tokyo, which is the only BMW dealer in Japan that is 100% owned by the manufacturer,[41] has a similar bonus system to the one you describe, but there are various reasons why others haven’t followed suit.”

For one thing, he said, “to maintain their targets, salesmen are often tempted to agree to big discounts, which cuts profits. If you try to control that, you won’t be able to sell as many cars, and their commissions will go down. They won’t be very happy about that. So very few independent BMW dealers joined that program because it attracted the wrong people – the ambitious rather than the experienced.”

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[41] This so-called “factory dealer,” the industry term for an outlet owned directly by the manufacturer, operates 11 different outlets in the Tokyo area.

Omori also noted substantial differences in service levels between the two countries. In the U.S., customers generally come to the showroom, but in Japan – especially with the large-volume domestic dealers – salesmen do a lot of cold-calling and conduct in-home meetings with potential customers. This takes time, and naturally reduces productivity. It should be noted in this context that door-to-door salesmanship is prevalent in Japan. It suffers from none of the negative stigma or associations made infamous by a legion of hapless – and often smarmy – American brush and encyclopedia peddlers.

Nevertheless, Omori said, "Our BMW salesmen do not do door-to-door sales for the initial contact. But we do follow up at home with existing customers."

We asked why they thought Big Three products were not very popular in Japan. They were not shy in their answers.

"Foreign cars need to have special features that Japanese cars don't have," Mizuno said. "In the 1950s and 1960s, Japanese young people really admired the Thunderbird and a lot of other models. They knew it was beyond their means, but it was their dream to own one. But the new U.S. cars are just like cats with their whiskers cut – they've been tamed, but they're not appealing! Back when we were selling GM cars, Ford was always coming up with innovative designs. But now, if Americans won't buy them, why should the Japanese?"

For his part, Omori recalled the period immediately after the U.S.-Japan auto agreement was reached. "The target figures the U.S. initially announced for the Year 2000 were completely unrealistic – laughable – and yet all these people in Detroit were talking about more sales for the Big Three… I had the distinct impression that they didn't know what they were talking about."

Omori paused for effect. "For example, the mid-term target for BMW in Japan is to sell 60,000 units a year, while in the U.S. with twice the population, BMW has been targeting about 120,000 units. We have yet to achieve that target in Japan. We don't know when we can achieve it. But Ford has been talking about selling 100,000 cars or more in this country. It's ridiculous."[42]

Interestingly, in the U.S., BMW just surpassed the 120,000-vehicle mark. The company did it with a dealer network of only about 340 outlets. Predicting flat American sales for 1998, BMW is in the midst of a major dealer restructuring plan which the manufacturer hopes will cut distribution costs by about 17%.[43]

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[42] BMW's 1997 sales in Japan were 36,298 vehicles.
[43] "BMW Sees Flat U.S. Sales in '98, Expands Distribution Plan," Dow Jones News Service, January 19, 1998; see also, "BMW, Aiming to Double its U.S. Size, Tries to Streamline its Dealer Network," *The Wall Street Journal*, June 12, 1997, p. A6.

Stern Warnings

Stern Shinagawa Co. Ltd. is one of 46 exclusive Mercedes outlets in the Stern sales channel that MBJ began assembling in the mid 1980s in an effort to augment its distribution network with Yanase. Though Yanase still accounts for nearly 78% of all Mercedes sales in Japan, the Stern showrooms, each of them independently owned by a separate company, sell most of the rest.

But while Stern Shinagawa may only have one outlet, it has big parents. The equity in the company is split 51% by Tokyo Mitsubishi Co., (a 100% subsidiary of Mitsubishi Motors Corp.), 29% by Shinagawa Machines, and 20% directly by MMC itself. The company has three full-time board members. Two of them, president Yoshiya Matsumoto and vice president Koichi Hamada, met with us in Japan.

Working under them are 32 employees that includes a sales force and service department with nine staff members each, a parts department with two employees and 12 people in various administrative positions. Unit sales for the fiscal year April 1996 to March 1997 were 351 vehicles, with total revenue of ¥3 billion ($24.8 million)[44] and net profit of only ¥50 million ($413,000). Like the rest of Japan, their sales had stagnated since April.

Hamada said they hoped to improve productivity, but noted they had very large operating expenses. Their salesmen averaged 3.2 units per month – less than the monthly average in the U.S. – but still one unit higher than the mean for all Stern outlets in Japan, he said.

"We are concentrating our efforts on developing a small segment of the market – Mercedes Benz accounts for about 1% of all auto sales in Japan [including mini-vehicles], but fully 12% of the imported passenger car market," Hamada said. In this regard, he said it was essential for showrooms to be exclusive to Mercedes. "We might have a problem if we were a dual. The sales force would just be pushing the brand of the moment. That's not good for MBJ, and it's not good for the customers. It also reduces dealer profit."[45]

He too was critical of what he saw as Big Three inattention to the market, particularly the lack of variety in the models that they offer for sale in Japan. "For a dealer, profit potential and product line-up are all-important," Hamada said. "If the Big Three want to sell, they need to offer more models. They need to satisfy customer concerns about quality. For example, Mercedes now offers three different classes of cars – the C, E, and S classes, plus a wagon and SLK roadster. Even within these models, there are numerous variations and configurations, and Mercedes is planning additional product launches."

[44] Unless otherwise indicated, all dollar-yen conversions are made at $=¥121.06, the average exchange rate for 1997 as calculated by the Federal Reserve.
[45] This is remarkably similar to arguments expressed by American dealers interviewed for the original study. See "Dealers, Dealers…," pp. 11-17.

Hamada said their franchise agreement with MBJ prohibited their selling other manufacturers' products in the Stern showroom. Theoretically, he said, they could do it if they first consulted with Mercedes and obtained permission. And, in addition, the owners of Stern Shinagawa were not contractually prevented from establishing separate franchise agreements as a separate company with other manufacturers and selling through other showrooms. Hamada said he had worked previously as an executive with Mitsubishi Motors Corporation, and the MBJ franchise agreement was much stricter about the issue of exclusivity than any Japanese maker's contract with its dealers. "The Japanese makers' franchise agreements require no exclusivity at all – it's completely free," Hamada said. "In the past, prior consultation was necessary, but this was changed because of trade pressure."

But in his view, the change was not good for Japanese dealers. "The number one concern is the profitability of the product," Hamada said. "From the viewpoint of the dealer, it's better to have an exclusive. It doesn't guarantee a monopoly, but at least there is less of a possibility that other competitors will come into your territory."

Hamada said there was no easy solution to the over-dealering problem in Japan. "For example, there are 11 vehicle manufacturers in Japan with a collective capacity of some 15 million units annually. But they are currently only making 11 million vehicles a year. Even so, a few makers are caught in an over-production situation. With more than 20,000 outlets in Japan, it's a game of survival of the fittest. There needs to be some kind of realignment and consolidation."

Given that over-dealering was also a recognized problem among importers, Matsumoto interjected, he did not understand the U.S. demands for more outlets in Japan, especially in light of low consumer demand.

"What would happen if the Big Three got what they wanted?" he asked. "I'm very skeptical about their current approach. They have introduced relatively low-priced models, but consumers see imports as luxury items. Maintenance costs are higher than the domestics because of quality and after-sales service problems, so I'm skeptical if they just increase the number of outlets, things will get better."

Hamada echoed this sentiment: "Considering the low demand, I have some doubts that expanding a dealer network is sustainable – because the individual dealer's situation may not allow for an exclusive franchise, which is what is being asked of them by Ford and Chrysler. Dealers may have to have dual outlets and sell others brands just to survive. It's the only viable approach for them."

Hamada said this situation could change eventually, "but only if the Big Three provide better models."

Marketing to the High End

Takehisa Takano, vice president of Mercedes Benz Japan Co., Ltd., is in charge of marketing and distribution for the German auto maker – one of seven foreign manufacturers to buck the downward market trends in Japan last year. MBJ posted a 5.4% increase with unit sales of 38,782 vehicles against 1996 sales of 36,773.[46] The company's ascendancy followed closely on the heels of BMW's success in the 1980s, but Mercedes took a rather different route in its marketing strategy. The company had enjoyed a relationship with Yanase since 1952 and set out to expand sales through this existing network, even after MBJ was established in 1986 as a wholly-owned subsidiary of Daimler-Benz AG.

At the same time, Mercedes set out to establish exclusive outlets by recruiting independent dealers into the "Stern" network. Later, in the early 1990s, the company began to press Yanase to establish exclusive showrooms for new model classes, and this effort began to bear fruit in recent years. Takano said Yanase would have a total of 80 exclusive Benz stores by the end of 1998, with a final target of 100 such showrooms. Today, MBJ has a total of 255 outlets throughout Japan – 192 in Yanase, 46 in the Stern channel, and 17 in the Mitsubishi network, where Benz sells only "E" and "C" Class cars in dual showrooms. While this last group had sales of only 298 vehicles in 1997, it fills a niche in local areas in Japan where it would have been too expensive for Yanase to invest in new real estate and construction.

While Takano agreed with the industry consensus on the 20/30 rule, he noted that the high margins on Mercedes cars might allow for a small dealer profit with sales of only 10 vehicles per month – provided the outlet was located somewhere in the Japanese countryside where overhead was especially low. This would be in striking contrast to the situation in the large cities, where you might have both small and large outlets competing against each other.

"In Tokyo, large outlets sell 500 units per year," Takano said. "In other big cities, 250 vehicles a year is a rather small outlet. And small outlets in Tokyo generally sell fewer

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[46] Many of the official sales statistics kept by trade associations and government agencies are based on new car "registrations," rather than actual sales, because this is an easier way to pick up and record the transaction for statistical purposes. However, relying on the registration figures masks the gray market phenomenon of so-called "parallel imports." These are cars that are purchased abroad through other channels and then brought into the country outside of the official importer's network. This might be done by an individual who wanted to purchase a specific model not offered for sale in Japan, or a by a separate company that wanted to take advantage of price differentials between countries.

In any case, Mercedes "official" sales reported by MITI and JAIA for 1997 were actually 41,905 units. The difference – 3,143 Mercedes vehicles bought on the gray market – are not counted internally by Mercedes Benz Japan, nor did we feel it was appropriate to include them for the purpose of computing efficiency ratios. Unfortunately, because of the difficulty in obtaining this kind of data, we were not able to arrive at this more accurate measure for most of the other companies surveyed.

than 200 units per year, but are located mostly in residential areas far from the center of the city."

Takano added: "In Mercedes' case, some areas of Tokyo have too many outlets – six, for example, when four would do nicely. But it's hard to cut the number [because of long-standing relationships with the dealers]. Even in some of the busiest areas of Tokyo, if there are too many outlets, sales will decline... I would bet the Big Three are not able to increase sales volume only by increasing outlets. If a dealer's territory is large, that means more sales opportunities for him."

Takano gave an interesting glimpse into the high service levels provided by domestic dealerships, especially the practice of "at-home" sales calls, which even a few years ago accounted for nearly half of all car sales in Japan, according to the Japan Automobile Dealers Association.[47] Because there is much stronger demand for domestic vehicles, Takano said, "a Toyota or Nissan salesman could make 100 home visits and perhaps develop as many as five buyers – not a bad average. In contrast, import salesmen would probably not find one buyer in a hundred such sales calls. That means that most sales of import vehicles are customer-initiated. So the big question is how do they trigger this call? They can't do that even if they increase the number of outlets."

Most importantly, Takano said, "There has to be some kind of partnership or guarantee to the dealer that even if the outlet becomes unprofitable, the importer will provide some kind of financial support. You either have to increase the sales volume or give some kind of assistance. First you have to make the existing outlet profitable. Then, if that happens, the dealer will open a second one nearby." This point was echoed by many of the dealers we spoke with. They were especially critical of Ford in this regard because the company was insisting on exclusive franchises but unwilling to provide substantial subsidies to dealers to see them through the costly start-up period.

Even mighty MBJ has had to come to grips with this situation. "Businessmen want to make a profit," Takano said. "Here at Mercedes, we don't give dealerships a lifetime guarantee, but the independent dealers in our Stern channel believe they can do business with us. These outlets opened in the heyday of the bubble economy. They got hit very hard. We wanted to avoid a situation in which Stern would close one after the other. But in order to keep them up and running, we gave them subsidies for three years to offset the operating losses."

Takano said this would also be the best long-term strategy for Ford under the present circumstances. "If I were Suzuki-san, I would not consolidate existing dealers. I would retain the existing outlets by giving them financial assistance. Of course, what I say is based on the assumption that there is a good communication between Detroit headquarters and Ford Japan, that they agree on the future road map… If there is no future strategic agreement between Ford Japan and Detroit, they will have to close

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[47] See also, "Toyota Calling: In Japan's Car Market, Big Three Rivals Go Door-to-Door," *The Wall Street Journal*, September 28, 1994, p. 1.

existing outlets… Ford set an ambitious target – 200,000 unit sales per year – they set a very ambitious target – but there's such a large gap between the target and reality."[48]

Asked about the clear evidence that Ford Japan had been closing as many outlets as it was opening, Takano said, "I don't know the specific outlets that were closed, but I heard that Ford closed 20 to 30 outlets so far – I don't know if they existed before or after the auto agreement." But, because word gets around, Takano said, "it must be very difficult for Ford to attract new dealers."

He also suggested obliquely that some of the key executives working with foreign auto makers may not be well suited for their jobs. "There are many Japanese who don't know much about the Japanese market," Takano said. "These are primarily Japanese businessmen with lots of overseas experience and good English, and they are hired by top management of the foreign companies. But it is often hard for them to be successful in Japan."

Despite his criticisms, it was clear that Takano had a lot of sympathy for the size of the challenge faced by the American auto makers. "It's hard for anybody to do that job," he said, noting that U.S. companies continue to misread Japanese consumers. The pursuit of "value," he said, does not necessarily mean the pursuit of inexpensive products, an apparent reference to Ford's decision to cut prices sharply last year.

"In Japan, lacquer ware from Wajima on the Japan Sea – one bowl might cost ¥10,000 to ¥20,000," Takano said. "You can say plastic is sufficient, but craftsmen have more time and are retained to add more value. People will spend money even if the price is high because they perceive value in the purchase. But if quality is below expectations, they won't buy even if the price is really low… Fifteen to 20 years ago, other Asian importers tried to make it in the Japanese market, but withdrew after a few years. I heard from a Mitsubishi dealer five or six years ago who was invited to preview the Chrysler Neon. They declined the offer…"

"So back to your question," Takano said. "There is a limit to what one importer can do. But the Big Three should improve the image of the U.S. and pursue product changes to attract consumers… Ford and GM have European designers in Europe. If the Americans are serious, they should do the same here [by hiring Japanese designers]. I think it's wrong for them just to demand an increase in sales volume or say the Japanese market is closed."

Takano also stressed the importance of a coherent long-term marketing and after-sales service plan. "In the initial phase – the first two or three years of a sales campaign – Japanese consumers might be tempted by a new model. But four or five years after the product launch, it's important for them to be satisfied. If there is a problem, they will

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[48] This was the original "Year 2000" sales target set by Ford shortly after the auto agreement. While the target has been fudged since then, the number 100,000 – an equally unrealistic figure – was until very recently still being repeated as a matter of company policy.

never come back… Forty years ago, most of the imported cars in Japan were American. But they were gradually replaced by German cars – the German auto makers didn't betray consumer expectations."

Takano was extremely critical of Big Three quality and model line-ups.

"I have a friend at Kintetsu Motors – a Ford agent. He complains that the control on the Ford headlight switch is too 'soft'. With a German car, you can feel the switch clicking at every interval. But with the American switch, there is no feeling that you're increasing the light volume. This is perhaps a small detail, but some people are very concerned about these details… There are other problems. The U.S. cars are not tightly put together. There is too much space between the metal panels. These details are not relevant to the proper functioning of the car, but Japanese consumers are very concerned about these things… At Toyota, the panels go through four or five stamping processes before they are ready. At Mercedes, we use as many as seven or eight stamping processes to realize the proper design."

Takano's explanation of why MBJ was able to expand 1997 sales despite the slow Japanese economy speaks volumes for the importance of a continuous stream of new models to maintain customer loyalty and excitement.

"Our new products made a big contribution to sales," Takano said. "The SLK roadster, for example, which sells for ¥4.9 million [$37,692 at $ = ¥130]. Our volume wasn't large – just 2,000 units sold. But we already have back orders for another 6,000 units even though there is only one model choice."

He added: "At the beginning of 1997, we introduced a 'C' class station wagon and did a model change on our 'E' class cars. The CLK coupe launched last September has sold 800 units in just four months, with a target of 3,000 for the year…. But 'C' and 'E' class sedans are our main product. Last fall, we introduced an 'E' class sedan with a sophisticated navigation system that cost between ¥500,000 and ¥600,000. But we held our price increase to just ¥100,000. Our customers know the value of the system very well…"

<u>From Mustangs to Old Gray Mares: "Anouk, Where Eeeeez You?"</u>

Tomotomi Arai is the General Manager of a DUO/Volkswagen-Audi outlet in Tokyo's upper-middle class Setagaya ward. There are more foreign cars per square mile of Setagaya than anywhere else in Japan, with a heavy emphasis on the ubiquitous German brands, but also a liberal sprinkling of Volvos, Rovers, and Jeep Cherokees. In 1996, there were 246,975 imported cars registered in Tokyo, and the denizens of Setagaya were

driving 44,139 of them – 18% of the total and nearly two and a half times as many as any other ward in the city.[49]

Arai's DUO outlet is one of three such dealerships owned by Tokyo Toyopet Motor Sales Co., Ltd., the largest auto dealer in the world with total 1996 revenue of ¥244.3 billion ($2.25 billion at $ = ¥108.78[50]) on sales of 76,932 new cars, 53,920 used vehicles, and 653,956 cars serviced.[51] The company is one of only 13 non-independent dealers in the Toyota sales network, with Toyota Motors Corporation holding 82% of the equity.

The DUO channel was created in 1992 to handle Volkswagen and Audi vehicles on an exclusive basis after the German manufacturer ended its long and sometimes stormy relationship with Yanase. Volkswagen's decision to leave the Yanase fold was based on a desire to establish its own import company in Japan and take direct control of its sales and marketing efforts to become more of a volume, rather than niche, seller. The move has paid off, despite the initial sales decrease the company suffered. Volkswagen and Toyota were able to build the DUO operation into a chain of 141 outlets, while at the same time VW pieced together 101 outlets in another independent sales channel called Fahren. According to Arai, about two years ago VW/Audi sales surpassed the previous levels achieved through Yanase. Nationwide last year, Fahren dealers sold 26,128 vehicles, and DUO dealers recorded sales of 34,002.

It should be noted that the Volkswagen-Yanase break is in many respects a familiar story for foreign car manufacturers in Japan. Historically, when foreign makers first approached the market, they did so rather cautiously. By concluding an exclusive deal with Yanase, the premier import car merchant, they could limit their initial investment by using Yanase as both importer and distributor. While profitable, the arrangement placed an effective limit on the number of cars that could be sold – not just because of Yanase's higher prices and exceptional service levels, but also because the vehicles would have to compete for a buyer's eye in a showroom filled with the models of other foreign manufacturers.

Over the years, other makers such as Volvo have also taken their leave of Yanase while, as we have seen, MBJ pursues its own hybrid three-channel sales strategy. Chrysler Japan's termination of its distribution arrangement with Honda was part of this evolutionary development, as was the series of acquisitions, beginning in June 1995, that culminated in a 100% stake in its own Japanese subsidiary in March 1998. Also part of this mosaic is Ford's joint build-up of the Autorama sales network with Mazda beginning in 1982 and then its subsequent 1994 take-over and renaming of the group as Ford Motor Co. (Japan) Ltd.

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[49] Coincidentally, imported cars attained about an 18% overall market share in Tokyo in 1996. In 1997, Setagaya residents bought 5,671 foreign vehicles – 30.9% of the 18,325 vehicles sold in the ward. [Sources: JADA, JAIA for Tokyo and Japan; Toyota Motor Corporation for individual ward data.]

[50] The average 1996 yen-dollar exchange rate.

[51] In contrast, as of March 1997, Republic Industries in the U.S. had a network of 278 dealerships with about $800 million in revenue, according to the National Automobile Dealers Association.

Similarly, last December, in yet another shift in Japan's auto landscape, Audi bought a controlling stake in Fahren to use the company as the base for an independent Audi Japan dealer network. Audi was scheduled to take over the import license from Volkswagen Japan Group (VJG) sometime in March. While the deal was made to give Audi a higher profile in the market, it was also an attempt to rescue Fahren from some of the debt it incurred because of the collapse of the bubble economy.

While most of these initiatives require a greater financial investment in the Japanese market and result in immediate and even medium-term revenue loss because of the termination of established outlets, the long-term strategy is clear: to build an exclusive distribution network and control pricing and marketing to boost brand image and – eventually – increase sales and profitability.

"There is no question that exclusive showrooms are more effective," Arai said. "It creates a much sharper focus by the dealer's management as well as the sales staff. For example, some Nissan dealerships used to handle Volkswagen Passat and Santana vehicles as a dual, but the partnership ended in failure because of problems of service and product quality. There is also a very different lifestyle and image projected by German and Japanese cars, and this can create risks in a dual outlet."

Arai noted that for relative latecomers to the market such as the Big Three, it was always more difficult to assemble networks of exclusive dealers because many of the best candidates had already been snapped up by the domestics and Europeans. Moreover, he said, there are sometimes legal and zoning restrictions – particularly in crowded residential areas like Setagaya – that make it difficult for newcomers to open sales and service facilities. But even if some of the official regulatory obstacles are removed, community opposition in the form of "Not-In-My-Back-Yard" protests about pollution and noise levels could still present potentially insurmountable obstacles to commercial development, just as they do in the U.S. As a result, foreign importers frequently try to make deals with existing dealerships to avoid the issue entirely.

Arai gestured out the DUO window toward the Chrysler dealer next door. "Route 246 – the main drag outside – is part of the old Tokyo Loop Line No. 8 and is quite similar to the U.S. situation," he said, in the sense that dealers of many different brands tend to cluster together on a strip much like fast-food restaurants. They are there to compete with each other, but also to create the atmosphere of a marketplace in order to boost business for everyone.

Arai said that because of this concentration, "customers no longer have any clear distinction between imports. Tastes are getting blurred, and manufacturers are harder pressed than ever to make a product that is clearly different." In this respect, he said, the Big Three's American-built cars have trailed far behind the European – and especially the German – entrants, which have garnered fully half of the import market for passenger cars in Japan.

This last statistic, while eye-popping, bears some explanation. Not all of these cars are Mercedes, BMW's, VW-Audi's or Porsches. The imports from Germany last year included 34,397 vehicles from Opel and 5,130 cars manufactured in that country by Ford. While Opel is a wholly-owned subsidiary of General Motors, you wouldn't know it for a second if you walked into a Yanase showroom to buy one. They are marketed as a uniquely German car, because the German reputation for top-quality highly-engineered machines is what sells in Japan and, for that matter, in America and the rest of the world. The average Japanese is not aware that GM owns Opel.

In any case, Arai said, while Chrysler had scored well with the Jeep Cherokee because of its distinctiveness, the Ford Taurus, GM Saturn, GM Cavalier and Chrysler Neon have not inspired any excitement. "Japanese consumers still expect to see something sexy from the U.S," he said, "something associated with the California design concept. But the current problem is psychological. People are losing their admiration for American cars."

Arai said he was now 50 years old and remembers when he was in college. "My father bought me a red Mustang convertible – used. The French movie, 'A Man and a Woman' had just been released," and he was captivated by the scene with Jean-Louis Trintignant driving around the beaches of Deauville with the top down and Anouk Aimée in his arms. "The Mustang was a pet project of Lee Iacocca when he was still at Ford, and there was a sense of yearning in Japan for an American car," he said. So, while Iacocca hasn't always been very friendly in his comments about Japan, there is no doubt that he contributed to the improvement of Arai's social life as a student. "The car was effective enough to attract some ladies," he laughed. "I won't tell you more. But it is that symbol of yearning that has been lost."

So what can the Big Three do to win it back?

Arai was direct: "Don't send us any compacts. And the designs are poor. There's not enough rigidity or strength. I drove a Cavalier for one year, but I felt if I drove it for one more, it would fall apart. The Americans should target the younger generation in their 20s to late 30s. Their tastes are clearly different from other generations, and they have good purchasing power."

Some cynics might consider the comment about the Cavalier to be a bit self-serving and gratuitous coming from a Toyota man who makes his living selling Volkswagens and Audis. But it should be remembered that the GM Cavalier has been re-badged in Japan and is being sold under the Toyota nameplate. Despite myriad quality problems, Toyota has promoted the vehicle aggressively and has been loath to discuss the situation publicly for fear of hurting both sales *and* trade relations.

Arai said the great attraction for German cars stemmed from their "focus on basic function and performance – safety, rigidity, stability, cornering, engineering – all the features that are fundamental for cars. The Japanese makers focus on comfort and options. They're very different kinds of cars."

Arai was asked about the demands of the Big Three, especially Ford and Chrysler, for more and more outlets in Japan. He invoked the law of diminishing returns. "Six years ago, when the first DUO showrooms were opened, total sales of VW-Audi were smaller, but the number per outlet was quite high. As the DUO channel gradually increased from 33 stores to 141, unit sales and profitability per outlet declined. For example, this DUO shop sold 355 vehicles last year – less than one and a half years after it opened. But if we sell 400 or 500 units next year and still earn the same profit, then 355 is better."

Arai then put his finger on the crux of the problem, and the reason why so many foreign car makers have set up Japanese subsidiaries to take control of their business. "For a dealer, profit is more important than volume," he said. "For an importer, volume is more important than profits.[52] I think this conflict will surface a lot in the future, and some import dealers will consolidate."

As long as foreign car sales kept growing, importers and dealers stayed on relatively good terms. But if imports decline, as they have for the past year, Arai said foreign car manufacturers will have to learn to help the dealer out of his predicament – "or both of them will get into trouble. The key to a dealer's survival will be to increase profit margins on new-car and used-car sales, maintenance and repairs, but there are a lot of import dealers who can't deliver good service."

Arai was asked what would happen if the U.S. makers really got what they asked for in terms of huge increases in the number of outlets in Japan. He saw a lot of potential trouble on the horizon, quite apart from the issue of low customer demand and dealer sales volume. "I remember when Toyota first started selling in the U.S. in the late '50s," Arai said. "The Crown couldn't even get up the hill in San Francisco. Then on top of that, management ordered an increase in sales. First we thought pricing was our key advantage, but then we realized good quality and maintenance were even more important. Are the Big Three really doing that in Japan?"

Arai said the same thing happened in Japan with VW/Audi. "They had terrible quality problems, but then became much better. But at first, we got an "it's not my department" response when we relayed the complaints to Europe. Finally, Volkswagen sent ten engineers to Japan to learn about the market first-hand. If the Big Three think the market is important, they should do the same. Japanese dealers have an image that American auto makers are not serious enough – that they are using trade frictions and resorting to pressure just to get what they want in terms of sales."

Arai recalled that when President Clinton visited Japan in April 1996 – nearly a year after the auto agreement was reached – he visited the nearby Chrysler dealership. "There was incredibly tight security, and police cars were all over my parking lot. My attention was

[52] It should be noted that in certain cases, such as Yanase's, the importer and the distributor are one and the same. In this situation, the dealer's character predominates and prices are kept as high as the market will bear.

completely focused on Mr. Clinton because he's my age. The American media were everywhere with their cameras, and one Japanese guy tried to throw yellow paint at the president – there are idiots in every country. But it made me think about the differences in generations in Japan. The older generation has a very set image of what a car should be, but the younger people are open to almost anything. The differences between imports and domestics are getting blurred, prices are often very similar, interest rates are low. It's a good selling opportunity for foreign makers."

THOSE THAT DID, AND THOSE THAT DIDN'T:
Japanese dealers tell why they do business with the Big Three… and why not.

Can't Make a Buck

Aichi Toyota is the successor company to Hinode Motor Co., Ltd., the first Toyota dealership in Japan, which opened in 1935 and unveiled the first vehicle ever made in Japan by Toyota. However, Aichi is a completely independent public company that trades on the Second Market Division of the Nagoya Stock Market. Its non-management staff is organized into a company-wide enterprise union with more than 2,000 members.

Of the more than 400,000 new vehicles[53] sold last year in Aichi Prefecture – the home of Toyota City and Toyota headquarters – Toyota models had a 53% market share. Aichi alone held about a 10% share, selling approximately 40,000 new cars, mini-vans and sport utility vehicles through 63 outlets – an astoundingly high average of nearly 635 units per outlet, far above the national average for Toyota dealers of nearly 355 vehicles per showroom. In addition, the company owns and operates 24 used car outlets, as well as three DUO VW-Audi showrooms. Aichi Toyota has a new-car sales force of some 680 employees, and 120 salesmen for used cars.

Naoki Yamaguchi, the company's president since 1976, gave a speech two years ago to the Foreign Correspondents Club of Japan to explain why most Japanese dealers were reluctant to sign direct franchise agreements with the Big Three. He said he thought the effort might help U.S. policy makers gain a better understanding of the market and make them less inclined to resort to trade sanctions. The simple truth, he said, was that dealers could not make money given the low demand for American cars, the high costs of building showrooms and service facilities, and the demands for exclusivity.[54]

[53] Excluding mini-cars.
[54] Naoki Yamaguchi, Foreign Correspondents Club of Japan, June 20, 1995. In his speech, Yamaguchi said, "…dealers in Japan simply don't have the resources to spare for building separate sales outlets to handle American cars. Nor can they be sure they could earn a profit on the American vehicles if they did set up sales outlets," Yamaguchi said. "If the question were one of selling American cars alongside Japanese cars in their existing outlets, dealers might be more enthusiastic. But the American auto makers have resisted that option."

Yamaguchi himself rejected a direct approach by Ford Japan based primarily on these three factors – and one other: Ford's apparent determination to build a dealer network far in excess of its needs. Speaking in the conference room of his Nagoya headquarters, Yamaguchi said: "Konen Suzuki and I have been good friends for a long time. I know him very well. But our primary concern is to create profitable dealerships. Ford's plan was to establish a network of 700 outlets throughout Japan, with 49 in Aichi Prefecture alone. At that time, Ford had seven to eight outlets in Aichi – all independent dealers in good locations. They wanted to sell 200 to 250 new cars a year in each outlet. But at this level [17 to 21 cars per month], it isn't profitable. So we asked them to give us responsibility for the entire territory of Aichi Prefecture, which they were unwilling to do. We decided to reject their plan on our own."

Analyzing the details of the deal, Yamaguchi said he and his top executives reached the conclusion that sales of 200 to 250 cars per outlet were "out of the question – because 200 per outlet means a minimum of 140,000 new cars sales per year nationwide if they create the 700 outlets they were talking about… Remember, they wanted to set up 49 outlets in Aichi. But this was unrealistic. At the most, 15 outlets would be suitable, and they wanted us to handle only three of these. We asked them: 'Are you really sure you're going to make 49 outlets in Aichi?' They said, 'Yes.' But the locations they offered our company were not good locations." Later, in an exchange of faxes, Yamaguchi added that even if one computed from the 100,000-unit sales target adhered to by Ford until the end of March, "that calculates down to 12 cars per outlet per month, which wouldn't be profitable. Our annual monthly sales for Toyota is 50 cars per outlet."

When asked what he thought would have been a realistic arrangement, Yamaguchi replied immediately: "Fifteen outlets with new-car sales of 200 a year at the most."

But could that be profitable given what he had already said?

Yamaguchi replied: "Well, that could be under certain conditions – like a deal in which we could use our existing outlets to sell the cars, and if they could introduce some attractive models. But Ford insisted on completely separate showrooms."

In this, Yamaguchi said, Japanese auto makers give their independent dealers wide latitude to run their business as they see fit and don't try to get involved in day-to-day details as a condition for granting a franchise. "Basically, the makers ask a dealer to be responsible for a certain area," Yamaguchi said. "They don't dictate how many outlets we should have. We are just Aichi Toyota and we are responsible for the territory. At the moment, we have 63 outlets, and some aren't profitable. But we don't shut them down. We just keep them alive… In Japan, makers and dealers trust each other, but that trust can have both positive and negative meanings" – the negative in this case being the money Aichi loses every year by not shutting down the unproductive showrooms.

His comments were reminiscent of an interview given in 1995 by Motoh Katsumata, the president of the huge Toyota Katsumata Group near Tokyo. Katsumata began selling

Fords in five of his outlets in November 1994. One of his biggest pet peeves is the company's insistence that he follow a standardized blueprint for all of his Ford showrooms.

"They tell you that if your building is this size, your sign has to be this big and so on," Katsumata said. "To break down that system of very detailed regulations seems to come as an attack on their pride. In Toyota's case, it's different. All you are required to do is put up one neon tower and the rest of the dealership is left to your individual discretion."[55]

Yamaguchi noted several aspects of the distribution system that were different in Japan from the U.S., suggesting that acquisition of outlets one-by-one would not be a viable strategy for a foreign car maker. Yamaguchi said this was because there were many more outlets in Japan that are owned either in whole or in part by the car manufacturers themselves – although he noted a major exception is the Toyota sales network where most of the dealers are independents. He said Nissan, for example, owned equity in about 80% of its outlets. "Consequently, if a large dealer with deep pockets like the American Wayne Huizenga were to come into the Japanese car market, he would in many cases have to negotiate directly with the car makers themselves," Yamaguchi said.[56]

He added: "Some people in the Japanese industry foresee a Big Bang in the distribution of cars – just like in the financial sector, but I am skeptical. In the U.S., the National Automobile Dealers Association [NADA] is a powerful group and can put pressure on the auto makers, but in Japan, JADA is not so powerful and can't negotiate effectively on behalf of the dealers." In addition, Yamaguchi said, "many Japanese owners – especially independent owners – don't really have a concept of retirement. An independent will work until the last day of his life. That's part of Japanese culture." Yamaguchi also spoke of the high cost of land and rental properties in Japan, a factor that makes it particularly difficult to accommodate U.S. manufacturers' demands for an exclusive showroom and service facilities to handle their models.

"Another aspect of the Japanese system is that registrations are time-consuming and complicated," Yamaguchi said. "In Japan, dealers cannot do the registration. The owner and a professional processor must complete it. It takes about 10 days. It's just a kind of red tape designed to keep the job of a professional registrar… People have been quite critical of this system, but Diet members [elected officials in the Japanese parliament] receive some support from the registrars, who are required to have the owner submit proof that he has a parking space. Usually, this is a retired police department employee. So the system creates many jobs. It's a structural problem in Japan."

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[55] "What to Do to Sell US Cars in Japan," Internet Netscape News, June, 1995; see also "Roadblocks, Roadblocks Everywhere: Ford dealer Katsumata isn't moving many Mustangs for now," *Business Week*, June 19, 1995.

[56] In America also, Huizenga wound up in a difficult battle with both Toyota Motor Sales, USA, and Honda Motor Co., whose managements were quite concerned about the possible negative effects of a large organization on quality, service and – quite naturally – sales. In both cases, the auto makers reached a private settlement with Huizenga.

Of particular interest to us were Aichi Toyota's experiments with an incentive compensation system, in addition to the traditional salary system. "Three to four years ago," Yamaguchi said, "we gave ¥5,000-¥8,000 per car and nothing if the salesman sold less than three cars a month. But now we have introduced the 'Challenge Staff' system – but only for the salesmen who want to participate. In this case, the salesman receives ¥55,000 to ¥60,000 per car, but he gets no bonuses and overtime pay."

Yamaguchi said that of his nearly 700 salesmen, "about 350 are enrolled in the program, and they are very productive. In many cases, their annual salary exceeds ¥10 million [$82,000]. About a hundred salesmen can reach this level. This is the biggest incentive given to salesmen in Japan. We only have 3% sales staff turnover rate. They would like to stay with the company… I really thought all of the salesmen could get involved. If a salesman can sell 70 to 80 cars a year, that would be very good for the company."

To avoid the problems cited by Omori at BMW's Toho Motors – enticing ambitious but inexperienced staff members into the fray – salesmen are first graded to see if they qualify for the incentive program. They must have sold a minimum of 50 new cars the previous year, and then they are expected to sell between 30 and 40 cars in the first six months after they switch over. Otherwise, they are encouraged to go back on salary so they will be protected from a large income loss. For a top earner who sells 80 cars a year, 48% of his total compensation would come from incentives and 52% from salary.

But, Yamaguchi said, returning to the subject of Big Three difficulties, "the fundamental requirement for success is that the models should be attractive to the Japanese consumer. We are trying to sell the Cavalier. I think it's a good car, but for unknown reasons, it doesn't sell.[57] We still don't know why, but for some reason they do not appeal to Japanese consumers."

And as for the contradictions in Ford's strategy? "It would be better to expand the unit sales per outlet first, then expand the number of outlets… For example, let me tell you about our DUO (VW-Audi) sales channel. We sell about 40 new cars per month in each of three outlets, which translates into sales of about 1,400 a year. And this is *profitable*," Yamaguchi said, carefully emphasizing the last word.

Back to the Future

Makoto Nakajima hopes his second marriage to Chrysler will be better than his first. Twenty years ago, when Chrysler held a substantial level of equity in the Mitsubishi Motors Corporation, he was the executive assigned to run Saitama Mitsubishi Colt's Chrysler showroom. The result was a disaster.

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[57] Sales of the GM Cavalier, re-badged as a Toyota, were 9,406 in 1997.

"In 1978, Mitsubishi and Chrysler still had a very good relationship," Nakajima said, "but back then Chrysler's products were very, very bad."

He has nightmare memories of three lemons – the Omni, the Horizon and the Valiant – that were shipped to Japan at the time. It was Nakajima's job to sell them, but it proved impossible. After 12 months, his company shut down the showroom.

"It took two years for the manufacturer to get rid of their inventory," Nakajima recalled. "For us, it took five years. As a result, I was passed up for promotion and transferred to a job I didn't like."

But now that Nakajima is president of the company, he has placed a bet that future business with Chrysler will justify his latest investment – an exclusive franchise agreement and a new Chrysler showroom that he opened last October under the name Saitama Higashi Chrysler Ltd. In it, he is selling the right-hand drive Voyager minivan, the well-known Jeep Cherokee and Wrangler, and the Neon. So far, they have been selling only about 10 units a month, with about 60% of all sales being registered by the Voyager and 30% by the various Jeep models. But the Neon, true to its form in the rest of Japan, has not attracted much customer interest. Nakajima simply referred to it as a "big flop."

Nakajima said they needed to sell about 20 new vehicles a month in order to make a profit in the new outlet – at the low end of the 20/30 rule – but he said he was able to conclude a deal with Chrysler that didn't force the company to make a major investment in new facilities. Yes, Chrysler did require them to build an exclusive showroom, but the company already owned the land and they were also able to utilize the same service garage for both the Chrysler and Mitsubishi product lines. This would have been out of the question with Mercedes Benz, the other importer with whom Nakajima had held some discussions. While Saitama Colt did make some new hires, they were able to hold expenses to a minimum by transferring some other staff members and executives who were already with the company.

One of them was the man who – 20 years earlier – had urged Nakajima to take on the challenge of selling the Omnis, Horizons and Valiants. On the day of the interview, this gentleman – now general manager of Saitama Higashi's sales department – was seated across the table when Nakajima was asked how soon he expected the new enterprise to begin generating enough cash flow to cover operating expenses. The sales manager jumped into the discussion to say that he expected Chrysler sales to pick up after April, when the Honda dealers would be finished selling off their Jeep inventories at bargain basement prices.

"Well, now that I'm president, if you don't start making a profit this spring, it's your turn [to be transferred]," Nakajima said, as the room exploded into laughter at what everyone acknowledged was the sheer impossibility of the task.

Still, Nakajima said, he does expect to do a lot better with the Jeep and the Voyager than the lemons of yesteryear. "Chrysler's minivans are an excellent product," he said with a bit of salesmanship, "better than the Honda Odyssey and even better than Mitsubishi's Delica. We can also compete quite well with Benz because there is no equivalent in their line-up." Nakajima estimated his best-case future sales scenario with Chrysler to be somewhere between 20 and 30 units a month.

But such optimism pales in the face of Saitama Colt's main business, which is selling the entire line of Mitsubishi products through two sales channels known as Galant and Car Plaza. Nakajima said his company had a total of 11 new-car outlets in the Galant division, plus two used-car sales facilities. The Car Plaza division has three new-car outlets in Saitama Prefecture.

In the April 1996-March 1997 fiscal year, Nakajima said, the Galant showrooms recorded new car sales of 5,160 – or 39 units a month per outlet – while Car Plaza sold about 840 vehicles for an average of 23 cars a month. Reflecting the general downturn in the Japanese auto industry, Galant sales in the first six months of the 97-98 fiscal year were down to 2,010 units, but still in the profitable range of 30 a month per outlet. Car Plaza unit sales were only 300 – just shy of 17 units per outlet per month.

Why did Nakajima and his company decide to take another chance with Chrysler in light of their previous bad experience?

He said there were two basic reasons. "First, despite the trouble, I felt close to Chrysler. We had maintained various continuing relationships that grew out of the old Chrysler-Mitsubishi alliance. Our company was founded 50 years ago, and I was always interested in imported cars. We discussed offers from French, German and Swedish makers."

"But more importantly," Nakajima noted, "Chrysler said they would give me the whole of Saitama as an exclusive territory. There is severe competition among dealers. For example, in Saitama alone, there are 19 dealers handling Mitsubishi vehicles with about 60 outlets. But Chrysler was ready to give me the whole prefecture. On top of that, it was completely up to my discretion as to how many outlets and sub-dealers I decided to set up."

He said this was particularly important because all of the Saitama Colt companies are independent, with no equity held by Mitsubishi, and he wanted to maintain his freedom to do business as he saw fit. Ultimately, Nakajima said, he decided to make a deal for only half the prefecture, but that was his decision, not Chrysler's.

Nakajima was asked if he was aware that the Chrysler distribution deal with Honda was in the process of coming unraveled before he signed the new franchise agreement, since the termination of the pact would strengthen the position of all of Chrysler's independent "main dealers." He said his first talks with Chrysler began about two years ago at a time when the Honda network was selling 10,000 Jeeps a year. "I was convinced," he said,

"that those numbers meant there was a good partnership between Chrysler and Honda, that they would never give up that business. On the other hand, the main dealers for Chrysler – who had no other maker's products to augment their sales – were getting pretty worked up about the fact that the Honda dealers were discounting their Jeeps. The main dealers complained to Detroit frequently."

Then, when Nakajima went to Chrysler's Michigan headquarters early last summer, "to my surprise I started hearing rumors that Chrysler was seriously considering termination of the Honda contract. I didn't believe it at first, but then I spoke to the executive in charge of the Asian region."

In part, Nakajima attributed what he called his own dealership's "current very low level of sales of Chrysler models" to the fact that Honda dealers had indeed been working off their remaining inventory of Jeeps since the contract termination was announced last September. (In this respect, he took a little of the sting out of his earlier quip at the expense of his sales manager.)

"The Honda guys were offering very steep discounts," Nakajima said, "sometimes less than our purchase price.[58] Now it was my turn to complain to Detroit about lost sales, but I got nowhere. They said, 'We sacrificed. Now you sacrifice.' So we get no subsidy or incentive from Chrysler to help us over the start-up period."

Interestingly, Nakajima said, when he told Chrysler executives in Detroit about the past problems his company had had with Chrysler products, "they didn't know the history." But fortunately, he said, the company's products were "much improved" since then.

Nakajima said Chrysler Japan Sales owns its own dealership in Saitama, but Nakajima's exclusive territory includes 50% of the prefecture's area and 60% of the population. He said the franchise agreement was one year renewable.

When speaking of the problems of over-dealering in Japan, Nakajima – like others we interviewed – volunteered that he was aware of a number of Ford dealers in Saitama prefecture who wanted to terminate their franchise agreements because of low sales and the high number of outlets.

"Ford Japan has built a significant dealer network with quite a number of outlets," Nakajima said. "One dealer per city with three or four outlets would be enough, but Ford has many more than that. You know, customers are not blind. They quickly pick up on the problem and start shopping around for a good deal. 'This dealer offered me this, this

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[58] It should be noted that the Honda dealers were not acting in a predatory fashion, but simply responding rationally to market forces in their own special circumstances. Because of intense competition and the overall downturn in auto sales in Japan in 1997, they were already discounting various Honda models by as much as ¥200,000 or more per vehicle (upwards of $1,600). It would have been virtually impossible for them to refuse their customers the same discount on Jeep models which were, after all, being sold from the same showroom.

dealer offered me that.' As a result, prices are spiraling down quite steeply. And this is a real problem, because especially with imported cars – unlike domestic cars – you can't depend on volume sales to make a profit. The profit generated for each unit sold is crucial for imported cars. So Ford dealers are going through quite a few difficulties."

"When I met with executives from other companies, I felt they didn't understand the Japanese market. For example, in the U.S., when you have a large city – say with one million people – the next big city is quite far away. Whereas in Japan, we have large cities right next to each other. But Ford and Rover have established dealerships covering every city in Japan with one million population. So at the end of the day, there are dealerships handling Ford and Rover quite close to each other. Competition is driven by discounts. I know some of the dealers handling Ford want to leave the network precisely because of this problem."

Sitting on the Fence

Almost before we could sit down for a little small talk, Toshio Nakamura, the executive managing director of Ford dealer Kintetsu Motors Co., launched into a passionate – but short – speech about the openness of the Japanese market and what he considered the poor quality and appeal of American cars.

"The market is open. The product is not good. I hope you will write that."

Mitsuo Sato, managing director of the oldest Ford franchise in Japan, was equally unhappy. He spoke bitterly of the so-called "gray market," and both men indicated they were seriously considering withdrawal from the Ford sales network. Sato noted that more units of some American models were brought into the country through "parallel" importing companies than through authorized sales channels. He cited the famous case of the Chevy Astro, the GM minivan that has achieved almost cult status in Japan and which at one point was (and perhaps still is) the best-selling American vehicle in the country – even though neither GM nor its agents were aggressively marketing them. The Astro, which has a very small following in the U.S. and hasn't been redesigned in more than 12 years, became a particular favorite among affluent Japanese yuppies, who would tear out the interiors and customize them with an array of furnishings and accessories.[59]

Sato said the Astro phenomenon was what he called "rather accidental," but there were still more than 10,000 units being sold on the gray market. Similarly, he said, Chrysler and Ford also had models that were being imported into Japan independently because they were not offered for sale at regular franchised outlets. "Many of our younger generation

[59] See, for example, "How to Captivate the Japanese Consumer: The Cult of the Astro Van," *Fortune*, August 18, 1997. In 1996, it was estimated that about 14,000 Astros were sold in Japan on the gray market alone, putting it in a virtual tie with the Jeep (actively marketed through exclusive Chrysler dealers as well as the Honda network) as the most popular American model in Japan. In third place was the GM Cavalier distributed by Toyota, with sales of about 12,000 vehicles.

look to America to satisfy their tastes," Sato said, "but the Big Three just aren't importing the cars that fit these tastes… For example, when you look at the European makers, if they sell 100 different models in their own country, you will be able to find 80 of them in their showrooms in Japan. But in the case of the Big Three, you might find just 10 different models in Japan," Sato said.

Among the vehicles sold through the gray market, according to Sato, were the Jeep Cherokee (especially before Chrysler agreed to lower the price), the Caprice, the Dodge Ram pickup truck, GMC Suburban, GM's Tahoe, and the Corvette. Sato said the situation had changed on the Corvette only recently because Yanase, GM's Japanese distributor, had dropped the price on the 1997 models. The Thunderbird was also brought in through parallel imports up until 1996, he said, but Ford discontinued the model even in the U.S. last year, so it is no longer available anywhere.[60]

Sato and Nakamura said documenting the true size and composition of the gray market was always difficult, but we were later able to get a pretty good feel for it by analyzing several import statistics and cross-checking them with sales recorded by authorized dealers. According to 1997 MITI statistics on new car registrations, there were 16,544 GM "commercial vehicles" sold in Japan last year. The same records listed 1,402 Ford commercial vehicles and 934 commercial vehicles for Chrysler. The catch is that the three U.S. car makers do not sell commercial vehicles in Japan. The numbers show up in the registration statistics because customers buy the non-commercial versions to avoid paying a higher tax, then convert them to commercial use before they are registered. But a quick check with Yanase – the only authorized non-commercial Astro dealer in Japan – revealed the company sold only 608 Astro vans in 1997. So if the Astro is still selling well above 10,000 copies a year (as seems likely from the commercial registration numbers), we can be fairly certain that virtually all of them are "gray market."[61] If 80% of the Big Three "commercial" vehicles came in as parallel imports, the total would be over 15,000 vehicles – more vehicles than any of the Big Three imported individually and sold through their legitimate sales channels.[62]

Nakamura said Kintetsu Motors had been a Ford dealer for 40 years, just 10 years less than Sato's New Empire. But while their comments about Ford strategy and products in

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[60] Among the other models terminated in America in 1997 by Ford were the Probe, Aerostar and Mercury Cougar. The company subsequently announced that a new redesigned Cougar aimed at the younger generation would be launched in 1999 and aggressively promoted on its own Internet web page.

[61] One of our Japanese researchers digging around in this arcane world discovered that it is actually possible to obtain a license plate in Japan without specifying the name and type of the vehicle on the paperwork. If the vehicle passes emissions and safety tests, an owner can simply write "unknown" in the appropriate spaces on the application. Not all drivers do this, however. As a result, local Ministry of Transportation offices were able to provide an unofficial breakout of GM's 16,544 "commercial" vehicles. About 2,300 were listed as Chevrolet Blazers, 860 were identified as Astros, and some 200 were Silverados. The balance – a total of 13,184 vehicles – were simply listed as "Chevrolet/Type Unknown." Nearly all of these would be "gray market" Astros.

[62] It's not only the Big Three that have this problem. As we saw in an earlier section, Mercedes Benz Japan confirmed that more than 3,000 Mercedes registered in 1997 were gray market cars.

Japan – if publicized – could not possibly be designed to increase their own sales, they were reluctant to say categorically that they would discontinue their business relationship with Ford.

"We have always been loyal," Nakamura said. "So my hope is to remain. But if we cannot generate a profit, we would have to seek other possibilities… There is an on-going discussion between Ford Japan and Detroit. We would very much like to increase the model line-up."

Nakamura added a strange twist to the volume of criticism that has been lavished on the Big Three's failure – until just four years ago – to make right-hand drive models for Japan. "The current Big Three thinking is just to focus on right-hand drive vehicles, but our customers are used to left-hand drive, so we have to keep at least some of these models. Unfortunately, the American mid- and small-sized cars are just the same as Japanese cars. Left-hand drive might even add some prestige for some customers… Also, only the steering wheel has been moved on the U.S. cars. It's not a real right-hand drive in the sense that the directional signals have also been switched on the steering column."

Sato said he had been in the industry for only six years. "My father started this business. I was surprised – we have one single outlet – by how small the profit margins are. The warranty [from the manufacturer] covers only a very narrow area. So it means the dealer has to be responsible for many, many items. When the warranty runs out, the situation could even generate a loss."

"I would say there are not too many dealers who are currently pleased with Ford's policies," Nakamura said. "Ford wants to increase the number of outlets over a very short period. And actually too many outlets came into the network. Some entrepreneurs in other business lines have been setting up dealerships. These newcomers are frequently impinging on other dealers' territories. This is a consequence of wanting to sell a high number of units as quickly as possible."

"There is a structural economic problem in Japan," Sato added, referring to the over-dealering situation. "Many other manufacturers and dealers are not making money either. But everyone is rushing to popular models… When it comes to Kintetsu or our company, if the situation becomes too difficult, we would have to close…"

Nakamura said that when he complains to Ford that they are not enforcing the territorial boundaries in the franchise agreement, "They say they are very sorry, but they don't say they will do anything about it."

Nakamura said he might even consider litigation if the situation got worse, but he avoided any definitive statement about terminating his franchise agreement with Ford. At the moment, he said, Kintetsu had a total of 10 outlets, including three Stern Mercedes Benz showrooms in and around Osaka. "We couldn't survive with just Ford. We opened the first about eight years ago, then we opened the second five years ago, then the third one in

Nara just two years ago… For all three combined, we sell between 500 and 650 units. It's a very good business."

But Sato said he had only one outlet, having closed one in Chiba some time ago.

"My basic philosophy is to survive – even if it means reducing the size of our company... We are concentrating on a fixed customer base and treating them very well. We have whole families buying from our outlet, and they sometimes ask us to help them purchase other makes of cars. So we are also selling Mercedes Benz, Ferrari, BMW, Rolls Royce, Bentley, Volvo or whatever. We're acting as a sub-dealer in a sense."

Sato said he had sold an average of only eight Fords a month in 1997, and 10 or 11 vehicles a month the year before that. "This year we're down to three or four cars a month, although in previous years we were selling 70 or even 80 a month," Sato said.

Nakamura said he had had a similar experience, although on a much grander scale. His problems began in 1982 when Ford decided to set up its own Japanese subsidiary and began building the Autorama dealer network with its equity partner Mazda. The competition from the increased number of Ford outlets was devastating. "Kintetsu was selling about 100 units a month before Ford Japan was set up and we imported directly from the U.S.," Nakamura said. "Our all-time high was between 1,600 and 1,800 cars a year – about 1965 or 1967. Now we sell about 800 to 900 a year for all 10 outlets. That's only half the volume, and the profit margin is about one-fifth what we had in our best years. In 1996, we sold 1,300 cars total. That was so-so. We generated some profits."

Building for the Future

Although he is a university graduate and greets visitors to his office in a suit and tie, Haruo Yumoto looks more like the kind of man one expects to see emerging from an auto repair shop with a tire iron in one hand and an oil-stained rag in the other. And indeed, this bearded, plain spoken owner of seven imported car outlets has worked his way up through the ranks.

After graduating from university in 1958, he signed on with Toyota as a salesman of new cars, then 10 years later shifted exclusively to used car sales for the company. While still maintaining his association with Toyota, he struck out in a new direction 14 years ago, setting up a Honda franchise. Then, a year later, he concluded a franchise agreement with BMW. His first contact with Chrysler products came when Honda reached an agreement with the American auto maker to distribute Jeeps through the domestic company's dealer network. At the time, it made sense for Honda on two levels. One, the company felt the gesture might help to improve trade relations and blunt pressure from the U.S. and, two, it helped fill a hole in the Honda product line, which at the time did not include any sport utility vehicles.

"Until recently, we enthusiastically sold Jeeps through our three Honda outlets, and we were number one in the number of Cherokees sold," Yumoto said. "Three years ago, without notifying Honda, we established a separate showroom dedicated only to the Cherokee. When Chrysler started looking seriously for independent dealers, we concluded a separate franchise agreement with them directly."

Apart from the favorable sales record, Yumoto said, "Another factor in my decision relates to my personal life. I was born in Peru, but I also spent a year and a half in Texas. The U.S. is my favorite country. I had seen how great the U.S. was. American cars have not sold well in Japan in terms of volume, but I believe in their future."

Yumoto said he now owns seven different outlets – two dedicated exclusively to Chrysler products, three to the Honda line, and two to BMW. Comparing the sales records of the different makes, Yumoto said he sold about 850 Hondas last year (an average of 283 units per outlet), 320 BMWs (160 per outlet), and 190 Chrysler vehicles (95 per outlet).

"BMW was by far the most profitable, then Honda because of the large sales volume. We have yet to make a profit from the Chrysler showrooms," Yumoto said.

Koji Takano, the general manager of Yumoto's Chrysler operations, said virtually all of their sales had been the various Jeep models. "Regrettably, their passenger cars have not been so popular. We sold a total of only seven Chrysler cars last year – some Neons and one or two of the Stratus – but Chrysler stopped making the Stratus."

Speaking of customer perceptions of the Neon, Takano said, "The biggest problem is that brand recognition is very low. Many people have not even heard of the car. Last year, Chrysler cut back both PR and advertising. It was a very severe cut – it's almost non-existent right now."

At the same time, Takano said, "The Jeep exposure was quite good… The customer response was strong. For one thing, it has a longer history in Japan – since about 1984. Then, since 1991-93, the price has been reduced to make it more accessible from the customer's point of view. And of course, the sport utility boom is on in Japan."

Asked about the termination of the Chrysler/Honda distribution agreement, Yumoto said, "It was a natural course for Chrysler to proceed with its own business in the Japanese market. I expected Chrysler would be more determined to increase their efforts. There are still some areas where I think they should do more, but looking back I think they have made steady progress."

Yumoto added: "But let me discuss the larger implications of your question. The Big Three demanded an increase in dealers. One difficulty they may face is that customers have had some bad experiences. Dealers cannot expect to do a volume business or to achieve profitability. The product line-up is still small. The Jeep Cherokee is popular, but

there are no other models that are… When I signed the deal with Chrysler, my own employees asked, 'Why?' But my business is now attracting a lot of attention."

Asked if he thought he could eventually break even, Yumoto replied: "Of course. I am an optimist."

Asked about American trade complaints concerning outlets, Yumoto preferred to look at the question from a business perspective only. "I think there are too many dealers set up by the auto makers themselves," he said. "In Japan, there are two categories – independent and manufacturer-owned or affiliated. I personally feel that there are too many dealers set up by the manufacturers, both domestic and imported. They set a higher value on volume of units rather than profitability of the dealer's business."

Yumoto was asked how he would rank the various dealer networks in Japan – both domestic and imported – from the point of view of quality.

"I really can't comment on the domestics because these dealers' priority is to sell volume, and they are in a very severe competition. On the imported side, however, I have a high regard for Rover of the U.K. and Volvo of Sweden. They are developing in a good manner befitting the market."

What about U.S. complaints in other areas?

Yumoto said: "Regarding their concerns on zoning de-regulation [to permit the construction of additional service garages in residential neighborhoods], actually I think I agree with them – because it's very difficult to set up a new outlet. But this situation is beginning to see some improvement. I also personally feel that their other demands are not so reasonable. Of course, it is more important to provide attractive product. This might require them to come up with better models based on a deeper understanding of the market."

Takano echoed those sentiments. "The gap between trade and business issues is very wide. Sometimes the problems might appear so subtle and so small – like customer color preferences. But we sometimes get vehicle colors that don't sell well in Japan, or we can't get a certain color because the U.S. companies decide not to make it for export. You get the feeling that when the Americans finally decided to make right-hand drive vehicles for Japan, they thought they had solved all the problems of the market. So they tend to ignore all the other important things. We try to communicate these issues, but without much response… Consumers are very fussy about these things."

Echoing a complaint raised by Kintetsu's Nakamura, Takano said the right-hand drive configurations provided by the U.S. companies are not completely adapted to the market. "For example, the usual set-up on Japanese cars is for the light and direction signal arm to be mounted to the right of the steering wheel, and the wiper controls and wheel-tilt to the left. In America, of course, it is the reverse." So, Takano said, they get right-hand drive

vehicles with all the controls on the wrong side of the steering column, which is immensely irritating for someone used to driving Japanese cars. "All Jeeps in Japan have this problem."

In the same vein, an even more egregious omission occurred when Chrysler first began shipping right-hand drive Jeeps, Takano said. The gear shift lever between the seats was left unmodified, so the handle was protruding in the wrong direction for a driver in Japan. "At least we don't have *this* issue any more," Takano said.

Car Wars: All Over the Lot

Kyoichiro Shibata is living proof that even the biggest and brightest Japanese companies can lose their way when they enter into a new business – even in their home market. The president of Nissho Iwai Motor Sales Corporation (NIMCO), which is one of four separate sales channels in Japan for the French-built Peugeot, tells a story that for sheer complexity would put Byzantium to shame.

The serpentine twists that Shibata's company has been through began with a decision by its parent, the giant trading company Nissho Iwai, to find a way to get into the automobile business in Japan. Nissho Iwai's strategy evolved as a direct result of the 1985 Plaza Accords among the G7 nations to take concerted action to weaken the value of the dollar, particularly vis-à-vis the yen. Since such a move was certain to make exporting to Japan more attractive for foreign companies, Shibata said, Nissho Iwai wanted to take advantage of the new opportunities by expanding its activities on the import side.

The company's first efforts to build up its then very small presence in the auto industry began by trial and error, Shibata said. In 1988, they concluded a joint venture with the Suzuki Automotive Company to import GM cars into Japan, capitalizing on Suzuki's equity relationship with GM. At the same time, Suzuki was approached by Peugeot, which was already distributing its products through Seibu and Rover. The resulting joint venture, called Suzuki Import Car sales, served as distributor in Japan for Peugeot and whatever GM models were not already being handled by Yanase – such as Pontiac. In addition, the agreement between the companies held out some hope that they might get GM's Saturn business if the U.S. auto maker ever decided to enter the market with that line.[63]

But after only two years, Shibata said, GM and Yanase entered into serious negotiations to expand GM's business in Japan, and Pontiac was included in the deal. The Suzuki venture's designation as importer was summarily terminated, and Yanase was named in their place.

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[63] Talk of Saturn's imminent entry into the Japanese market has been around for years, but GM repeatedly postponed the launch date.

“That left us with Peugeot only,” Shibata said. “In that short time, we had invested more then ¥10 billion [$82 million] in land and new buildings, and had built six outlets and one service garage… But then the bubble economy exploded, and the business situation with just Peugeot models was not very viable.”

In their first restructuring in 1993, Shibata said, they shut down two outlets and the service garage, but about the same time, a company named Mizwa won the import rights for Sweden’s Saab from Seibu. Mizwa soon approached NIMCO people and asked them to sell Saab together with Peugeot. “At the time,” Shibata said, “there were already three Japanese distributors for Peugeot – Suzuki, Rover and Seibu – and there was a cut-throat fight between the companies.”

As a result, Shibata said, Peugeot organized a new joint venture company – this time with Peugeot parent PSA holding the majority equity. The new combination excluded Rover, but Suzuki, NIMCO and Seibu struggled along for three more years before the company finally failed. Peugeot then asked Inchcape, a British company that was selling Toyotas in Europe, to piece together a new Peugeot Japan and split the equity with PSA 50/50. The other players, including NIMCO, kept their dealerships.

“So within 10 years,” Shibata said, “the Peugeot importer changed three times, the car’s market reputation was destroyed, and all of the partners suffered a huge financial loss.” In addition, he said, since 1993, the Saab importer changed twice. Mizwa terminated its agreement with the Swedish company in September 1996, whereupon Saab formed a 100% owned import company as a GM division of Japan. “That didn’t even last one year,” Shibata said. “Last year, Saab Japan went out of business and transferred its import rights to Yanase. Saab had been very good, very profitable for us, contributing about 28% in gross profit.”

So that brought Shibata and NIMCO back to square one, with just the Peugeot business in Tokyo and the Porsche dealership in Osaka – oh, he hadn’t mentioned that? They now have four outlets – two that sell Peugeot only, located in the upscale Meguro and Setagaya wards of Tokyo – and one each in Osaka (Porsche and Peugeot) and the Kansai city of Nishinomiya (Peugeot only).

Shibata said the best revenue years for the various ventures came in 1990, when they sold 5,400 cars for Peugeot, and last year, when they sold 5,760. Of that, NIMCO accounted for about 21% of the total with 1,200 Peugeot sales through its four outlets. The Meguro store finally turned a small profit last year with 700 unit sales, 400 directly to customers and another 300 sold wholesale to sub-dealers in the countryside.

Inchcape itself last year sold 2,995 vehicles through its network of 97 outlets, while Seibu accounted for 1,152 units, and Suzuki dealers sold 413 vehicles. “Inchcape is trying to consolidate the dealer network, but we are fighting,” Shibata said, lest they get consolidated to death. “We should have gotten out of the business after the joint venture with Suzuki fizzled, but we made a big investment, and right now we have about 4,000

accumulated customers who require service, so it's more difficult than ever to quit. With land prices down one-third since the bubble, we need about a hundred years to recoup."

At the time of the interview on February 2, Shibata said sales had been good in the past two years and they were hoping to expand market share and reach break-even on an operating basis in one or two years. He said their service income was now covering about 40% of total overhead, and meeting the remaining 60% with new and used car sales was "do-able." He said they needed to sell between 250 to 300 units annually (21 to 25 a month) to make the outlets profitable because the margins on the Peugeot 306 and the new Peugeot 406 sports sedan were "very good." They should be: the 406 sells for ¥5.1 million, slightly more than the Mercedes SLK that enjoyed so much success when it went on the market last fall.

Shibata said NIMCO's gross profit on sales was 13% -- again, very good – but he feared slower sales and severe price competition from Opel and Volkswagen. He was also afraid that domestic outlets, faced with a large over-dealering problem nationwide, might turn more and more to imports to augment their sales opportunities. He specifically cited the VW/Audi deal with Toyota DUO dealers, and the Ford-Mazda combination.

"If this trend continues," Shibata said, "traditional import car dealers [such as Kintetsu or New Empire] cannot survive because of high overhead costs in Tokyo and Osaka. He said rental costs for 750 *tsubo* – 8,070 square feet – in Tokyo were ¥8 million a month, while long-established Toyota and Nissan dealers were paying only ¥3 million for twice the space. He said other operational costs, however, were "about the same as for domestic dealers."[64]

"In any case," Shibata said, "Ford dealers cannot make money; Chrysler dealers cannot make money. But Yanase does make money. They have a nationwide channel, and most of them are dual brand sellers. I doubt they're making money from Opel because of big volume discounts. Yanase also cut prices because of competition from VW – rock bottom prices to attract customers. They haven't forgotten their fight with Volkswagen."

Shibata agreed with many other dealers who criticized Big Three imports for being too similar to Japanese cars in size and design. "Small cars is not the image of America," he said. "The image of American cars is big and powerful. That's the problem with Ford Japan and with the Cavalier."

Do the Big Three really need more outlets right now?

"That I cannot understand. By increasing the number of outlets, they are creating even worse competition among the dealers," he said, adding that both Konen Suzuki and Hideo

[64] The lower overhead costs for the domestic dealers stem primarily from earlier market entry. In some cases, land and facilities are owned outright, or long-term leases were negotiated well before the "Bubble" years.

Hohgi, the former presidents of Ford Japan and Chrysler Japan, both came from domestic manufacturers who do a volume business. "They were trying to copy that system."

Shibata agreed with MBJ's Vice President Takano that door-to-door sales would not work for the American companies because their existing market share was too low. He also thought there might be a dealer consolidation in Ford's future.

"The dealers on the front line need to make money to invest and re-invest," Shibata said. "For that, we need volume, but we also need to limit competition so that volume can reach a certain level – say 200 cars a year. Ford dealers cannot do that kind of volume, but they still have the competition. And management cannot give incentives on cars that aren't being sold."

Shibata also stressed what so many of his colleagues noted: "I think the most important factor is the product. If it's attractive, the customer will come a long way to buy it."

Shibata did not reserve his criticisms just for American vehicles, however. "The Peugeot commitment to Japan is still weak," he said, adding that there was a certain negative mentality engendered by PSA president Jacques Calvet, who has been very outspoken in his cultural criticisms of Japan and the Japanese.

He also thought Ford had a foothold because of its control of Mazda. Ford's stated plan to produce American cars in Japan after the year 2000 might also be an opportunity, he said, since transportation and homologation costs were certainly extra and perhaps unnecessary expenses on the export side.

Asked to name the U.S. products with appeal, Shibata cited the Chrysler Voyager, and the Chevy Astro, the king of the gray market. "These were so attractive initially, but Japanese manufacturers quickly developed competing products," such as the Honda Odyssey, he said. Shibata said Chrysler was once approached by a Japanese company about importing the Dodge Caravan, but – incredibly, in his view – Detroit headquarters first demanded a guarantee of 800 units in the first year.

He said he thought the Voyager might have the potential to sell 1,000 units a month for one to two years. But as to the others?

'The Taurus – nobody likes the looks. Same for the Mondeo. The Neon? They failed – they tried to sell by price only," Shibata said.

In for a Penny, In for a Pound

Motoh Katsumata, president of the largest privately owned auto dealership in Japan, began selling Fords in five of his 250 outlets in November 1994. He says he did so because he believed imports could eventually capture 15% of the Japanese market, and because he felt Ford had made the greatest commitment to Japan.

His grandfather was a Ford dealer in the 1920s and 1930s, but since 1962 the company had been selling only Toyotas. While he has resolved to stay with Ford, he has been extremely critical of the company's products in Japan, especially the jelly-bean design and what he calls the "foxy-eyed" headlights of the Taurus and Mondeo. He also has serious doubts about the viability of Ford's distribution system, which is the lifeblood of any big business anywhere. He believes a huge injection of capital by Ford management is necessary to keep the dealers going until the cavalry arrives in the form of new models. Otherwise, Katsumata said, Ford could lose as much as 20% of its sales force.

This ambivalence is palpable. A discussion with Katsumata is a fascinating blend of bluntness, candor, optimism and pragmatic efficiency.

"I told the people from Ford who came to Japan to do research, I told them that the Taurus was just like a beaten catfish – it won't sell," Katsumata said in his office above one of his Chiba showrooms. "Ford is very slow to take action on problems. This is very different from the Japanese car manufacturers. For example, if Toyota's new model isn't selling well in the first six months after the launch, they will make changes in the design to reflect the tastes of the customers." But so far, he said, the Taurus has been languishing without any mid-course corrections.

For example, when Katsumata first opened five Ford showrooms in 1994, he sold a total of only 46 vehicles. The next full year of sales was better – 323 cars were sold from six outlets. In 1996, when he added a seventh Ford showroom, Katsumata sold 371 vehicles, an average of only 4.4 cars per month per outlet. Last year was even worse – a total of only 350 cars were sold.

But despite these gloomy numbers, Katsumata returned unexpectedly to his (somewhat tempered) upbeat assessment. "Among the Big Three, Ford has the greatest potential for future growth in Japan. Ford in a sense is very similar to Toyota as a company. I'm not so worried about the number of units Ford sells right now. Toyota produces five million cars worldwide, and Ford about six million. They are very similar companies. They have a warmth in their management style. That's why I was so much attracted by Ford. My grandfather when he started auto sales in Japan, he became a Ford agent – that was 75 years ago. So because of my grandfather, I thought it would be a shame if I let someone else have the Ford franchise in Chiba. I wanted to inherit what my grandfather had done… Even if the Ford sales turn out to be unprofitable, I'm determined to continue this business."

But having said that, Katsumata has a lot of doubts about whether that potential will ever be realized. He also has very different views from many other dealers who believe Ford has been making a mistake by pricing too low. "Looking at the current import market, German cars are too expensive for ordinary consumers," he said. "Their prices are higher in Japan than in other countries. They will have a hard time in the future. GM and Chrysler also have a strategy of higher prices, so they will not be accepted well. But Ford pricing is very similar to Japanese cars, so if Ford can capture the heart of Japanese consumers, they will have a success in Japan."

But – and this is where Katsumata's views re-converge with the majority of dealers we interviewed – capturing the heart of Japanese consumers, in his view, means developing products that are distinctive and attractive. He just believes it can be done at price points that don't send buyers away in droves. Taken to its logical conclusion, the notion seems almost unthinkable in the current market environment: that Ford, with the proper strategy and model line-up, could someday become a volume player in Japan.

Katsumata said that next year, Ford was planning to introduce two new models – the Ka from Europe and a smaller version of the Lincoln [the LS6/LS8 that was recently unveiled to favorable reviews in the U.S.], which he said looks a bit like the Nissan Cedric – "I saw them two years ago in Detroit – but it will be one more year before they are launched, so the question is whether the Ford dealers in Japan can hang on until then."

"The Ka is cute," Katsumata adds. "It's made in Spain and looks a little like a Beetle. It's very different from Japanese cars. Ka has a very distinctive shape. More than 200,000 units were sold in Europe last year."

What would be the price in Japan?

"I hope it's below two million yen. The value of the yen is very low right now, so it might be difficult . If they were priced at ¥1.5 million at the lowest and ¥1.8 million at the highest – that would be a big hit in the Japanese market – maybe more than 10,000 vehicles a year."

And the small Lincoln?

"We already have the LS 400 and Cima in Japan, so if they are introduced at ¥7 million or ¥8 million, that will sell – not in large volume, but they're still cheaper than the Mercedes 500 or 700 or 300, so it will generate some demand – maybe 500 units per month, 6,000 vehicles a year."

But 16,000 more vehicle sales annually by Ford – and at the moment these two models seem to be the only new ones in the pipeline – add up to an average of just over 50 more units a year for each of Ford's 304 outlets nationwide. That comes out to an increase of only about four cars a month per showroom, which is not the stuff of which volume

businesses are made. So we came back to the same question. Can the dealers survive until May 1999 when the models are scheduled for launch?

The answer, Katsumata made plain, was no – not without a large injection of cash to help the dealers and their salesmen weather the storm. "Suzuki-san's job is on the line. Probably he wanted to receive financial assistance from Ford headquarters, somewhere in the range of ¥3 billion to ¥6 billion to assist all the dealerships in Japan…

"If I were Mr. Suzuki – the president of Ford Japan – then I would have requested ¥5 billion in assistance [about $38.5 million at $ = ¥130], and I would do my best not to decrease the number of Ford dealerships at least for this year. And we would wait for the new product launch – the Ka and the small Lincoln model… But if the president of Ford Japan is not very explicit and does not make a strong demand like that, then Ford Japan will be in a very difficult position for this year as well."

In that case, Katsumata said, "I would close some of the existing dealers and cut the number of outlets and wait for the new product launches scheduled for the spring of 1999… So the greatest challenge for Ford Japan for the year 1998 is how many Ford dealers are patient enough and will stay loyal to Ford until that new product launch."

"If Ford provides no incentives," Katsumata said, "then 20% of the existing outlets [about 60 showrooms] might have to be cut." But if the assistance were made available, "I would give the money to the salesmen in the form of a direct commission without going through the stores… What is necessary for Ford Japan now is to support the sales staff. It can't be done by the dealers. They just don't have the resources."

We told Katsumata we had asked about the possibility of financial assistance when we discussed the subject with Suzuki, citing the example of Mercedes Benz' decision to provide support for its independent Stern dealers who had gotten into financial straits because of the bubble economy. But Suzuki seemed opposed to any special help to individual dealers beyond the normal incentive program and new-car financing the company offers. We wanted to know if Katsumata was under the same impression.

"I myself don't know what Mr. Suzuki said to the Ford executives when he visited Detroit recently, but I would guess that he didn't make a very strong explicit demand," Katsumata said. "Maybe when he was asked by Ford executives for his opinion, he might have said he would try to retain the current dealerships as much as possible, but probably he didn't say how much he wanted to receive in financial assistance from Ford… but if Ford looks at the February and March sales figures and really becomes alarmed that Ford Japan is not getting a good result, then headquarters will recognize the reality."

But, Katsumata said, the heads of the foreign car importers in Japan might be reluctant to be entirely candid with their headquarters about the current low levels of sales in Japan. "Mr. Booker [W. Wayne Booker, Ford's vice chairman for international operations] does understand the situation in Japan to some extent. When he came to Japan last year, he

asked my advice, and I said we need ¥5 billion. So he knows that. But Volkswagen and BMW and Mercedes are not aware of that because their cars sold well last year. The sales started to drop last fall, but their current sales are down 45% from a year earlier."

Katsumata went to his desk to retrieve some computer printouts, ticking off the sharp drops for various importers to dramatize his point. "BMW – they sold only 1,142 units for January, down 58.5 % from January 1997. Opel was down 66%. Volkswagen down 64%. Chrysler down 17% -- they only sold 16 units nationwide in January. Ford down 67%. Saturn sold only 59 units in January."

"So," Katsumata said, "the sales decrease of imported cars is very conspicuous. The entire auto market in Japan has been in a very difficult condition from the end of last year to the beginning of this year, but I'm afraid that German and U.S. headquarters are not yet fully aware of the problem. All the imported cars except Ford are highly priced. For example, BMW makes 200,000 units in the world and sells 50,000 in Japan. But when it comes to sales, 50% of their profit comes from Japan."

The stakes for foreign auto makers in Japan are enormous, Katsumata said. "What I would like you to emphasize in your study is that the Big Three need to cherish the Japanese market. They have to place a huge importance on the Japanese market. Otherwise they will lose the Southeast Asian market. Ford headquarters knows that, but unless they are established as a good brand in Japan, they cannot establish themselves as a first-class brand in Southeast Asia.

"Just like the Japanese people looked at American cars historically as very good cars with a good image, Southeast Asian people are now watching the Japanese market. Unless the American cars sell very well in Japan, they will not be accepted in Southeast Asia. That means that GM must sell Cadillacs in large volume in Japan so they can be accepted in Southeast Asia. For the Big Three, it is important to study the market in Japan and increase their shares. That is the key to their success in Southeast Asia. In other words, if they are Number Three in Japan, they will be Number Three in Asia."[65]

Katsumata was asked about U.S. trade rhetoric and the continued demands for 200 more outlets a year for the Big Three. We also noted that Ford itself – at least in its official statements – had continued to suggest that sales of 100,000 vehicles a year by 2000 might be possible, and perhaps even 200,000 vehicles annually within the next 10 years. While this seemed to have the cart before the horse, we asked Katsumata if he had any other suggestions.

"They can wait for the launch of the Ka and the small Lincoln. If they sell very well, they can open more outlets after that… Even if they would like to do it now, no dealers would be willing to join them," Katsumata said. "Mr. Suzuki might say the efficiency in Japanese outlets is very low, but the situation is very different in the U.S. and in Japan. The car

[65] Japanese auto makers currently hold a 90% market share or better in most Asian countries.

salesmen in America are just like cooks in Japanese restaurants – they are very professional and they do a lot of job-hopping from one restaurant to another to improve their situation. But in Japan, Japanese salesmen – after graduating from university – they are trained in the company. That is not the case in the U.S. So the image of salesmen in America is also very different. In American society, car salesmen are regarded like people wearing gold Rolex watches – that kind of image…"

Like Yumoto at Tama Chrysler and Arai at DUO 246 and Yamaguchi at Aichi Toyota, Katsumata complained about Japanese regulations and zoning laws that restrict the locations where dealerships and service garages can be built. He also said the auto registration process was too cumbersome, requiring about a week to complete the paperwork and obtain the necessary certification that the buyer of a car has a parking space available to him.

"Even if American cars were selling very well, and auto makers would like to increase the number of outlets in Japan, they will face administrative barriers and regulations. They cannot open wherever they want – there are restrictions," Katsumata said, adding, "I am working with the U.S. Embassy to change this situation. But we have to deal with multiple ministries – the Ministry of Transportation, the Ministry of Construction, the Ministry of Home Affairs."

Be careful, Katsumata was told, every time you invite *gaiatsu* (foreign pressure) in one area, you get it in another. It's easy to turn on, but hard to turn off. This elicited a loud burst of laughter – and a rueful nod and a smile from Katsumata indicating that he was all too aware of the problem, but probably going forward with his Embassy plans nonetheless.

One fascinating observation made by Katsumata had to do with the approach being taken in America by Wayne Huizenga's Republic Industries, which is assembling a large chain of outlets for new and used cars in order to combine operations and consolidate costs. As far as Katsumata is concerned, Huizenga is simply taking a page from the Japanese book.

"For example, a small dealership in America is run by a family. The father is the president, the mother is the senior managing director and the eldest son is the general manager of the vehicle section, and they also do financing and insurance. They sell 100 units a month, and Republic comes and buys them out, dismissing the family members. Then they replace the accounting and insurance operations with a computer system that is installed at Republic headquarters. This is what many Japanese dealers have already done in Japan," Katsumata said – including, it went without saying, the Katsumata Group itself.

He had the same view of Huizenga's business activities in the used-car market. "Republic now has a huge network for used car sales, and they control the operations by computer. Used car salesmen in the U.S. are something customers in the U.S. don't trust very much… Republic changed this distrust and made the system transparent to buyers. But again, from my perspective, they're just copying the way Japanese dealers are doing it."

For example, he said, the Katsumata group has seven dealer/principals and 209 outlets. "PDI [pre-delivery inspection] is done in one location [instead of at 209 separate facilities]. So Republic has that idea too. But if Republic is planning to do business in Japan and they are going to buy us, there is very little room to streamline the business." To demonstrate the extent of the economies of scale that his company has already achieved, Katsumata later sent us a breakdown of his seven sales channels. For the fiscal year ending March 1997, the 209 showrooms were staffed by a total of 4,534 employees (only 21.7 workers per outlet) and enjoyed total revenues of ¥191 trillion – or more than $1.58 billion.

We asked Katsumata about Ford Japan's complaints that domestic networks were effectively closed off to foreign makers, and that large sales territories for Toyota dealers presented an obstacle to market entry. He didn't see the connection:

"Toyota territory size presents an obstacle to Ford? I don't think that's true… When I asked Toyota if I could handle Ford, they said if I did it through the Katsumata holding company, then it was okay. But I said this doesn't work because it requires too much investment [to set up a new company]. So we negotiated and I got an agreement that I could handle Ford through the Toyota dealership. We are probably the only Toyota dealership to handle Ford cars in all of Japan. So Toyota is not involved in this program. I am handling Ford cars in my DUO outlets. Toyota gives me 100% freedom to pursue this business… For example, when I handle Fords and Toyotas at the same time in one outlet, I said to Toyota that I would put Toyota on the first floor and Ford on the second floor and connect the two floors with escalators. We have already done that in two outlets."[66]

Finally, Katsumata was asked if he might reconsider his commitment to Ford if the new product launch in the spring of 1999 was not successful. He dodged the question, but artfully.

"According to the original Ford schedule, Ka was supposed to be launched in Japan last year," Katsumata said. "But the air conditioning and automatic devices did not fit in the body, so they made minor changes and decided to postpone the launch until 1999. If they had been introduced last fall or this year, the situation would be very different."

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[66] This would suggest that not all of Ford's 304 outlets in Japan are in fact "exclusive," as the company claims. Much depends on the definition, however. Since Ford's stated policy – supported by U.S. government trade rhetoric – is to sign up exclusive showrooms only, it would not be surprising if Ford Japan decided that an escalator between showrooms provided a sufficient degree of separation to claim the outlet as an "exclusive." Katsumata, however, clearly thinks of it as a "dual." "As far as we are concerned, Ford has accepted duals," he wrote in his fax. "We run the Ford business mostly with dual outlets now, but we will consider changing them to separate Ford outlets if Ford sales go up. Two out of seven outlets are separate outlets now."

In the last analysis, it may be impossible to reconcile all these little nuances. One thing is certain: when it comes to numbers and definitions, everyone in the business is fudging somewhat.

SATURN JAPAN: EXPERIMENT IN ERROR?

The View from Kobe

Akira Morikawa is a man who is clearly under the gun. Having signed a franchise agreement with Saturn Japan to operate two outlets in the Kobe area, he is among a small group of Japanese dealers spearheading a controversial experiment to see if the auto maker's concepts about one-price car sales and a tightly knit dealer network can be successfully imported into the country.

The problem, according to both admirers and critics of Saturn, is that the current model line-up may itself be too weak to represent a fair test of the company's sales strategy. And even if that were not the case, many dealers seem to have grave doubts about the effectiveness of the no-haggle policy in general. They also wonder if Saturn's other principal selling points – immaculate showrooms, a well-educated and salaried sales staff, and extremely high levels of customer service – will be sufficient to differentiate the brand in a country that has already raised these elements of marketing to a high art.

But there is no question that dealers and manufacturers across Japan are watching the Saturn experiment closely. With the auto industry in recession and distribution networks already cluttered with too many outlets, they are looking for anything that might give them an edge against their competitors. So far, however, the disappointing sales record of Saturn – only 602 units sold nationwide from April through December 1997 – has kept their attention focused on the negatives. Interestingly, their criticisms of the Saturn strategy are strikingly similar to the independent judgments of American dealers about the relative potency of the same sales techniques in the United States. While the jury may still be out, there is already substantial evidence suggesting that Saturn – and, more importantly, others who might consider replicating Saturn's sales strategy – may find that a niche market is the best that can be hoped for in either country.

For Morikawa himself, who is director of Saturn Kobe Co., Ltd., the decision to enter into an exclusive franchise agreement with the GM subsidiary was driven by a variety of factors. For one, he believed strongly that the only high growth potential left in Japan's mature auto market was on the import side, and the European makers were already spoken for, in the sense that they have a sufficient number of showrooms. Secondly, the parent company of Saturn Kobe owns 18 Isuzu outlets, and General Motors holds a 37.5% equity stake in Isuzu, so there was a natural fit in terms of the two companies' histories and existing relationships.

Morikawa said he was first approached by Saturn two years before the April 1997 start-up. "Six months later," he said, "several dealers raised their hands to participate." He said he was intrigued by the business prospects because "Saturn was a completely new way of thinking. They provide education services and teaching to familiarize dealers with

the system. What impressed me the most was that we spent so much time with the network, with the 'Saturn Way' – a unique way of thinking."

Morikawa conceded sales were "rather slow by Japanese standards, but we're beginning to penetrate the market, to familiarize customers with Saturn. We've only been at it eight or nine months."[67] He added that he had come to have a great deal of faith in the manufacturer's low-pressure approach as well as Saturn's emphasis on continuous after-sales service, creating what the company likes to refer to as the "Saturn family."

Morikawa said the one-price Saturn policy was an effort to overcome consumer distrust of dealer practices. "One big reason is pricing," he said. "Because discounts exist, the fair price of a car is unclear to customers and this creates a lack of confidence. Saturn's policy is a step to break down this negative situation."

Another reason for his betting on Saturn's future, Morikawa said, was because the American share of the Japanese market was unusually low, while the German share was unusually high. "But General Motors is the largest maker in the world, and the Big Three are beginning to take more pro-active efforts in Japan. So we went for GM – not just Saturn – because we forecast an increase in U.S. sales in this country," Morikawa said.[68] "For a long period, the number of imports was stable at about 10,000 a year. Now it's up to more than 300,000...[69] There is a realistic demand for imported cars. The import share today is about 10%, but maybe this could go to 20%. The growth curve is very steep."

Morikawa said a third reason for going with Saturn had to do with the performance of the cars. "GM owns Opel of Germany, and Saturn is based on the Opel platform," he said. "The size and style of European models seem very appropriate for Japan."

<u>One Price – No Dice</u>

But many other dealers disagreed strongly with this analysis, noting that Saturn's model line-up played directly into the strengths of Japanese manufacturers rather than creating a distinctive appeal of its own. Toho Motors' president Kazuo Omori (BMW) was typically blunt: "Imported cars must have a special feature or appeal not available in Japanese cars. For that reason, BMW, Mercedes Benz and Jeep are all attractive cars to the Japanese consumer. Whereas Saturn – that car is so Japanese, it doesn't have anything American about it… That's where the Big Three aren't getting it right. They're trying to compete

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[67] To put the sales numbers in perspective, at the other end of the product launch spectrum, the Volkswagen "Polo" was introduced in the Japanese market on August 19, 1996, and received 2,200 orders in the first two weeks, the most successful entry for import cars to date. See "Volkswagen Group Japan – Lucrative Japanese Market; 130,000 level by the Year 2000," *Nikkei Business*, September 30, 1996.

[68] Interestingly, this decision coincided with the sharp jump in Big Three sales – from a very low base – that began in 1994 as a result of the introduction of some right-hand drive models. A straight-line extrapolation of those sales figures would have led to some very optimistic and unsustainable forecasts.

[69] According to MITI car registration statistics, total passenger car import sales for 1997 – including the so-called reverse imports by Toyota, Honda, Nissan and Mitsubishi – were 341,495 vehicles.

with Japanese makers. They're going at it the wrong way around. The Saturn is just bland, average, plain. The coupe is outdated." Omori laughed. "On the other hand, take Rover [especially the Range Rover with its classic safari design]. It's so obsolete, it's selling. If it's only slightly obsolete, it hasn't got a chance."

Despite his criticism of the Saturn models themselves, Omori was upbeat about the potential of the one-price sales strategy in Japan. "The marketing approach alone can't sell the product," Omori said. "If they had a good product, I think the market would just explode."

A survey of 540 dealer-principals by J.D. Powers Japan, taken in September and October of 1997, provides some support for Omori's optimism. The study noted that "dealers have become particularly dissatisfied with manufacturers' overall responsiveness to their needs, as well as the models they provide" and said that "intense competition and falling revenue have begun turning dealers' attention toward a number of non-traditional sales approaches." Specifically, the study said, "one-price" selling was now an attractive option for 77% of the dealers surveyed.[70]

But dealer willingness to experiment with one-price sales techniques may be more a reflection of the current bad market rather than an endorsement of the efficacy of the strategy. Most dealers still haven't tried it, and many doubts remain.

"I went to a briefing for Saturn candidates," said DUO general manager Arai, "and they talked about how the one-price policy and the decision to severely limit the number of dealers would ease competition among them and perhaps even contribute to an increase in the number of outlets *within* an existing dealership. The strategy could be attractive, but I don't think the Saturn models themselves have enough product strength."

There is a strong consensus among Japanese dealers that – almost as much as product quality – the lack of variety of Big Three models acts as a serious damper on customer enthusiasm. With a population of 125 million – about half of which are licensed drivers – there is a great range of tastes that cannot possibly be satisfied by a limited selection. Koichi Hamada of Stern Shinagawa, noting the great advantage Mercedes' wide model range conferred on them in Japan, also singled out the one-price strategy as a good concept, but one that would suffer because Saturn offered only three basic – and very similar – models. "One brand, three types of cars," Hamada said. "That's not enough to secure profits."[71]

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[70] J.D. Power Japan, December 17, 1997.

[71] The same problems and concerns have been raised about Saturn in the U.S., where small-car sales have been dwindling steadily for the past several years. Saturn sales fell 9.9% in 1997 and 20.2% in the first two months of this year. This has forced significant (nearly 19%) production cutbacks, lower prices and cut-rate lease arrangements on current models, and stirred a continuing debate about whether GM's struggling division should have introduced mid-sized models, SUVs and the like in order to keep the business of its young customers as they grew older. The line-up of the three current models – a coupe, a wagon and a sedan – has not been expanded since it was launched about 10 years ago, and the mid-size Saturn LS will not be introduced into the market until the spring of 1999.

Kyoichiro Shibata, the Nissho Iwai Peugeot dealer, went a step further. Big Three profit margins in Japan are generally quite low, he said, because of the need to offer discounts in competition with Japanese cars. For example, in his analysis, Ford dealers once enjoyed gross margins of 16-18% per vehicle, but price chopping now cut it to no more than 8-10% -- and in many cases much less.[72] Margins on the low-end Saturn line would by definition be even worse. The implications for the future of the business make for a kind of double whammy: even if dealers can somehow become profitable over the long-term – a very dicey proposition at best – the manufacturer itself might never recoup its original investment.

More fundamentally, many prominent Japanese dealers question how much leverage Saturn can get out of its claims of extra good service. Katsumata already speaks of the enterprise in the past tense. "Providing very high quality service [is] the conventional business method of dealers in Japan," he said. "While these things might appear to be a very new approach from the American point of view, this has been practiced for many years in Japan. So this perception gap was the cause of the Saturn failure." In the absence of a hot new product, Katsumata implies, trying to pitch Japanese consumers on the merits of service alone is making the classic mistake of bringing coals to Newcastle – or, perhaps more accurately in this case – diamonds to South Africa.

And for all the media hype generated by one-price strategies, some dealers remain decidedly unconvinced of its ultimate utility. DUO's Arai felt one-price sales techniques were "not very aggressive" and would eventually dampen the enthusiasm of the sales staff, who would be denied both a sense of excitement and leverage in the negotiating process.

Mamoru Ishizaki, president of Honda Clio Kyoritsu, makes the same point from the customer's perspective. "One price – I think this will be difficult to work in the Japanese market because consumers expect a discount. They want to come out of the dealer's showroom thinking they got a good deal. So there is always a discount race. The intense competition among dealers makes such a policy extremely difficult because there is always someone who is willing to undercut you. We would like to stop this and go in the other direction because it is hurting dealer credibility. So the one-price deal is a nice idea, but Saturn is not selling very well. Probably this has to do with the product itself."

Ishizaki's managing director, Youji Hamada, summed up the psychology quite succinctly. He held up an advertisement from a Japanese newspaper and smiled ruefully. "This is a so-called 'one-price' insert ad we placed last week. One-price, one-price, one-price," he said, tapping the ad for effect. "But the term is really contradictory – because that's where we start the negotiation."

For a more complete discussion, see "Many at the Saturn Factory are Finding Less to Smile About," *The New York Times*, March 6, 1998, p. 1. See also, "Saturn Looks to Redefine Strategy," *Detroit Free Press*, March 18, 1998.

[72] The interviews with Kintetsu Motors and New Empire Motors recounted above are consistent with this analysis.

Japan is Not So Different

This dilemma is quite consistent with the situation in America, where many dealers and analysts feel the majority of customers *prefer* to negotiate because this is the best way to get the lowest price. There is solid evidence for this. According to Mark Rikess, a dealer-consultant specializing in one-price selling, a one-price dealer earns an average net profit of $250 per new car sold, while National Auto Dealers Association (NADA) statistics show the average dealer earned $70 in net profit per new vehicle sold in 1997.[73]

Art Spinella of CNW Marketing Research in Bandon, Ore., concludes: "One-price takes some hassle out of the process, but the vast majority of consumers still feel they got taken at a one-price dealership." Similarly, a January 1998 survey by the Dohring Co., a Glendale, Calif., market research firm, showed that a majority of respondents preferred to shop at a negotiating dealer – 48% compared to 32% who liked the one-price approach. Likewise, *Consumer Reports* advises its readers: "You can often get a better deal than the one-price dealers, we have found, if you are willing to shop diligently and bargain."[74]

Jim Jones, owner of the Northeast Chevrolet in Greensboro, N.C., tried the one-price approach for three years, then switched back to bargaining. "We had customers leaving here furious because we wouldn't move $50," he said in a recent interview. "Anybody that tells you one-price is non-confrontational is not telling the truth."[75]

Ultimately, the one-price strategy may appeal to a relatively small segment of the market in both Japan and the U.S. – people who are more interested in avoiding hassles and the stress of negotiations than they are in obtaining the best deal. This squares with auto maker and dealer perceptions across America. For example, Jake Kelderman, Executive Director for Industry Affairs at the National Automobile Dealers Association (NADA), says the one-price concept in the U.S. has not been gaining in popularity and is currently in use at fewer than 10% of the country's outlets, although he notes (à la Hamada at Honda Clio Kyoritsu) that this statistic is a bit fuzzy because of the difficulty in defining a one-price or non-negotiating dealer. "Even 'non-negotiating' dealers negotiate," Kelderman says.[76]

It is an interesting question whether the existing very high service levels in Japan – where most auto salesmen are college-educated – may have already reduced the hassle factor to the point where one-price marketing has even less of an appeal there than in America. In light of Saturn's poor sales performance so far, Morikawa was asked how he would define future success. "Ordinarily, it takes three years to achieve profitability for well-known

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[73] See Earle Eldridge, "One-Price Deals Save Time, Hassles, but not Money," *USA Today*, March 11, 1998, page 1.
[74] *Ibid.*
[75] *Ibid.*
[76] Telephone interviews with Jake Kelderman, March 27, 1998, and April 14, 1998.

brands," he said. "But the Saturn brand name has not penetrated at all – it will obviously take more time than that. You have to take a long-term view."

In this respect, Morikawa added without irony, "Buying property is not a good option [for a Saturn dealer]." He did the arithmetic this way: at least 500 square meters or *tsubo* [5,380 square feet] of surface area for the lot, and 300 *tsubo* [3,228 square feet] for a showroom. This translates into a minimum monthly land rental of ¥3,000 per *tsubo* – or ¥1.5 million for the lot – and ¥5,000 per *tsubo* for the showroom – or another ¥1.5 million.

"So you have roughly ¥3-5 million per month for facilities, utilities, etc. An outlet with 10 staff would incur personnel costs of another ¥5 million a month. That gives you a total cost of ¥8-10 million a month [$66,000-$82,000], plus other costs such as service fees," Morikawa said. "A Saturn showroom with anywhere from 10 to 30 people would cost ¥10-20 million a month. To make a profit, you need a margin – say ¥300,000 per vehicle – which would mean you need to sell at least 30 cars a month" – a far cry from Saturn's current monthly average of 4.5 vehicles per outlet.

Because of these economic constraints – the high overhead costs plus the need to sell a certain minimum volume – Morikawa said it was essential to limit the number of outlets – that is, effectively increase the individual dealer's sales territory – to give them an opportunity to reach those levels with existing low demand.

"This is particularly important when you're dealing with a car that is brand new to the market," he said. "The best case for Saturn would eventually be between 70 and 80 outlets and 20 to 25 dealer-principals." At the time of the interview in February, Saturn Japan had a total of 15 outlets owned by 10 dealers.[77]

"From a commercial perspective, the key for American cars is the quality issue," Morikawa said. "You can do a certain amount with PR and advertising. But the car is, after all, mechanical. That's why we chose Saturn. The interior of Saturn is not great by dealer standards, but the technical capabilities are where we find real value."

This is very similar to Yamaguchi's assessment at Aichi Toyota, where he has his own problems selling the GM-built Cavalier. "I personally think Saturn's a good car," Yamaguchi said in our interview, "but somehow it doesn't sell well. There are two outlets in Aichi, and they're only selling three or four units a month…. The design of the interior is bad, but still more attractive than the Cavalier."

Morikawa was asked about complaints in the U.S. market that with only three models to choose from, Saturn owners had nowhere to go when it came time to "trade up" to a

[77] In the United States, Saturn has a dealer network of approximately 360 outlets nationwide.

bigger, more expensive car. Of necessity, they would be forced to buy a competing brand.[78] How did he perceive this problem in Japan?

He mentioned the new Saturn model in the production pipeline. "There is a U.S. factory building a new car with an Opel platform and a 2-litre engine…[79] Once Saturn gets more market penetration here, it would be natural for a customer to want to move up to a higher level model – and I as a dealer would like to be able to accommodate these customers," Morikawa said.

Despite the very discouraging start, GM's management has understandably been keeping a stiff upper lip in public. Keith Wicks, president of the Saturn Japan division, recently addressed the situation in comments that, while somewhat equivocal, were nevertheless accepting of the market realities.

"Many of our 15 stores opened after October last year," Wicks said. "In addition to the fact that Saturn was entirely new with no brand recognition, considering the monthly sales per store it has done well. The annual sales volume of GM Cavalier sold by Toyota is about 10,000 units through 1,000 stores. So far, Saturn sales per store has not been disappointing."[80]

What Wicks is suggesting is that if the Toyota showrooms are only selling an average of about 10 Cavaliers each per year (10,000 ÷ 1,000), then the annual Saturn average of 40 units per outlet (602 ÷ 15) should not be judged harshly. But this gets back to the classic "apples and oranges" confusion between "dual" and "exclusive" showrooms. The owners of the 1,000 or so stores that handle the Cavalier do not depend on it for their financial survival. Their primary business is selling a full line of profitable Toyota vehicles through the same sales channel. The exclusive Saturn outlets have nothing to fall back on. They must survive on Saturn alone – an impossible task in the absence of manufacturer subsidies, very deep pockets, or some other form of fiscal relief.

At another level, however, Wicks avoided the numbers game that has plagued American marketing and trade rhetoric in Japan. This was refreshing. "We are not volume oriented," he said. "We are working to make sure our dealerships make a profit. We would like to increase the sales volume in a manner that our brand would become better known. But we will set no numerical targets so that dealerships would not have to achieve impossible sales targets."

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[78] The three Saturn models in Japan sell between ¥1.6 million and ¥1.8 million, or the equivalent of about $12,300 to $13,850 at $ = ¥130. See also, "Stuck in Neutral: GM's Saturn Discovers How Tough it is to Sell in Japan," *Far Eastern Economic Review*, May 22, 1997.

[79] The Saturn LS, as it will be called in the U.S., was developed in Europe as the Opel Astra and will be built at an existing factory GM owns in Wilmington, Del., rather than at the main Saturn plant in Spring Hill, Tenn.

[80] "Priority on Dealers' Profitability," interview with President Keith Wicks of GM Japan Saturn Division, *Nikkei Sangyo*, March 12, 1998.

Honda Clio Kyoritsu and the Unbearable Lightness of Mailings:
Innovative Solutions in a Tough Market

If you want to get a taste of how tough the competition between dealers can be in Japan – and see first-hand the level of innovation such activity can generate – just pay a visit to Honda-Clio Kyoritsu in the Tokyo suburb of Kawasaki.

Mamoru Ishizaki, the company's president (whom we met briefly in the previous section), has a problem that most dealers wouldn't want to encounter in their worst nightmare – six other Honda outlets located within several miles of his main store, and all selling essentially the same products! Yet with remarkable agility, his business has managed not only to survive, but to thrive – through a process of creative product differentiation, nimble personnel management, fresh marketing concepts, and an intense focus on building brand image through research and constant experimentation.

For nearly three hours, Ishizaki and his number two, Youji Hamada, treated us to a fascinating discussion of their business activities and market perspectives, dividing their time about equally between their own company's marketing strategy and – alas, because we insisted – their views of the Big Three's Japan operations and American trade complaints.

With no equity ties to Honda Motor Co., Ltd., Ishizaki built his business from a small Honda motorcycle showroom in 1966 into an operation that now encompasses two sales channels and 12 outlets (including one service center and one used car dealership) that last year generated revenue of ¥10 billion (about $82.6 million). "When I became independent, I didn't have a very clear picture of the future. I went to the U.S. for 20 days to study the dealer network… [Because of that], I decided to set up suburban outlets as well as outlets in the city," Ishizaki said. Today, his company also owns a motorcycle dealership in Tokyo's Moto Ward and holds equity interests in Honda Body Service, a sheet metal company; Yokohama Motor Sales, which markets the country's biggest camping car; and Auto Auction Tokyo, a used car dealership.

In 1997, the five new-car showrooms in his Clio channel sold 1,931 vehicles – an average of 386 vehicles per store – while the Verno channel had sales of 1,300 vehicles, or 260 units per outlet – "not so good" according to Ishizaki. The Clio figures include 28 Jeep Cherokees (sold as part of the now-defunct Honda-Chrysler deal) and 249 copies of the Honda Accord made in America. At the time of the interview, Ishizaki said he had three Grand Cherokees left in inventory, but these would be his last. "In our case," he said, "we sold the Jeeps out of the same showroom as the Hondas. We treated the Cherokee as just another commodity car."

The sales staff in the Clio channel has been posting some extraordinary numbers for Japanese dealerships. Hamada said the company employs about 15 people per outlet, and the salesmen average 5.9 units per man per month, well above the national average.

"What we expect, however, is seven units a month, which would mean about 84 units a year," Hamada said. "Our best salesman sold 101 vehicles last year [an average of 8.4 new cars a month]. But we set a goal of 150 a year. This has improved productivity."

Hamada was asked how they were able to keep raising the bar on sales targets without hurting staff morale. "That's always on the back of our minds," he said. "You may have noticed I have a tan. I just returned yesterday from a 10-day trip to Saipan with our sales people," adding that Honda Clio had devised a compensation system for salesmen that was based on a combination of basic salary and sales incentives. "The incentive portion of the package is weighted 70% on the number of cars sold, and 30% on the profit margins of the cars. Then we compute total compensation using the same ratio – 70% coming from salary and 30% coming from incentives."[81]

"This is much better than the national average for Japan," Hamada said. "Especially since we are an independent dealer, we need to structure our compensation system so it will improve the dynamics and competence of the sales force. If we increase the incentive portion too much, that could hurt morale [by removing an important security factor]… It's a very delicate balancing act."

Another path to high staff morale, of course, is high consumer demand for the company product line. "There are two ways of reaching the customer – through home sales and at the showroom. We have an existing customer base of 9,000 people. Our challenge is how to increase that base. This road," Hamada said, gesturing out the window at the Shin Kanagawa highway, "is the main north-south artery that runs through Kawasaki. There are seven Honda outlets on this one strip, all selling very similar cars. How do we differentiate ourselves from the competition?"

Ishizaki and Hamada began passing around sales materials and brochures they saved from the November 1997 Specialty Equipment Market Association (SEMA) show in Las Vegas, a huge annual convention featuring after-market parts, accessories, specialty and performance equipment for the automotive market. Last year's show attracted more than 32,000 domestic and international buyers.

"There are a lot of custom cars on display, many of them based on Honda models,"[82] Hamada said. "What's 'in' in America these days is so-called 'aero' parts, aluminum wheels, leather seats, wood paneling, running boards. So we concluded a contract with a company called LA Custom Parts and had them design special accessories to modify standard Honda vehicles like the popular Odyssey minivan and the Step Wagon."

Their efforts were much more sophisticated than just borrowing American concepts and importing them into Japan. "Actually, the tastes of Japanese customers are fed back into

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[81] This is a bit less ambitious than Yamaguchi's "Challenge Staff" program at Aichi Toyota, where top salesmen earn 48% of their income from commissions.
[82] For example, the lowly Honda Civic has become a favorite of young American car buffs who like to soup it up and accessorize it with racing components.

these companies so that the molds can then be made in the U.S.," Hamada said. The result, he added, was that no other Honda dealer on the Shin Kanagawa highway had models that looked anything like the vehicles in the Honda Clio showroom. "We are offering a completely different assortment, even though they are the same cars coming out of the factory," Hamada said.

Ishizaki added that "accessories are a huge potential market in Japan that has been growing steadily but is not yet fully developed." He said a recent exhibition at the Tokyo Big Site convention center "included about 750 different modified custom cars, and the event drew a very large number of visitors. There are big margins on accessories… Yes, it's very profitable."

But, noted Ishizaki, none of the American auto makers had yet seized on this market trend to incorporate these features in their own cars offered for sale in Japan.

"Relatively speaking, American cars are not really appealing to Japanese consumers," Ishizaki said. "As a dealer, we would like to get into imported cars as well [because it's the only growth area in Japan]. But I have observed many dealers selling Fords. They are having a very difficult time and are being forced to close some outlets. Used car prices are also a big disincentive for a Japanese consumer, especially when compared to European cars. The American imports just don't hold their value."[83]

Of the Ford dealers he had heard were having problems, he cited three specific cases: Ford Tonichi, New Empire Motors (the Tokyo company we encountered earlier in this study), and Ford Century in Kanagawa. Ishizaki said Ford Century, owned by the giant trading company Itochu, had already closed two outlets and was now operating only one. The problems at Ford Tonichi have already received a fair amount of attention in the Japanese and American press.[84] The chain, which is owned by Tokyo Nissan, began offering Fords in two of its outlets in 1994, but by late 1996 they had sold only 400 cars and run up debts of some $2.8 million. At the time of the interview, Ishizaki said it was his understanding that Tonichi was considering merging the two outlets into one to cut costs.

However, with behind-the-scenes pressures building not to close such a high-profile dealership, Tonichi shortly thereafter decided instead to take a page from Ishizaki's book and begin marketing highly customized versions of Ford's stock model line-up. Since they were already offering deep discounts on the current models without much success, Tonichi

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[83] For example, the March 1998 issue of *Car Sensor*, the most popular used car magazine in Japan, listed the average price reductions on three-year-old models as a percentage of the selling price. Japanese and European models generally dropped 35% to 49% of their value after three years. The Chrysler Neon, however, loses 55% of its value after only two years (it was not launched in Japan until 1996), while the GM Pontiac Grand Am dropped 56% over three years. The Ford Taurus's "price-down" ratio was listed at only 40%, but the car has not been selling well at all because of a lack of consumer interest.

[84] See, for example, "Can Swagger Sell Tauruses to the Japanese?", *The Wall Street Journal*, April 23, 1996; "Selling US Cars in Japan: More than a Matter of Trade Policy," *Financial Times*, September 19, 1996; "Dealers Criticize Ford of Japan," *Automotive News*, August 7, 1995.

basically opted to completely reconfigure the cars on the showroom floor. In addition to the installation of aerodynamic parts, which costs about ¥380,000, the dealership will also lower the suspension and install wider, sportier tires for an additional ¥1 million – a total of more than $10,600 at current exchange rates ($ = ¥130). This extraordinary "ex-post factory" retrofit is promoted in the showroom with a "back to the future" nostalgia pitch that includes a restored 1964 Ford Mustang and photographs depicting the 1998 versions of the heavily modified Taurus and Mondeo.[85]

Ishizaki said New Empire's managing director, Mitsuo Sato, was also a shareholder in his Verno channel. "They've been selling Fords for 50 years," Ishizaki said, "but right now they are having a very difficult time and are just getting by selling BMWs, Porsches and other models. They only have one Ford outlet now. I get the sales statistics from the dealers' association every 10 days, and we know how many they are selling – and I sympathize with them… This is because the [Ford] products don't meet the needs of the Japanese market."

But having said that, Ishizaki conceded that the turnover in Ford outlets over the years had resulted in a better distribution system overall. "Now that they have some newcomers [in the system]," Ishizaki said, "they have a better network for maintenance and service. The situation has improved."

But when it comes to imports, high praise was reserved – again – for the Europeans. "BMW really established their brand image in this market," Hamada said.

"Yes," Ishizaki agreed, "Volvo and Volkswagen as well. Volvo is using a very aggressive public relations and advertising campaign on safety issues. But they're not as successful as the Germans. Their sales network is a relative latecomer to the market, and the variety in the models they carry is not wide enough. The cars themselves look heavy."

Hamada again: "BMW and Mercedes Benz showed a great sensitivity about the market. In that respect, they really did their work well – getting to know the lifestyle, the highway and traffic situation, consumer preferences. In Japan, where there is an average of only one car per family in the cities, BMW and Mercedes fit the needs very well. They can be driven on both formal occasions and for more casual uses. Volvo has yet to acquire that market competence."

Ishizaki and Hamada are constantly searching for ways to improve their marketing position. They are studying the development of the Internet, both in the U.S. and in Japan, as a future sales tool. And they continue to make frequent trips to the U.S. and other countries to learn from their colleagues. If the Saturn one-price concept turns out not to work in Japan, what would they think of the approach taken in America by Republic, which has already assembled a huge chain of some 278 outlets? Could that work in Japan?

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[85] "Ford Tonichi Will Stop Offering Endless Discounts by Selling Custom-Designed New Cars to Customers," *Nikkei Sangyo*, March 16, 1998.

"Well, I know what Republic is doing is buying lots of dealers and selling at lower prices," Ishizaki said. "Last summer I visited a Honda dealer in Manhattan – my daughter works for Goldman Sachs in New York – and I asked him what his biggest headache was. He was complaining that Potamkin[86] across the street was undercutting them all the time. When he put an Odyssey minivan in his showroom, Potamkin would somehow find an Odyssey from somewhere and cut the price." Ishizaki said the biggest used car dealer in Japan last year sold 2,000 new cars, so – contrary to Katsumata – he felt a Republic-style operation might find a niche in the country, provided they could maintain service at a level expected by consumers.

Most recently, Ishizaki and Hamada created what they call a "video letter," a 10-minute videotape featuring a tour of their main Clio showroom, its current models and, of course, the unusual accessories they have installed to modify the vehicles in the product line-up. Hamada said the video production was done in Japan, but they had the tapes reproduced less expensively in the U.S. Still, he was asked, the first-class postage would be quite high, making a mass mailing a very costly proposition, wouldn't it?

Hamada smiled and shook his head, tossing the tape across the table. It weighed only a couple of ounces. "Since it's only 10 minutes, we use only that much tape and save a lot of weight there," he said. "But more importantly, we know our customers are not going to play it more than a few times at most. So the tape housing is specially constructed of very light material designed to withstand that kind of easy use."

The unbearable lightness of mailings suddenly becomes quite affordable in those circumstances.

A Most Happy Fellow

The world looks pretty good to Kimishige Kodaira from his office in the hills of Utsunomiya some 80 miles north of Tokyo. For the past 18 years, right alongside the Isuzu trucks and sport utility vehicles that crowd his lot, he has been selling 10 different makes of imported cars. Business is good, and there is nary a trade dispute in sight.

The reasons for it are not immediately apparent – until one's gaze travels past the Isuzu showroom to a totem pole of colorful paneled signs emblazoned with the logos and names of some of the most coveted vehicles in the world. There they are, right next to the street, mounted one on top of the other: Aston Martin, Ferrari, Lotus, Maserati, Jaguar, Fiat, Bentley, Alfa Romeo, Rolls Royce, Lancia.

To actually see one of these in the flesh, you would have to travel to another of Kodaira's 10 outlets in Tochigi Prefecture – only a 20-minute drive from the Utsunomiya office. It's

[86] Potamkin is a large American car dealer with multiple franchises.

worth the trip – not just for the display of new cars – but also for the 1950's vintage Jaguar 120 racer that sits gleaming in the center of the showroom. Kodaira has spent years restoring it, and on weekends he likes to get it out of the office onto some of the local roads where he can put it through its paces. "It's running beautifully right now," he says. "It's pretty fast."

Obviously, the usual calculus of the Japanese auto industry goes right out the window in a case like this, and Kodaira is delighted to entertain his visitors.

"I first started out in the car business selling Isuzu products back in 1970," he said. Shortly thereafter, General Motors bought a major stake in the Japanese car and truck manufacturer, and Kodaira was approached about the possibility of selling GM cars. Since the U.S. maker's two leading brands, Cadillac and Buick, were already being marketed in Tochigi through Yanase, Kodaira said he was left with the more "down market" models from Chevrolet, Oldsmobile and Pontiac.

"So the very beginning of the story was an initiative taken by GM," Kodaira said "As it happened, the three Japanese importers for GM were also handling Alfa Romeo, Opel and Jaguars, so I was able to get into that business at the same time. But when the second oil shock came in 1979-80, most of these importers went bankrupt and I lost the right to the GM brands. The remaining models were European."

"So," Kodaira said, "for the first 10 years of my business, I was mainly handling GM models. But we had a number of problems selling the cars, especially because of bad fuel efficiency and their large size. And since I personally love the European models, when the oil shock hit, I stayed with them in my main import business. Now, 30 years later, they are still my mainstay – even though the importers have changed hands many, many times."

"People who aren't familiar with my company are always curious about how an Isuzu dealer winds up handling Italian or British models. But obviously, this is a product of accumulated historical reasons... So my company is therefore a little peculiar and unique, but that's a real sales advantage for us because our customers – who are real fans of foreign cars – know how we got here."

Kodaira noted that models such as GM's Saturn and Chrysler's Neon competed directly in Japan with such strong domestic cars as the Toyota Corolla and Nissan Sunny, which he said were "very popular because they are quite cheap and technically very good. For this kind of down-market car, the Japanese models are the strongest, actually. On the other hand, the foreign models we are handling have no overlap in the marketplace with the Isuzu models that we handle. On top of that, Isuzu stopped production of its passenger cars a few years ago, and in the segment that I would call "hobby" foreign cars, we already have a strong customer base."

Kodaira explained why the "20/30" rule was fine for some people, but not for him.

"Our foreign car division is very, very profitable, first of all," he said. "With Saturn and Neon, you need to achieve a certain sales volume, which requires a rather large staff. For example, with Rolls Royce and Ferrari, if I sell three units a year – that's a good year. With Jaguar, I might sell three a month. In fact, none of the 10 models sells in the hundreds per year. So, we have no absolute target as to volume, and we are under no pressure from manufacturers. As far as staff is concerned, we have only three salesmen, six mechanics, one "front" man, and two office girls."

Kodaira said his monthly revenue target, including service and parts, was ¥50 million, with annual revenues in the range of ¥600 million (about $4.96 million). His unit prices – about ¥8-9 million for a Jaguar and ¥20 million for a Rolls – obviously contain huge profits. On the Isuzu side of the business, however, things are quite different.

"We need to do volume there," Kodaira said. "Every month, it's sell, sell, sell. I don't like it. But I do believe there is a good combination between the two different kinds of business."

The Isuzu operation has 10 outlets, with a staff of about 300 people, including about 50 salesmen and 90 mechanics and service staff. They sell a variety of sport utility, light commercial and even rather heavy, high-powered (and much more expensive) commercial vehicles, so the normal sales levels that govern a volume business would not necessarily apply at this end of the product spectrum either. Further, not all outlets sell all vehicles. Some are dedicated to small models, others to the larger models. In good times, Kodaira said, they sell about 300 small units a month, and about 70 to 80 large units monthly. Because of the slow economy, those targets are now down to 100 small units and 50 large ones.

On the foreign car side, Kodaira was especially proud of his after-sales service capability, an area in which traditional import dealers in Japan are especially weak. Each of his 10 outlets in Tochigi functions as a "recovery point," he said, so that customers would never have far to go to find qualified mechanics. "If necessary, we pick up the customer's car at his home," Kodaira said.

"When I think of 'down market' models, I believe the Japanese makers learned a lot from the Europeans about quality," Kodaira said. "On the other hand, Japanese makers learned about efficiency and volume production from America. The combination makes them the strongest worldwide in 'down market' cars."

But Kodaira has little interest in expanding his business by getting involved with another brand of down-market or even mid-market cars. To put a new line into the midst of the Isuzu showrooms would detract from the success of that operation – and probably hurt his relationship with Isuzu. Alternatively, creating a new company to accommodate the brand would involve making investments that would be hard to recoup.

“Our company would be better off to keep the foreign car business inside the dealership. Perhaps that’s not the most pro-active or aggressive strategy, but that’s the way we like it,” Kodaira said.

Theoretically, Kodaira said, the easiest way to introduce new product lines would be to sell American and European models that were not yet being imported into Japan. In effect, he said, this would be an effort to capture the gray market that already exists for these types of vehicles. “I’ve already received offers to be the direct importer of such models, but I know full well that importers change all the time. In my own experience, I have had to do business with five different importers of Jaguars, for example. But foreign car companies’ headquarters are taking charge of the products in Japan,” he said, noting the recent termination of the Chrysler/Honda distribution agreement, as well as the historical efforts of BMW, Mercedes Benz and others to become their own importer. “It would be much too risky for me… And I am not interested in selling Ford models.”

Aside from the obvious charm of a man who long ago figured out a way to turn his passion for foreign cars into his life’s work – or hobby, as he might call it – there is something compelling and instructive about the reasons he has steered clear of the many offers to expand his operations into other product lines. In effect, the uniqueness of his business tends to underscore the validity of the rules that most dealers and car makers must play by.

THE PRODUCTIVITY DEBATE: ARCANE BUT GERMANE

When we met with Konen Suzuki on February 2, 1998, he was still president of Ford Japan, and Ford was still officially standing by its previously announced annual sales targets of 100,000 vehicles by the year 2000, and 200,000 vehicles by the year 2010 or earlier.[87] But on March 17, Suzuki announced his retirement,[88] and his successor, former Honda executive Iwakuni, immediately soft-pedaled the sales issue with this non-committal statement: "If it is possible to sell 100,000 cars in 2000, it will be wonderful."[89] Just two weeks later, on March 31, W. Wayne Booker, Ford's vice chairman for international operations, completely abandoned the target and refused to set a new one.

"We are afraid that it may be difficult [to achieve]," Booker said in an interview with a leading Japanese newspaper. "Since we are unable to predict the future of the Japanese economy, it is difficult to set a specific target for the future… I only mean to say that we are unable to present a clear numerical target because we cannot estimate the total market."[90]

This and other comments by Booker represented the first public recognition that Ford must institute fundamental changes in its marketing and product strategy in order to be successful in Japan and to adapt to current economic conditions. He addressed these issues as well, noting that Ford would have to develop "new sales methods to meet the needs of the new types of [value-conscious] consumers that are currently emerging." He also acknowledged that Ford would have to "establish a strong brand image not only by providing customers with better value but also through various measures such as maintaining the price of used Ford cars and improving customer satisfaction by offering better after-service."

But Booker stopped short of announcing any cutbacks in the company's current distribution network, and he also made no mention of any special subsidies to dealers or direct commission incentives to salesmen. "We have no plan to consolidate Ford dealerships and Mazda dealerships," he said, adding that Ford will try to "maintain both brands" while seeking cost savings in the production process and through better research and development. And finally, he addressed the most important issue of all, the weak appeal of Ford's current model line-up. "After the year 2000, there will be Ford cars made by Mazda which are designed by Ford and manufactured by Mazda in Japan," he

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[87] Actually, Ford originally set 200,000 units as its target for the year 2000, but in an interview with the New York Times in May 1996, Suzuki called this forecast "sort of propaganda." See "Dealers, Dealers…," p. 24.
[88] The retirement was effective April 1, 1998.
[89] "Ford Japan Unit Names Former Honda Executive New President," Dow Jones, March 17, 1998.
[90] "Reviewing Strategy in Japan – No More sales Targets, Analyzing the Needs of Customers," interview with Vice Chairman Wayne Booker of Ford, *Nikkei*, March 31, 1998.

noted. "We will be able to introduce products that are better suited for the Japanese market."[91]

Blaming the System

While the Booker statements seemed to presage at least a partial reversal of Ford's policies and marketing strategy while Suzuki was at the helm, it was not yet clear at the time he made them just how substantial or effective these changes might be. Accordingly, this analysis of our discussion with Suzuki is not intended in any way to take advantage of his retirement to win debating points. Rather, it is meant to illuminate his most significant disagreement with the original study, that we failed to adequately consider and analyze the low "internal productivity" of Japanese auto dealerships. By focusing instead on "external productivity" – that is, the number of cars sold per outlet per month or per year – Suzuki argues that we give a distorted picture of the Japanese market. In the process, he contends, outlets that might be profitable – assuming significant internal adjustments were made – are instead depicted as not viable because of low unit sales. In short, instead of laying the blame on Big Three products and marketing strategy, we should be attacking a system that – in his view – is by its very nature inefficient, inhospitable to foreign competitors, and unwilling to embrace innovation. If these time-honored practices were swept away, he suggests, unit sales of just 10 new Fords a month would be enough for an outlet to turn a profit, rather than the 20 to 30 we identify as the bare minimum.

While we remain unconvinced by these arguments, we believe the issues should be aired in some detail so that those unfamiliar with the Japanese market can get a better sense of why individual auto outlets operate the way they do. As the foregoing interview summaries dramatically indicate, we didn't meet a dealer in Japan who wasn't racking his brain to come up with more ways to be efficient, to increase profits, to raise staff morale, to develop more effective compensation plans, and to find alternative sales methods through the Internet, direct mail or other forms of advertising. A few dealers, as we have seen, have even taken the drastic step of modifying stock cars – in the case of Ford Tonichi, even retrofitting after they had languished in inventory – in an effort to add value, differentiate the product and attract buyers.

Some of these efforts are paying off, and some are not. But the process is evolutionary, not revolutionary. Suzuki envisions a far more drastic overhaul of dealer practices, and he focuses particularly on the internal productivity of Japanese sales and service staff – that is, the average number of new cars sold per month by a salesman, which in Japan is 4.5 vehicles, and the average number of vehicles repaired per month by an individual mechanic, which in Japan is 40 – or about two cars a day.[92]

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[91] *Ibid*. Aside from the clear marketing advantages of designing and building cars in the country, there is also an exchange rate incentive for Ford because of the relatively strong dollar and its increased purchasing power in Japan.
[92] Japanese Automobile Dealers Association (JADA) statistics.

These figures are generally acknowledged to be well below U.S. industry averages, but we discovered that there is some substantial confusion about what the corresponding numbers are in America. For some reason, almost all the Japanese dealers we spoke to were under the impression that salesmen in U.S. dealerships averaged 10 new car sales per month. This seems to have become the generally accepted figure – "the number," as the PR people say – in the continuing trade debates as well. In fact, it was repeated so often everywhere we went that we almost neglected to double-check it ourselves.

But NADA executive Jake Kelderman says the average in the U.S. is only seven units a month. What's more, he says, the number hasn't changed in some 30 years. He attributes this to "human nature" – the fact that the sales process is a one-on-one situation between a salesman and a buyer. "This requires a lot of time. It's hard to speed up the process. It usually takes about two weeks to make a deal, and there's the paperwork for arranging financing and deciding what to do with the old car," Kelderman says. Similarly, he confirmed that mechanics in the U.S. average about 4.5 repairs per day – about twice as many as in Japan, but also essentially unchanged over the years. One factor that tends to keep the numbers stable, according to Kelderman, is the fact that, despite the media attention given to the rise of such large "fast-food" type car dealerships as Republic Industries, Auto Nation and Car Max, "the auto business has been fundamentally conducted in much the same way" for the past three decades. For example, Republic's 278 showrooms nationwide constitute just over 1% of the 22,701 total car outlets in America.[93]

So the overall internal sales productivity gap is much less than generally perceived – even by Japanese dealers who would naturally want to see their businesses portrayed in the most favorable light. But there is still a disparity between the industry averages in the two countries, and this is what requires some discussion.

"The issue is they are losing money – not just the domestic dealers, but many of the import dealers are having financial problems borrowing from the bank, and they are suffering with very, very cold sales – an incredibly bad market," Suzuki said. "…So without changing the structure – the business way, the business practices – of the dealer operation here in Japan, it might be very, very difficult to overcome the low sales productivity and the very low service productivity."

We asked if he could be specific about what changes he would like to institute in Ford outlets. Suzuki said that he had just initiated what he called "a new way of selling in dealer operations and [the] management system," but he indicated this was proprietary information. Nevertheless, if those changes could somehow be successfully implemented, he said, "On a national average, if a dealer can achieve 15 units per sales outlet, if the dealers are smart enough, they can make a profit. That's my gut feeling. Even with only 10 units, some dealers are making profits."

[93] Interviews with Kelderman.

But this flies in the face of the 20/30 rule – even allowing for the several exceptions mentioned in our case histories – and would to our mind be inconceivable for a commodity auto product at the low or even middle range of the market. While Suzuki rightly pointed out that dealers can get substantial revenue from used-car and service operations – and are therefore not dependent on new-car sales alone for profits – virtually all of the dealers we interviewed included these elements in their profitability calculations. Moreover, the Big Three have the worst record among foreign and domestic manufacturers of helping their dealers build ancillary profit centers.[94] So we asked Suzuki if he could cite an example of a dealership that was making a profit by selling only 10 new cars a month.

He could not name one, although he did mention a well-run Toyota dealership in Kobe with average monthly sales of about 30 new cars. "He [the dealer] is allocating a smaller number of salesmen to the stores," Suzuki said. "…That is the real situation. The majority of dealers might have 10 salesmen in one store. He is selling 30 units – yes – and only four salesmen."

The problem with this approach, however, is that large staff cuts such as these – even if they could be achieved with minimal disruption of the employer-employee relationship – would only be possible if major reductions in service levels were instituted. But Japanese consumers have come to expect a very high degree of pampering when they buy a car. This could change if the Internet becomes more and more popular, or if in-home sales calls decrease, but it probably will be a relatively slow process. The fierce competition among dealers guarantees that any reduction in service levels by one would be seized upon immediately by competitors to win away business. In addition, there are questions of minimum staffing levels that would put a limit on the amount of savings that could be achieved with personnel cuts. The inescapable conclusion is that dealers are not saying no to large restructurings or other sudden streamlining measures just for the sake of avoiding change. They are saying no because to do otherwise could threaten their basic economic survival. It should be recognized that this is highly rational behavior; it cannot be dismissed with a facile reference to the "Japan is different" paradigm.

Of significant interest during the discussion, Suzuki confirmed that Ford ended the year 1997 with 304 exclusive outlets in Japan – five fewer than the company had in 1995, the year the auto agreement was signed, and 16 fewer than in 1996. Although this was in itself tacit confirmation that a large number of outlets had also been closed during the past several years, we were not able to address the question of outlet turnover with him

[94] For example, a J.D. Power Japan "Dealer Attitude Study" released in December 1997 examined the overall industry dealer satisfaction index. The research showed that Toyota had the most satisfied dealers for the third year in a row, followed closely by Volvo and BMW. Nissan, Mitsubishi and Rover placed fourth, fifth and sixth respectively, with ratings either above or equal to the industry average. All other manufacturers had dealers with below-average satisfaction levels. The study, conducted in September and October 1997, was based on 744 franchise evaluations provided by 540 dealer principals. It asked them to rank auto makers in seven categories: responsiveness to dealers, vehicle supply, sales representatives, service relations, sales training, parts, and warranty.

directly. An attempt to clarify the issue through a later exchange of faxes was unsuccessful because of Ford's management change.

However, during the meeting, Suzuki repeated his frequent assertions that importers were denied access to dealers of domestic cars, and he insisted that manufacturers of foreign cars needed more outlets to support their sales efforts. "I believe we need more dealers because we have a long-range big vision and objectives to achieve [sales of 200,000 cars a year before 2010]… I understand it requires time. If you want to make progress in any country, you need a franchise," he said.

He said that despite the severe financial difficulties of many dealers in Japan, they were still reluctant to add a foreign product to their line-up. And while he acknowledged that considerations of product suitability and quality played a part in these decisions, he indicated this was a problem for the other American manufacturers, but not for Ford. "…Chrysler and General Motors Saturn are struggling. Probably they are the most frustrated people in Japan, because their product line-up is not ready fully for the Japanese market. They know that, but at the same time they would like to increase the number of the dealers' sales outlets before the product line-up is coming."

<u>Studying the Problem to Death</u>

To get a better sense of these productivity issues from the perspective of independent dealers, we spoke at length with Kinji Kunieda, managing director of the Toyota National Dealers' Advisory Council. He first earned his stripes as a young executive assigned to resurrect Toyota's failed efforts to enter the American market in the late 1950s.[95] Today, he administers a group that provides research and business advice to the hundreds of mostly independent Toyota dealers in Japan.[96]

Kunieda said the Toyota distribution network, while it has evolved over the years, was originally patterned after the U.S. model of concluding franchise agreements with independent dealers who have strong ties to the local community. These kinds of "hungry" entrepreneurs, it was believed, would develop into highly motivated and competent managers who could leverage their credibility and knowledge of the community to build a strong financial base. In large measure, Kunieda said, this model was successful and remains in force today. Of the 309 dealer-principals in the network, 296 are independents from local areas nationwide. However, by and large, this system is unusual

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[95] For a brief account of his U.S. experiences, see "Dealers, Dealers…," p. 12.

[96] The Council represents a total of 468 dealers, 309 of which sell vehicles through Toyota's 5,771 outlets in five sales channels – Toyota, Toyopet, Corolla, Auto and Vista. These are roughly equivalent to the five divisions of General Motors – Cadillac, Buick, Oldsmobile, Chevrolet and Pontiac. Four other Toyota channels engage in such other businesses as fork lifts, after-sales parts, rental and leasing, and housing sales. In addition, about 100 of the 309 vehicle dealers operate 141 DUO showrooms, which sell imported Volkswagen and Audi vehicles exclusively. GM's Cavalier, which has been re-badged as a Toyota in Japan, is sold through the Toyota channel.

in Japan when compared to the distribution networks of the other domestic makers, which own a much bigger percentage of their dealers.

Kunieda worked with Ford's Suzuki in the U.S. years ago and was very much aware of his former colleague's arguments about the need for massive change in the Japanese auto industry. He conceded internal sales productivity at U.S. dealerships was higher – although he too was using the number 10 instead of seven units per month – but noted that sales methods in the two countries varied sharply.

"In the U.S. historically, it is the customer who goes out to visit an auto showroom to purchase his car. I observed this all the time when I was in the United States, and it seemed quite appropriate for a country as large as America," Kunieda said. "But in Japan, the "motorization" of the country happened relatively quickly after the war. For the most part, people had no idea about the mechanics of buying a car, and a system of door-to-door sales was instituted both to educate consumers and make it easier for them to purchase their first car."

So, he said, the individual salesman and other personnel at the dealership literally walked their customers through the sales and registration process, answering questions, filling out the paperwork and, if necessary, even running errands to make sure the buyer was satisfied. After that, service levels based on these personal relationships were refined and extended so that customers were spared the need ever to leave their homes. When it was "time" to buy a new car (usually when the registration cycle required a new inspection), a consultation was arranged at the customer's home, a model was selected, a trade-in and purchase price were negotiated, insurance and registration forms prepared, and then the salesman arranged to pick up the old vehicle and deliver the new one. This is a level of service that is unknown in the U.S. "But today," Kunieda said, "this is beginning to change gradually. I would say that from now on, the purchasing system will evolve and become more similar to the U.S. type."

Tomoji Komatsu, a Kunieda colleague and a director of the council, complained that Ford Japan "has not really proposed any concrete solutions. It's obvious if you find a way to double your internal sales productivity, it would generate much larger profits for that outlet. But given the Japanese car business – dealing with various local habits and the Japanese ways of thinking and selling – four or five units a month may be quite realistic."

Unknowingly, Komatsu echoed the complaints of the managing directors of Kintetsu and New Empire Motors. "…Ford Japan sales people are quite disappointed in this regard because Ford's top management are urging them to sell 10 units a month… But as to how to sell 10 units per person, there is no practical instruction from Ford at all."

Kunieda added: "I don't know exactly how Mr. Suzuki's philosophy has evolved, but I do know that throughout the whole country, dealers and managers of Ford outlets are quite unhappy because Ford Japan is just repeating the principles and theory, but when it comes to practical advice, there isn't any. So people are getting very frustrated."

He was reminded that Ford's plan for dealer reform was proprietary. "I understand it could be proprietary," he replied. "But everybody involved in the Japanese auto industry has been saying that Japanese dealer profitability has been low, and for this reason many times people from Japan went to the U.S. to learn from that system, to study it, to see how we could sell 10 units a month. But I personally feel we have invested too much time in this study.

"On the other hand, it takes time for the customer to change his mind. That has begun – mostly with young people in urban areas who are now going out to showrooms to buy cars. But in the countryside, people remain quite conservative and are sticking to the old ways… On the other hand, sixty percent of SUVs in Japan are sold in showrooms. The situation varies from model to model, car to car, and from generation to generation."

Kunieda recalled his own experiences selling cars in the U.S. and Germany. "There is no question that service levels in Japan are much higher," he said. "Japanese service levels have actually been going beyond customers' expectations – to such an extent that I would say we are 'over-servicing' in Japan at the present time. Well, I would not really like to say I am in favor of lowering service levels – because it's not a very a nice expression. But I would say we might try to 'normalize' service levels in the future… We can reduce these staffs eventually, but we can't do it overnight. We have made a commitment to both our employees and our customers."

Then, Kunieda hit on an aspect of the trade debate that helps put into perspective some of the comparative gamesmanship between America and Japan. "I believe if you look at NADA statistics, I would say sales promotion is a big cost item for U.S. dealers, and it is perhaps at the equivalent level of our personnel costs. So we are not putting the money in the same place."

Indeed, NADA estimates annual advertising costs for dealers in the U.S. to be in excess of $5 billion a year, and our check with industry sources revealed other significant differences in measurements of internal productivity at dealerships in the two countries. In Japan, for historical reasons, the majority of salesmen are college-educated and get the lion's share of their compensation through a salary – although, as we have seen, many Japanese dealers have been experimenting with incentive programs for a long time. As a result of this and other factors, the average turnover rate for sales staff in Japan is between 11-13%. Kunieda said the average for Toyota dealers in 1997 was 10.7%. In Nagoya, Aichi Toyota's president Yamaguchi reported an extraordinarily low turnover rate for his salesmen of 5%, of which he said 2% was due to compulsory retirement.

In stark contrast, the national average in the U.S. stands at a relatively stable 70% turnover annually,[97] which means that American car salesmen are largely an itinerant group that – much like Katsumata's joking reference to Japanese chefs – is constantly on

[97] NADA.

the lookout for openings at higher volume outlets. The potential negative impact on service levels because of inexperience and the lack of a personal relationship with the customer are self-evident, but the implications go well beyond this. Inexperienced staff members also require more supervision. NADA statistics indicate dealers hire an average of one supervisor for every 2.3 salesmen,[98] while in Japan, according to Kunieda, one group supervisor is required only for every four to five salesmen. All of this led to average pre-tax profits of 1.7% for the NADA group in 1997,[99] while JADA dealers had average pre-tax profits of 1.2% -- again, a much smaller discrepancy than much of the trade rhetoric would suggest, and an area that could bear some future research.

But the question arises: what would have happened if Japanese auto makers, when they were putting together distribution networks in America, insisted on replicating the system with which they were most familiar? Could they have convinced American consumers that in-home sales were more convenient, even if this led to higher car prices? Could they have convinced dealers to hire better educated sales staffs and put them on salary or pay them special incentives, risking a reduction in dealership profits but significantly increasing the quality of service to customers? Could they have found college graduates willing to take the job? If dealers objected to the higher overhead costs for sales staff, couldn't they simply lay off some of their surplus supervisors to offset the expense?

If any or all of your answers to the above would have been 'no,' then you can begin to appreciate the difficulties Japan's auto makers and dealers face when they contemplate large-scale restructurings of the distribution system in Japan. In this, we don't mean to suggest that any or all of these changes would be appropriate or even workable for car dealers in America. We just want to point out the different styles that have evolved in the respective distribution systems. In the final analysis, direct line-by-line comparisons from country to country may be more misleading than helpful, especially when the larger context of industry practices and consumer preferences is ignored. Rather than comparing Japan to America or vice versa, it might be more productive to compare Japan to Japan. This is, after all, the market that the Big Three are trying to sell to.

In this context, the 20/30 rule has a great deal of relevance. "Yes, generally, I agree," Kunieda said. "In Toyota's case, depending on the location and size of the outlets, a dealer might need to sell 25 to 35 units a month to make a profit, and even 40 to 50 units a month in our larger outlets."

He said this was largely because of high land costs. "For example, in the U.S., when you buy a house, the land just comes with it. Whereas in Japan, first you have to know how much the land costs, and the house is rather an afterthought," he said.

His conclusion was that Ford Japan's strategy had not been adaptable enough. "Mr. Suzuki has a lot of experience in the U.S., and he respects the American way of doing

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[98] NADA. See also, "Auto Dealers and Makers Look to Trim Distribution Costs to Boost Dealer Profits," *The Wall Street Journal*, February 2, 1998.
[99] NADA's Jake Kelderman says this figure dropped to 1.4% in early 1998.

things. If he were conducting business in the U.S., there is no doubt he would be successful," Kunieda said. "But he is working in Japan now, and he may have some trouble applying American ways. In Japan, his approach is not convincing. There is too much of a gap between his statements and reality."

A similar message came from Katsumata, who said: "The biggest problem is the bad product. And if we cannot bring a very good right-hand drive car from Ford, it wouldn't be very useful for dealers to start training programs. Even if salesmen took part in those programs, that would not lead to better results. So good product is the key to success… And if there's no good product scheduled in the future, then dealers will withdraw from the franchise agreement."

Did he agree with the 20/30 rule?

Katsumata: "Yes, I agree."

Even if you have a good service and used car department?

"Yes."

Kunieda felt that despite the difficulties being encountered by the Big Three, there were some significant opportunities being missed in the market. "If I were in [Ford's] position," he said, "I would go after smaller outlets – perhaps even used-car dealers – at the grassroots level. Instead, they are approaching very large dealers – especially Nissan and Honda – and trying to convince them to shift to Ford… But unless there are some real success stories of Japanese dealers selling Fords, I don't think other dealers will follow… I don't know if [Ford's] biggest problem is staff or implementation of policy or the products. But in any case Ford products are not selling that well at the moment."

He added: "There are about 2,000 large dealerships in Japan, and Ford is targeting these large dealerships trying to convince them to shift to Ford. This is not working. I would go after the 13,000 dealerships that are selling used cars in Japan, and I would tackle them one by one to make them solid Ford dealerships."

Kunieda harked back to his experience in the U.S. "Back then, no Big Three dealers were interested at all in handling our models or becoming Toyota dealers. Instead, we went to Studebaker outlets, because Studebaker had stopped production. Then I shifted to American Motors to recruit them. So gradually, I built up the Toyota network in the U.S. to the extent that they finally became very appealing to American customers."

His colleague Komatsu suggested another approach: "I really do not understand why Ford is not making full use of the Mazda dealer network, which exists all over Japan – and everyone knows today that Mazda is a *de facto* subsidiary of Ford."

But Kunieda said, “At present, Mazda is in a difficult [financial] situation, so I’m sure Ford does not want to do anything to make things worse. But if Mazda’s business deteriorates, Ford should give them more help… In the final analysis, Ford will keep the good parts of the Mazda business.”

Working with the System

While he shows considerable – and understandable – frustration with Japan’s slow economy and auto industry recession, Chrysler Japan Sales chairman Keisuke Egashira seems to be trying to work within the system rather than seeking to overturn it.

“We’re all suffering. There is no exception,” Egashira said, pointing to a 10.7% decrease in Chrysler sales in Japan for 1997. He said total sales for 1997 were 14,432 units (down from 16,170 in 1996), of which about 80 percent were Jeeps, some Voyager minivans, and just a trickle of Neons.

He appeared to have little problem with our analysis of two of the most contentious issues raised in our dealer studies – the question of minimum profitability levels and the number of outlets that have been “churned” or “turned over” as the Big Three seek to reorganize their distribution systems. Asked about the industry consensus on the 20/30 rule, Egashira replied, “That’s essentially correct.” He added the usual caveat that the actual number would vary depending on various factors such as the size of the dealer’s initial investment, whether or not he leased or bought his land and showrooms, and whether he was located in an urban high-cost territory or a more rural area. “A dealer with a very small investment might be profitable with as few as 10 new cars sales a month,” he added, although he said that would be a relatively rare case.

On the question of outlets, Egashira said that when Chrysler Japan Sales was first formed in June 1995, the company had 117 outlets throughout Japan. “We haven’t added that many – there has been the elimination of some outlets,” he said. “Overall, the total hasn’t increased drastically, but the quality has increased tremendously.”

We mentioned our meeting with Saitama Mitsubishi Colt president Nakajima and his recent decision to begin selling Chrysler products again after his bad experience 20 years ago. Egashira said he was familiar with Nakajima’s situation, where he already owned the land and was able to open a Chrysler showroom on existing property and handle service and administration on his Chrysler and Mitsubishi vehicles through a shared facility. Even in this case, Nakajima insisted he needed 20 to 30 new-car sales per month to turn a profit, and Egashira concurred.

In urban areas, he said, while 30 vehicles per month was Chrysler Japan’s target minimum, the company’s “basic strategy was to increase both the sales average per outlet and, eventually, the number of outlets. To do this, an outlet would have to achieve profitability at least in the third year. Otherwise, it could become quite painful.” Both he and

Assistant Vice President David Kanda also noted that outlets had profit potential in their parts and service operations. "Not everything is dependent on new-car sales," Kanda said, "and dealer commitment and dedication is also important."

Egashira reflected on last year's decision by Chrysler to terminate its indirect distribution agreement for Jeeps with Honda Motor Co. In 1996, the Honda dealer network sold 10,368 Jeeps, accounting for nearly two-thirds of all Chrysler products sold in Japan. In 1997, Egashira said, Honda dealers still sold about two-thirds of all Jeeps marketed in Japan, but this segment now made up only about 50 percent of Chrysler sales nationwide.

"The decision [to terminate] was taken from a long-term viewpoint, but it was very painful. The Honda volume was so important, it was not an easy choice," Egashira said. "Chrysler is trying to take a long-term view… Dual dealerships present a conflict for both the dealer and the sales staff. In 1995, Chrysler decided on a policy of establishing main [exclusive] dealers in Japan with large and well-defined sales territories to protect them from competition from other dealers and help insure their profitability."

"This presented a clear conflict with the Honda network," Egashira said. "At some point, they [the Honda dealers] had to be terminated." Their primary business, after all, was selling Hondas. The Jeeps, while a nice sideline, were not crucial to their overall profitability. "But main dealers – that's all they have… They have to survive with a single product line."

At the time of the interview, despite Chrysler's nearly 11% drop in 1997 unit sales, Egashira said his company was not offering any special incentives on current models, which he noted was different from industry practice. He said Chrysler recently had a six-month low-financing rate of 1.9% in place, but this program ended in December.

Speaking of his company's long-term strategy, Egashira said, "The name Chrysler is not so well known in Japan yet. Perhaps the name Jeep is better known. But it is very important to build brand image, and it is very important to have exclusive showrooms."

Over the past couple of years, it was noted, Chrysler Japan has sold fewer than 10 new vehicles per outlet per month, even in its more productive and exclusive showrooms. This would mean that the company needed to triple sales over the next three years to break the 30 cars per month profit barrier. Egashira concurred. "Something like that, yes," he said, adding: "That's easy to say, but not so easy to achieve."

Indeed, a J.D. Power Japan survey of usage and attitudes has already identified a potential problem area for Chrysler that would justify Egashira's concerns. While Japanese consumers are increasingly eager to purchase recreational vehicles, the study found they are most interested in minivans and station wagons. The volume of off-road type SUVs will probably not increase beyond the current limits.[100]

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[100] The J.D. Power Japan "Usage and Attitude" survey randomly canvassed 4,000 vehicle owners in nine major cities during May 1997.

Although the Daimler-Chrysler merger was not on anyone's radar screen at the time of the interview, it is doubtful whether Chrysler could leverage anything from the Mercedes Benz Japan dealer network to increase sales opportunities. Yanase would certainly be a non-starter because of the omnipresence of General Motors. The Mercedes Stern channel has 46 outlets, but they would have nothing to gain and everything to lose by converting exclusive showrooms to duals. And the Mitsubishi channel used by MBJ constitutes a pittance. In addition, Mercedes is now marketing its own high-end sport utility vehicle in the U.S. which – if exported to Japan as well – would compete directly with the fully loaded Chrysler Grand Cherokee.

"We are taking a very logical approach to the market, using research firms to check demographics to determine the optimal size of the main dealership for each territory in terms of profitability," Egashira said. "The study is not complete yet, so we can't say what is optimal."

Given the current situation of low sales per outlet, he said, "Consolidation is not the purpose of our game. To impose profitability will become our goal. As a result, however, some consolidation [of dealers] might be necessary… Over the years, profitability among Japanese auto dealers has not been so high. The productivity of Japanese car salesmen has not been so high."

Egashira added: "It will take a certain amount of time to change this." He conceded that direct comparisons between U.S. and Japanese dealer productivity were not necessarily valid given the disparity in service levels of the two systems, and he agreed that Japanese consumers may not be ready to accept the more "no-frills" approach of the American dealer methods.

Asked about the contradiction between market realities in Japan and the constant complaints from Washington trade officials and Big Three executives in Detroit about the need for more outlets in Japan, Egashira said simply, "We like to stay out of politics."

Ford Does a "180" – Maybe

Notwithstanding the hints of change suggested by Suzuki's retirement and Vice Chairman Booker's comments at the end of March, it was not at all immediately clear how or when Ford might move to alter course and improve its market position in Japan. But recent and sudden developments suggest that matters may be coming to a head faster than anticipated. In one of the more dramatic statements to come out of the Japanese auto industry in some time, Ford Japan's new president Iwakuni announced what amounted to a complete about-face in corporate strategy in mid-April, saying "the courage to say no" to Ford executives in Detroit will be the salvation of his efforts in Japan. Contained in separate interviews with *Automotive News* and *Nikkan Kogyo*, Iwakuni's comments laid waste to two decades of trade rhetoric about "invisible" import barriers and numbers

games about outlet totals. Specifically, Iwakuni pinpointed bad and inappropriate product as the reason for Ford's failure in Japan, and he conceded what countless dealers have already told us: Ford outlets can only achieve profitability if they sell an average of 25 units per month nationwide – and somewhere between 42 to 50 vehicles a month in Tokyo.

Iwakuni also went well beyond Booker's much more general observations in March, saying that in the future he would like to end the practice of Ford selling re-badged Mazdas in Japan – a constant irritant to both Ford *and* Mazda dealers who must fight for limited customers with many of the same models in their line-ups, albeit masquerading under different names. In addition, Iwakuni also said he would seek ¥16 billion ($123 million at $ = ¥130) – nearly three times as much money as Ford Chiba president Katsumata had previously urged be spent – to support dealer operations, and another ¥10 billion for advertising and other promotional efforts.[101]

It is worth reading from these articles at some length:

> Barely two weeks on the job, the president of Ford Motor Co. (Japan) Ltd. is pulling the corporate-strategy equivalent of a hand-brake turn. For seven years, former president Konen Suzuki drummed home a single message: Give me more dealers, and I'll sell more cars in Japan. Ford therefore took a hard-line stance in U.S.-Japan automotive talks on the issue of access to dealers in Japan.
>
> No more. Eiji Iwakuni, a 55-year-old former Honda Motor Co. executive who succeeded Suzuki on April 1, says Ford needs better product in Japan, not more dealers who can't sell inadequate product.
>
> Because of fundamental shifts in auto retailing, Iwakuni said in an interview last week, "You no longer need so many dealers all over Japan."
>
> Instead, he said, the key to Ford's success in Japan will be vehicles that meet the specific needs of Japanese consumers. While he expects good sales for the Ford Mustang and just-unveiled 2000 Lincoln LS6/LS8, he also knows he will have to be willing to refuse some American models Ford may ask him to sell.

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[101] While these numbers are relatively large for the Big Three in Japan, they pale in comparison to the European investments in infrastructure and promotion, and they are completely dwarfed by the expenditures of the domestic auto makers. Many analysts have suggested that this is consistent with actual Big Three strategy – that the American companies have purposely limited their investments in Japan because of the possibility of only limited success. For example, in March 1994, David E. Cole, director of the University of Michigan's Office for the Study of Automotive Transportation, said efforts then just getting under way to introduce right-hand drive cars in Japan were largely symbolic and "related more to overall trade friction than anything else [so the Big Three could claim they were making real efforts to penetrate the Japanese market]… If the Big Three had the opportunity to go there with huge numbers and at low cost, they wouldn't do it anyway. That's because they need to spend their money in other places in the world that offer greater opportunity."

A similar point was made more recently by Christopher Redl, an analyst at ING Barings Securities Ltd. "To really generate sales in Japan, a foreign manufacturer has to spend a lot of time and money on advertising and dealers to build momentum," Redl said in a December 7, 1997, interview with *The Detroit News*. "The Big Three haven't put major money on the table because the returns are so low."

This strategy, of course, completely ignores the problem of the other Asian markets and the need to have a significant presence in Japan to use as a platform for entry into these large and fast-growing economies.

> "The courage to say no will save Ford Japan in the future. And I believe the head office is willing to accept my no," he said.
>
> Indeed, he pointed to his appointment as president despite his inability to speak English, as proof of Ford's commitment to the Japanese market.
>
> "That shows that they put less weight on communications ability than on actual business operations. They recognize the need for them to listen to customers, instead of internal company people," he said.
>
> [...]
>
> **Question: Are there any vehicles from Ford that you want to say yes to?**
>
> Answer: All are of only average level, so there aren't any that I'm eager to say 'Yes!, Yes!, Yes!' to. But Ford has very good brand equity. From my childhood, I adored Mustangs and I regret that Ford sells only 300 to 500 currently. So I'm thinking of tactics to persuade Ford headquarters to implement model changes to adapt those cars for Japan. The (new) Lincoln LS6/LS8 also needs a little adjustment for Japan. I want to sell 5,000 of that car.[102]

And, from the Japanese business journal *Nikkan Kogyo*, comes this exchange with Iwakuni:

> Ford, the world's No. 2 auto maker, is having difficulty in the Japanese market. Ford Japan's 1997 sales – excluding re-badged Mazdas – was 13,983 units with only 4.1% share in the imported passenger car market.
>
> Q: What is the cause of Ford's poor sales performance?
> A: The Japanese market has very particular 'Japanese specifications' that must be satisfied. One specification is whether a vehicle can carry four golf bags in its luggage space, another is whether a navigation system can be easily installed in it, or whether the car has a keyless entry system. The size of a vehicle must be within 1,801 mm in width in order to park in a tower parking facility. Vehicle sizes must be decided based on differing automobile taxes. Ford has lacked such meticulous attention to marketing detail. I told the executives of Ford U.S.A. that I would be a rule book on selling Fords in Japan.
>
> Q: How do you see the sales target of 100,000 in the year 2000?
> A: The break-even point of one sales outlet would be between 500 and 600 units a year in Tokyo and 250 units a year in a smaller city. An outlet that cannot reach that sales level will not have profits to re-invest [in new facilities and personnel]. Ford's current distribution network of approximately 300 outlets cannot survive unless they collectively average 300 new vehicle sales per outlet per year, which would mean a total of 90,000 units per year. I want to approach that target as much as possible by adding Mazda-made [but designed exclusively for] Ford vehicles beginning in the year 2000. In order to do that, we have to establish the corporate identity of Ford products and outlets.
>
> Q: What would be your first step to achieve it?

[102] James B. Treece, "New Ford chief plans an about-face for Japan," *Automotive News*, April 20, 1998.

> A: Ford's understanding of the Japanese market in terms of product development and sales policy is insufficient. Currently, it takes six months between placing an order to Ford U.S.A. and the arrival of the vehicles. As for product development, Ford U.S.A. is now formulating concepts for vehicles that will be introduced in 2002 - 2003. I will try to reduce that lead time as much as possible. I will try to change the awareness of Ford Japan by having managers who have the same questions I have.
>
> Q: What would be the measures for outlets?
> A: It will cost approximately ¥10 billion to establish outlet corporate identity and approximately ¥16 billion for some joint projects with dealers. Because Ford U.S.A. is getting down to business in Japan, I believe I can successfully obtain the necessary money. OEM sales of Mazda vehicles will be stopped in the future.[103]

Of course, there are a lot of "ifs" in this wish-list. Despite the new-found sense of urgency, there is no guarantee that Detroit headquarters will grant approval for the budgets as outlined, and there is no guarantee that Ford will come up with winning new designs for the Japanese market. There is also the question of lag times: how long can its current dealer network hold out without more and better product even if some form of subsidy is maintained? But if Iwakuni gets much of what he asks for, there are many who feel he has the experience to make important changes in both the Ford distribution system and the company's future design and marketing decisions in Japan. As the former president of Honda Clio Saitama, he is credited with taking the company from its position as the lowest volume Honda dealership in Japan to the top-selling spot in the auto maker's network. He is also given high marks for overseeing a three-year reorganization and consolidation of the Honda dealers across Japan before resigning from that post last February.[104]

The question is whether Iwakuni can execute such a high-speed turn and still keep the car on the road. At the very least, now that Ford's strategy has shed itself of the impedimenta of trade complaints, it should be able to focus more clearly on the business issues it faces in Japan. It promises to be a bumpy but interesting ride.

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[103] "Interview with Mr. Eiji Iwakuni, President of Ford Japan," *Nikkan Kogyo*, April 24, 1998.
[104] See, for example, "President Suzuki of Ford Japan Resigns, Unable to Free Himself from the Toyota Method," *Nikkei Sangyo*, March 18, 1998; and "Ford's Japan Chief to Retire," *Automotive News*, March 23, 1998.

RAMBO VS. GODZILLA:
AVOIDING ANOTHER TRADE FIGHT

A key question at this juncture in U.S.-Japan relations is whether Ford's U-turn on business strategy can be matched by an equally sensible shift in direction on trade politics. From time to time – particularly if one has one's ear to the ground in Tokyo – there is sometimes cause for optimism in this regard. After all, there has been no shortage of Big Three executives who have said their "mea culpas" about their companies' lack of effort in the market and promised to be better corporate statesmen in the future.

This latest round of soul-searching began last fall about the time of the Tokyo Auto Show. "Japan is not a closed market," said Louis Hughes, president of General Motors international operations. "You just have to understand it." "We decided we're not going to complain anymore. We're going to try to work around this," said François Castaing, Chrysler's former executive vice president for international operations.[105] "We feel like we have an even, equal chance at competition [in Japan]. There's nothing we've seen in the marketplace that is preventing us from moving forward," said Saturn Japan general manager Wicks.[106]

One of the more eloquent statements on this subject came some two a half years ago from no less of a figure than John F. Smith Jr., the Chief Executive Officer and President of the General Motors Corporation, who was the keynote speaker at the 11th Annual Dinner of the Japanese Chamber of Commerce and Industry of New York in November 1995. Speaking just five months after the bitter U.S.-Japan fight over auto trade was settled in Geneva, Smith made three telling points:

- "Japan should not be a scapegoat for the U.S. trade deficit, which is due mainly to America's own economic practices. The U.S. trade deficit mainly reflects a severe savings-investment imbalance."

- "Americans should know that 'Japan, Inc.' does not exist. 'Japan, Inc.' was a convenient way for the U.S. to avoid dealing with Japan's impressive competitiveness... Let me stress that Japan should not be blamed for the loss of American jobs. We in the U.S. auto industry believed for far too many years that we knew what American car buyers wanted, and we weren't about to change. The result of this arrogance was that consumers flocked to purchase Japanese cars in great numbers."

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[105] "U.S.'s Big Three Car Makers Now See Japanese Market in a Whole New Light," *The Wall Street Journal*, October 24, 1997.
[106] *Rochester Democrat & Chronicle*, September 9, 1997.

- "Japan remains a good friend and loyal ally of the United States, and we must not let trade frictions obscure this... One thing I wholeheartedly believe, however, is that U.S. political and business leaders must stop the Japan-bashing. Such rhetoric ... furthers old stereotypes about Japan…."

When a native Japanese, even a man with such vast industry knowledge as Ford's Iwakuni, is critical of American policies, these comments tend to be dismissed with glib regularity in the U.S. But how could the public utterances of GM's chief executive become so lost in the fog of trade debate?

The answer, of course, is that there is a huge disconnect between market perceptions in Tokyo and Washington, even among executives of the Big Three. For the most part, Japan-based officers and employees of the U.S. manufacturers publicly concede the market openness issue and the dealer/outlet profitability thresholds analyzed in this study. Even high-ranking political and commercial officers at the American Embassy are not reluctant to acknowledge the Big Three problems in off-the-record conversations. To insist otherwise in Japan would severely damage their credibility and – in the case of auto executives – risk alienating Japanese dealers and consumers alike. That these realities are ignored in the U.S., willfully or otherwise, suggests that many American policy makers who support an aggressive trade policy continue to be inoculated from criticism because of precisely those lingering stereotypes about Japan that Smith criticized in his speech.[107]

As the *Wall Street Journal* noted last fall, despite the many positive comments, "the Big Three's trade group, the American Automobile Manufacturers Association, certainly hasn't lowered its rhetoric about Japanese trade barriers."[108] Nor, it might be added, have many administration officials or Congressmen. To be sure, some of the more hyperbolic statements are part of the grand political theater that often characterizes Washington trade

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[107] While Alex Trotman, chairman of Ford Motor Co., has historically been more critical of Japan, he has begun to concede some of the market openness issues. In an interview with *Business Week* published May 4, 1998, he said the global playing field was "…fairly level, in the sense of fairly open markets. There aren't any major restrictions to the free flow of manufactured goods. There's China, of course, and places in the developing countries where there are still major barriers to the free flow of goods. But in the major markets of Europe, North America, and Japan, it's pretty open."

At one point in the interview, Trotman even raised the possibility that Ford might substantially increase its equity stake in Mazda, citing the buying power of the strong dollar vis-à-vis the yen. Curiously, however, he then switched gears to focus on the old complaints about alleged market barriers and the *danger* of a weak yen: "We have a controlling interest in Mazda today and with the yen [at a weak 132 to the dollar], if bargains emerge, we certainly would consider them… Down the road, if Mazda were to become a much more profitable company than it is today, then 100% [ownership] would be more advantageous than 33.5%… We're going to face increased pressure in Western Europe and North America from the yen because they're suffering so heavily in the region. Their solution, as always, is: Let's get the ships loaded up and send them to Europe and America. We're going to see very substantial trade difficulties this year between Japan and the U.S. as the deficit grows." Finally, asked about Ford's very low sales levels in Japan, Trotman said, "… The dealer issues are still difficult. But there are no big tariffs and no big barriers to shipping vehicles to Japan… It's a very, very difficult and nationalistic market. It's a very hard market to penetrate. We're just going to keep driving at it."

[108] *Ibid*, October 24, 1997.

politics. For example, AAMA president Card's frequent assertions that the Japanese consumer has been "denied choices" in the auto market seems to fly in the face of reality, but no one really seems to mind.[109] God knows, some people actually believe it, although the *Nikkei Weekly* published an interesting article last fall that quite accurately described the Tokyo Auto Show as "the biennial presentation [that] regularly draws more exhibits and visitors than any other motor show in the world… This year's show… features 771 concept and production models displayed by 64 companies from 14 countries."[110] A recent article in the *Detroit News* – datelined Tokyo – noted: "The Japanese car and truck market is the most cluttered in the world. A new model is introduced here nearly every week."[111]

But when political theater turns to crude slapstick or vaudeville, as it did in June 1995 when America and Japan almost landed in a trade war, it is not always so becoming to the players who are caught on stage when the jester crashes the scene. In this case, everyone's credibility suffers – and the United States loses respect in the eyes of the world. Our biggest trading partners, whether they are located in Asia, Latin America or Europe, are well aware of the many trade barriers and regulations that stand guard over the American business landscape. They see nothing amusing about the frequent lectures and parochial attacks by U.S. industry and political leaders on *their* governments, businesses and way of life.

Merton Miller, the Nobel laureate in economics from the University of Chicago, gave a memorable speech in California four years ago when U.S.-Japan trade tensions were at a peak. He said, "The U.S. merchandise trade deficit with Japan, about which you've heard so much, is in no sense a crisis… Those highly touted market opening initiatives will have no more than a temporary and trivial effect… The administration's program, if it succeeds, will benefit, at best, a few American firms. But if it fails, and leads to trade sanctions, it will impose huge costs on the rest of us, and the rest of the world. The Administration's Rambo-style tactics are thus the classic bad investment: a low payoff on the upside, but a big risk of loss on the down."[112]

Miller went on to say, "Japan, after all, is far and away our biggest [overseas] trading partner. Sanctions that reduce the flow of imports from Japan would inflict huge losses on American consumers and would destroy generations of successful diplomatic and trade initiatives by this country. Why risk it for the miserable pottage of an increase in sales by a handful of U.S. corporations? The answer, I suspect, is that the Administration felt it wouldn't have to invoke those sanctions. The mere threat would be enough." But, as Miller noted, it is only smart policy to allow for one's bluff being called. If you're not prepared to back it up, credibility goes out the window. And if the issue isn't worth the

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[109] See, for example, "Japan Trade Negotiations: No Headway," *Automotive News*, October 13, 1997.
[110] "Small Cars Star at Big Show," the *Nikkei Weekly*, October 17, 1997.
[111] "Big Three Vow to Succeed in Japan: Automakers Dig In, Woo Consumers in the World's Toughest Market. Deep Pockets Needed, Experts Say," *The Detroit News*, December 7, 1997, p. A1.
[112] Merton Miller, "Japanese Trade Relations: Rambo Takes on Godzilla," a public lecture at the University of California, Santa Barbara, April 21, 1994.

effort, why get reckless in the first place?

Perhaps Ford Japan's recent strategic shift and public admission that its past tactics were misguided could, finally, put an end to U.S. government and industry pressure for outlet quotas – or, as they say in the vernacular, "expectations." This would go some way toward restoring American credibility on both the trade and business fronts, and could reinforce positive trends that have been contributing to increased harmony in other areas of U.S.-Japan relations. One such area was highlighted by a recent study that showed foreign auto makers in the U.S. have invested more than $20 billion in transplant assembly and component plants. The study said the manufacturers (led by such Japanese companies as Nissan, Toyota, Honda and Mitsubishi, but also including such recent market entrants as Mercedes Benz and BMW) directly employ 41,000 workers in America, but also support the jobs of some 1.3 million additional workers at parts suppliers, advertising agencies, trucking firms and other support industries. Total spending by the international auto sector in the U.S., according to the report, came to about $43.2 billion, nearly 60% of which went for American-made parts, components and materials.[113]

This is just a tiny portion of the Japanese-American economic "baby" that Professor Miller was suggesting not be thrown out with the "bath water" of narrow and ill-conceived trade disputes. But given the forces that frequently come to bear in Washington, it would not be surprising if another round of automotive issues surfaced at some point in the not-too-distant future. There already are some danger signals that should be watched closely. A rise in bilateral U.S. trade deficits with Japan – despite the lack of a real economic rationale – is nearly always followed by mounting political pressure for domestic protection for specific industries or companies in the United States.[114] There has been a recent spate of visits to Japan, for example, by Congressmen seeking to use Tokyo as the backdrop for a well-aimed critique for the benefit of their constituents back home. Clinton administration officials also have been extremely critical of the Japanese government's management of the country's domestic economy and have chided Japan for "not doing enough" to help the other Asian economies (despite the paucity of direct American assistance to Asia and strong resistance in Congress to additional funding for the International Monetary Fund). Complaints in the areas of monetary and fiscal policy could easily spill over into the trade arena if popular sentiment were whipped up.

There are always temptations to "do something" about Japan. For example, in the statistical gamesmanship that accompanied the public relations effort over autos, the U.S. strategy was always to "pump up" the actual Big Three sales and outlet figures in Japan – but then complain they were never enough. This involved keeping a running total of new

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[113] The study, entitled "The Contribution of the International Auto Sector to the U.S. Economy," was commissioned by the Association of International Automobile Manufacturers (AIAM) and conducted by the University of Michigan's Office for the Study of Automotive Transportation, April 1998.

[114] Many analysts have noted that protectionism has been at the root of the American trade agenda on cars ever since Japan was forced to put a "voluntary" cap on its exports to the U.S. in 1981. While the quotas no longer exist, political pressure is thought to provide sufficient inducement for the Japanese auto makers to exercise restraint in their shipments to the U.S.

outlets (but not mentioning the showrooms that were closed) and "inflating" Detroit's unit sales in Japan (by counting gray market purchases and all of the Big Three vehicles made in Europe and exported to Japan). As noted earlier, this provided government policy makers with a safety valve against the most zealous American protectionists, since they could always claim they were "making progress." The problem was (and is) that this safety valve was only put to rather cynical use. Japan never got credit for the progress made. Instead, the Clinton administration – running for re-election in 1996 and wanting to portray the previous year's auto agreement as a major achievement – simply took credit for being "tough" against Japan.

If the mantra of official criticism were now to shift quietly and seamlessly from the outlets/sales issue to some other aspect of the Japanese automotive industry – say, car registration procedures, zoning regulations, or parts certification – it would only serve to underscore the continuing pressure game while ignoring the realities of the market. No doubt there will be some Japanese businessmen who stand to benefit and who will therefore encourage this form of *gaiatsu*. But the question needs to be asked: is it truly a worthy task of our government's highest ranking policy makers to be preoccupied with rewriting the minutiae of Japanese regulations and standards? Would any American bureaucrat or politician (federal, state, or city) tolerate this kind of intrusion into their sovereignty for even a minute – no matter *how* stupid the *American* regulation in question?

Focusing on the positive side of the U.S.-Japan economic, political and strategic relationship would be a far more productive exercise. We should not forget that General Motors, Ford and Chrysler are ranked number one, two and seven respectively on the Fortune 500 list of America's biggest companies. Both GM and Ford each have annual revenues exceeding $150 billion, or about the size of the entire GDP of Indonesia – if measured *before* the current financial crisis played havoc with the exchange rate. Both companies have the resources to pursue global markets as they see fit. Ford, for example, is sitting on a cash pile of some $21.3 billion, and chairman Alex Trotman has already spoken publicly about making a much larger investment in Mazda.[115] Even the "pre-Daimler" Chrysler, a much smaller company with $61 billion in annual revenue and a limited overseas presence, is nevertheless cash-rich – with some $7.5 billion in the bank and a pension fund sporting a $2 billion surplus.[116] Its resources and capabilities will only increase if the marriage to the German automotive giant proves to be a success. One could speculate, for example, about a potential merger or tie-up with the financially troubled Mitsubishi Motors Corporation, given Chrysler's long history with MMC and Daimler's past attempts to forge major business ventures with the Japanese company.

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[115] See *Business Week*, May 4, 1998.

[116] See, for example, "Chrysler Executives See Bright Prognosis," *Detroit Free Press*, Aril 3, 1998; "Ford's Operating Profit Rose 15% to $1.69 Billion in First Quarter," *The Wall Street Journal*, April 16, 1998; "GM Again on Top of Fortune 500 List," *Detroit Free Press*, April 8, 1998; "Big 3 Post High Profits in First Quarter," *Detroit Free Press*, April 18, 1998.

And Daimler-Benz has already confirmed that it is discussing a commercial vehicles alliance with the Nissan Motor Co.[117]

One thing, however, is certain. While all three American companies are playing catch-up because of years of neglect in Japan, they are clearly in a position to reverse those trends if they ever decide to commit the resources. The financial weakness of many of the dealers in Japan – and their unmistakable need to augment slack domestic sales with new and exciting foreign models – presents a golden opportunity to reach out to Japanese consumers. *If you build it, they will come.*

[117] See, for example, "Nissan to License Technology to Daimler," *The Wall Street Journal*, May 13, 1998; "Nissan and Daimler-Benz Discuss Alliance for Commercial Vehicles," *The Wall Street Journal*, May 12, 1998.

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