Environmental Concerns and Downstream Markers Challenge Japanese Automakers in Europe

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1. Introduction

Once again, the auto industry has begun consolidating on a global scale, most visibly with the merger of Daimler Benz and Chrysler. Japanese automakers are also being drawn into the fray, beginning with Daimler's acquisition of Nissan Diesel Industries, and hints of establishing broader cooperation with Nissan Motor itself. In the background to these developments is the growing pressure of environmental problems. This paper looks at the key trends in the European market–environmental issues and downstream markets (small and compact segments), and the response of Japanese automakers.

2. German Automakers Rush Downstream

At the vanguard of the global restructuring are the German automakers. Whether it is BMW's acquisition of Rover or Daimler Benz's startup of A-class production, what stands out are their forays beyond traditional boundaries. These moves are aimed at downstream markets, and Daimler's ongoing talks with Nissan should be seen in this light.

What would prompt these luxury automakers, who already enjoy global brand recognition, to move downstream? Three reasons come to mind: (1) environmental awareness, (2) growth markets, and (3) the success of popular automakers Toyota and Volkswagen in the luxury market.

While Europe has long been strong on environmental issues, they differ from Japan and North America in their strong emphasis not on NOx and other toxic emissions but CO_2 reduction. Thus there is a strong orientation toward lightweight, compact, and fuel efficient cars, and restrictions are being planned from 2000 to promote compact cars by policy guidance.

In addition, in the growth markets of Asia and Latin America in the 21st century, small cars are expected to be predominant due to income levels and road and other infrastructure conditions.

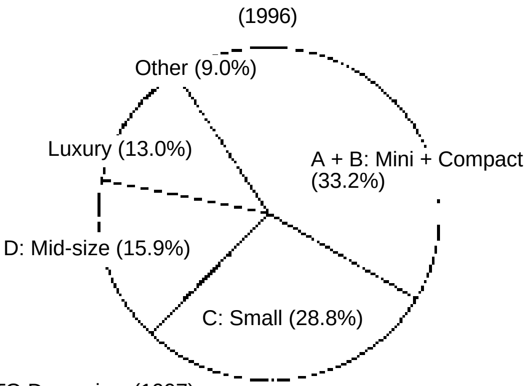
Amid this global downstream trend, and sensing danger from the success of mass producers Toyota and VW in the luxury market, European automakers—German in particular—have turned their attention downstream. Although Germany does not have a large market for compact cars, German automakers plan to introduce many new compact models in time for the EMU, with the added intention of entering Europe’s Latin markets (France, Italy, and Spain). To ensure profitability in low-priced compact class cars, they are implementing drastic cost-cutting measures such as modular production, which slashes assembly costs by pre-assembling parts into modular units.

3. Compact Cars and the Environment

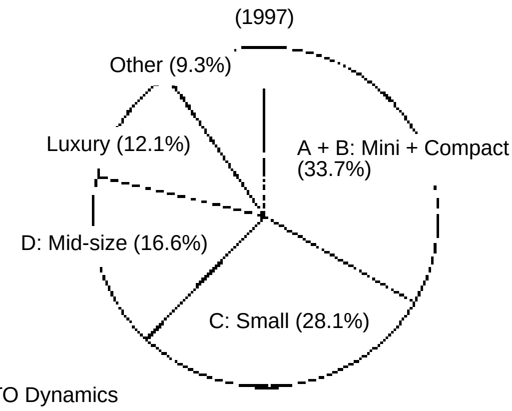
The European market is most notably characterized by the predominance of small cars. In particular, the Nissan Micra (March) and Toyota Starlet class cars (segments A and B) comprise the mainstream in Latin countries such as France and Italy, while the Nissan Primera class (segment D) leads in Germanic countries, and the Corolla class (segment C) in the U.K. This market composition stands in sharp contrast to the North American market.

Over the medium term, the key to market share trends lies in the merchandising power and cost competitiveness of compact class cars. This is because government policies are expected to encourage compact class car purchases, such as Germany’s D3 preferential tax treatment for cars with low fuel consumption and clean emission.[1] It is also the main reason Daimler Benz and BMW are leading the industry restructuring.

Figure 1 Europe's Passenger Car Market Segments



Source: JATO Dynamics (1997)



Source: JATO Dynamics

Table 1 Car Models by Segment

Segment	Model	Major market
A	Peugeot 106, Fiat Chinquechento, Ford Ka	Latin Europe (France, Italy, Spain, etc.)
B	Nissan Micra, VW Polo, Opel Corsa	Same as above
C	Toyota Carolla, Nissan Almera, Honda Civic, VW Golf	U. K.
D	Nissan Primera, Honda Accord, VW Pasato	Germanic countries

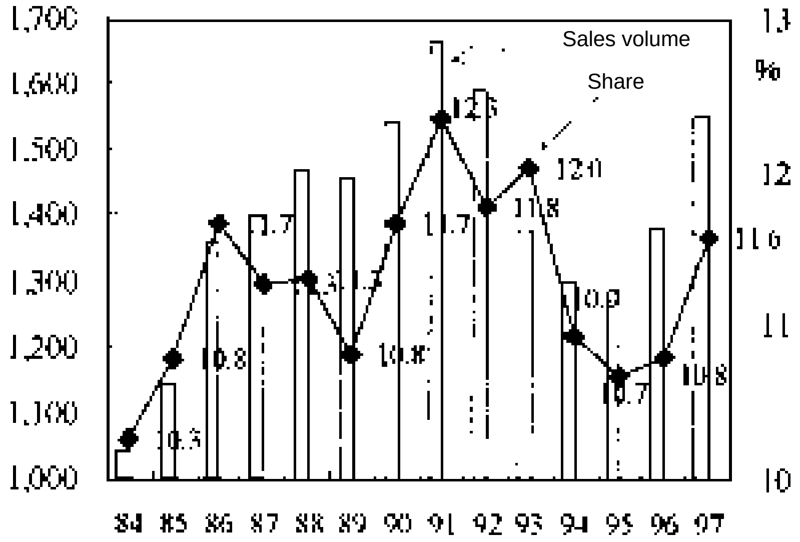
Source: Press reports

Table 2 Compact Car Production Plans of European Automakers (Actual)

Automaker	Segment	Model	Displacement	Production period	Details
Ford	A, Sub B	Ka	1.3L	96.10	$2 billion plant in Valencia, Spain with annual capacity of 200,000 vehicles. Uses module production method and receives 28 major unit parts by computer controlled conveyer transport from nearby industrial park.
Audi(VW group)	Sub B	AL2 (Concept Car name)	1.2L	99	300-million DM plant in Neckersulm, Germany produces 50,000 vehicles per year.
Rovr (BMW group)	A	Mini	1.0-1.4L	99-2000	Longbridge, U.K. plant has annual capacity of 100,000 vehicles.
Opel	Sub B	n.a.	1.0-1.3L	2000	Likely to be produced at *Majar Suzuki plant,* Hungary.
M-Benz	Compact Van	A-class	1.4-1.7L	97	200,000 vehicles per year in Germany, and 70,000 vehicles per year in Brazil from 1998.
M-Benz-SHM	A(Mini)	MCC-Smart	0.6L	98	New Hambach, France plant has annual capacity of 200,000 vehicles. Using module production method, will outsource over 80% to 10 tier-1 suppliers and 50 tier-2 suppliers. Reported price of approximately 16,000 DM.

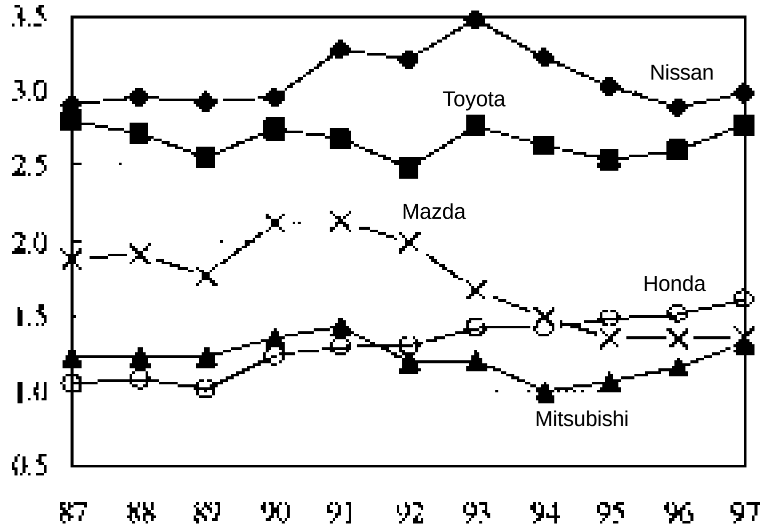
Source: Press reports

Figure 2 Sales Volume of Japanese Automakers in Europe (1,000 units)



Sources: AID Newsletter; *Automobile Statistics of Major Countries.*

Figure 3 Market Share of Japanese Automakers in Europe
(Passenger cars, %)



Source: AID Newsletter

4. Response of Japanese Automakers

(1) Sales Trends

Japanese automakers have an extremely small presence in Europe. Nissan has the largest share but is still only a niche player with a 3 percent share, a far cry from its large market share in North America. This can be attributed to the following factors:

1.As niche players with less than 5 percent market share, they suffer from marketing and production inefficiencies, and in particular from poor brand recognition (unlike North America, they neither have established brand names nor large local production facilities of more than 150,000 units).
2.Unlike North America, consumers' purchasing criteria place greater emphasis on brand name and design than functionality and economy.

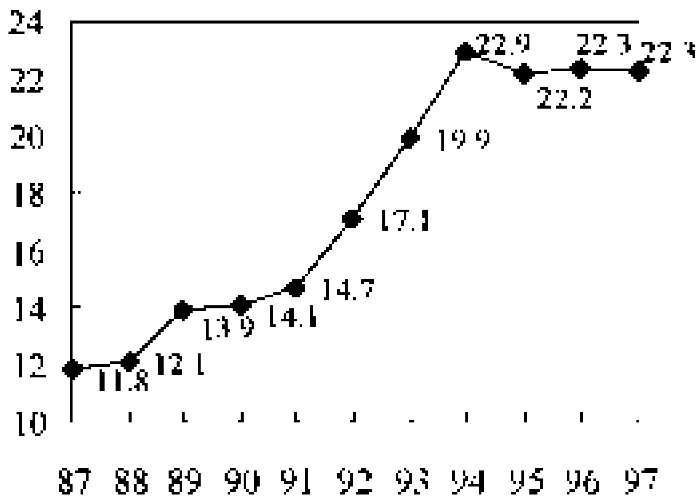
(2) Strategies

Under these harsh conditions, Japanese automakers basically have three strategies:

1. Localize production of compact cars
2. Increase emphasis on diesel vehicles
3. Increase brand name recognition by sponsoring motor sports.

In light of the popularity of diesel cars for their low fuel cost, particularly in Europe's Latin countries, and the priority on CO_2 reduction in Europe's environmental policies, diesel cars are a crucial part of the European strategy of Japanese automakers.

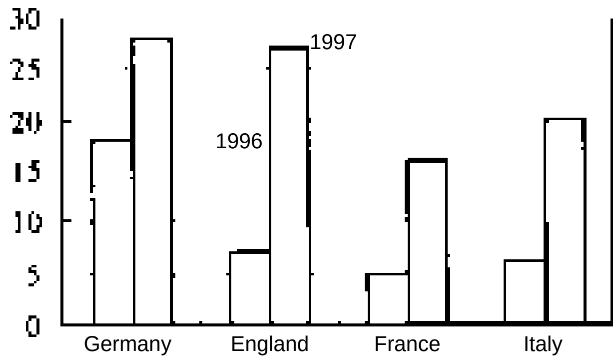
Figure 4 Diesel Ratio of Passenger Cars in Europe (%)



Source: AID Newsletter

Another characteristic of the European market is the extremely strong emphasis on brand recognition. Japanese makers have thus invested substantial funds in Lemans (Nissan in 1997, Toyota in 1998) and F1 (Honda in 2000, Toyota has expressed an intention) racing sponsorships. While this has boosted brand strength as well as market recognition, the massive costs are testing their financial strength.

Figure 5 Bridgestone's Improved Brand Recognition from F1 Racing (%)



Source: Press reports

(3) Corporate Strategies

Each company's strategy will deeply affect its performance and prospects.

1. Nissan

Nissan pioneered Japan's entry in Europe in the late 1980s by establishing the first local production plant in the U.K. as well as acquiring Spain's Motor Iberica. But its European operations suffered a 45-billion yen loss in 1996 before finally managing to break even in 1997.

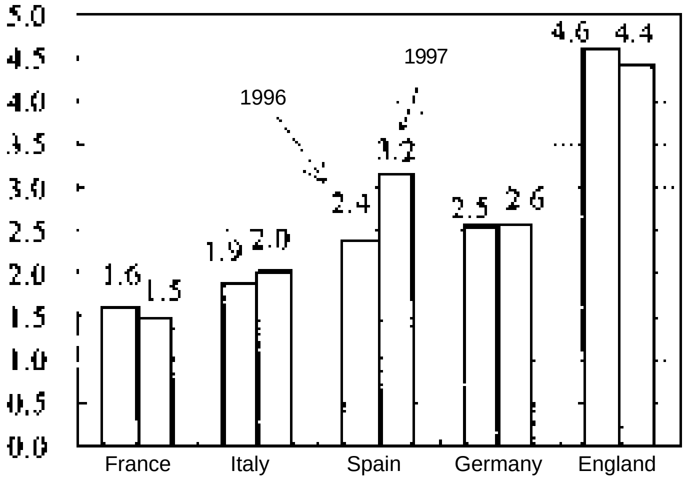
Table 3 Production and Model Introduction Plans of Japanese Automakers in Europe

	Automaker	Target	Model	Displacement	Year introduced	Production site	Planned volume (1,000/year)
Local production	Toyota	Liter car, B	Yaris	1.0-1.3L,GE/DE	99 (production in 2001)	France	150-200
	Mitsubishi	Compact MPV	Space Star	1.3L,1.8L GDI	98	Holland	50
	Nissan	Liter car, B	Micra (w/ minor changes)	1.0-1.3L, GE/DE (procured from Peugeot	98	England	n.a.
	Honda	Wagon	Civic Aerodeck	1.6L	98	England	30
		Liter car, B	Logo base	1.0-1.3L	99-2000	England	n.a.
	Suzuki	Liter car, B	Swift base	1.0-1.3L	2000	Hungary	100
Imports	Daihatsu	Compact MPV	NCX	1.0-1.3L	98	Japan	n.a.
	Mazda	Compact wagon	Demio	1.5L	98	Japan	n.a.

Notes: Suzuki will OEM to GM and Opel. GE: gasoline engine; DE: diesel engine
Source: Press releases and reports

Presently, Nissan’s priority lies in improving cost competitiveness. At the core is a radical attempt to pursue economies of scale by integrating platforms for five passenger and RV models being produced in the U.K. and Spain. The U.K. plant integrates platforms for B,C, and D segments, which have completely different sizes. The plan is even bolder than Volkswagen’s plan to integrate 16 platforms into four.

Figure 6 Nissan's Market Share by Country (%)

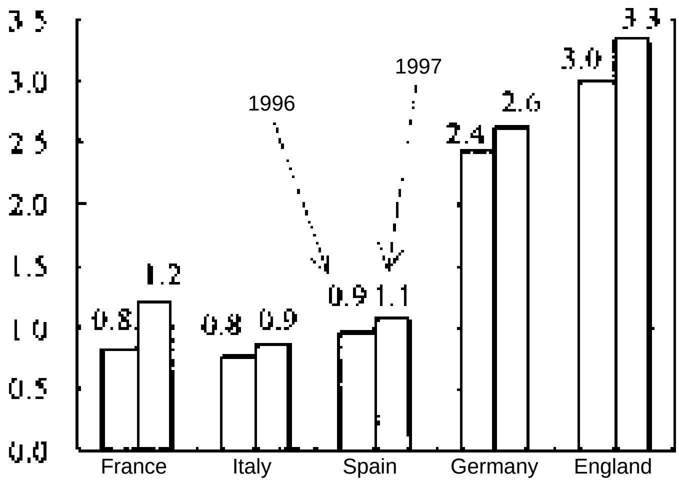


Source: AID Newsletter

2. Toyota

Toyota, who has posted consecutive record earnings on a consolidated basis, will achieve localization of its mainstream small car segments B, C, and D by advancing into France. The Yaris compact car slated for production in France is Toyota’s trump card for the Latin European market, where it suffers from a weak presence and trails behind Nissan. The Yaris will compete head to head not only against heavyweight Latin European automakers Peugeot, Renault, and Fiat, but also German entrants anticipating the EMU (VW Polo, Opel Corsa, Ford Fiesta, Ka). Toyota also plans to introduce the Lexus IS200 and compete directly against the BMW 3 Series and Benz C Class.

Figure 7 Toyota's Market Share by Country (%)

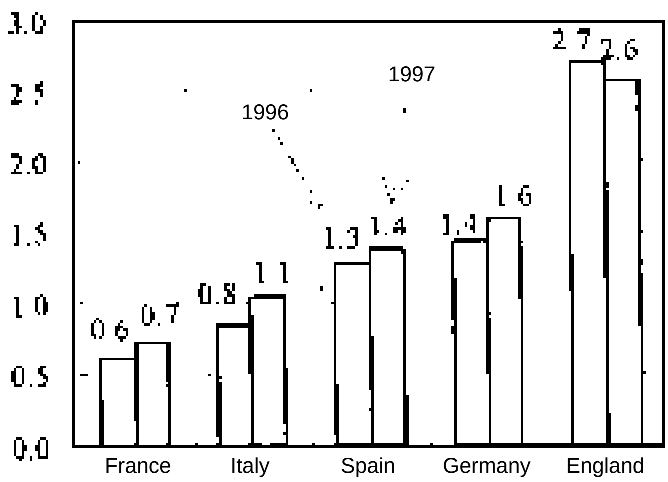


Source: AID Newsletter

3. Mitsubishi

Mitsubishi’s local production base is a joint venture with the Dutch government and Volvo. In 1997 its European operations posted a 7-billion yen loss due in part to startup costs. But unlike the North American market, Europe’s priority on CO_2 reduction has contributed to a favorable reception for the GDI engine. In addition to the Galant-base Charisma manufactured by Ned Car, its JV with Volvo, the success of its GDI-equipped small RV will help measure the GDI’s prospects. Presently, Mitsubishi’s European strategy is to rely on the GDI engine to capture niche markets for compact vans and small SUVs. It is seeking a foothold in Germany and England, where Japanese cars are better known, rather than in Latin Europe.

Figure 8 Mitsubishi's Market Share by Country (%)

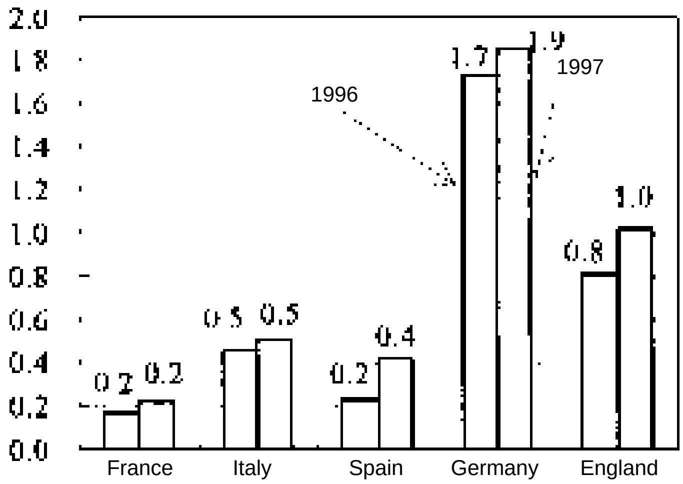


Source: AID Newsletter

4. Honda

After relinquishing its capital stake in Rover in 1994, Honda found its independent strategy being put to a test. But it expects to localize its main segment of small cars around 1999 with compact car production in the U.K. In addition, Honda reportedly plans to introduce a hybrid car simultaneously in Japan and Europe by 2000. After two consecutive years of record earnings on a consolidated basis, Honda is accelerating its European strategy.

Figure 9 Honda's Market Share by Country (%)



Source: AID Newsletter

With its return to F1 racing, Honda is earnestly reinforcing its brand image in the European market. This time, it plans to develop not only engines but chassis with the aim of pursuing both a technical and marketing edge. This is because in F1 racing, the promotional impact from supplying only engines is limited. But the cost will not be small: Ferrari, who competes in F1 racing and supplies both the engine and chassis, reportedly has an annual budget of 20 to 30 billion yen. This burden is expected to delay the profitability of Honda's production of compact cars in Europe, where earnings are much smaller than in North America.

5. Fight Against Time

Since the basic strategy of Japanese automakers other than Mitsubishi is to maintain an independent stance with some occasional cooperation, considerable time will be needed to grow European earnings to levels comparable for the North American market. Meanwhile, amid growing differences in performance and financial strength, fatigue from Europe's severe competition could possibly reverberate to their main businesses. Even European automakers, who have long enjoyed market segmentation, are restructuring to buy more time and to expand market share. As Japanese automakers try to make inroads in Europe, their independent stance will increasingly be challenged.

On this point, attention has focused on the ongoing negotiations between the Daimler Group and Nissan, and on Toyota's response.

In Nissan's case, major synergies could be achieved through economies of scale and R&D efficiency if the three companies involved move ahead to integrate platforms, standardize car models and basic components, and establish mutual supply relationships. While press reports state that cooperation is presently limited to small trucks for emerging markets, this could ostensibly be expanded to include strategic tie-ups involving passenger cars for the European and North American markets.

To move into the Latin European market, Toyota has set up local production for compact cars in France. If Toyota continues to reject any form of strategic tie-up, it will need considerable time to reach the 5-percent market share level, a level at which substantial efficiencies can be achieved in sales and production. Meanwhile, French and Italian automakers struggling with weak earnings expect financial difficulties ahead, such as development costs for environmental conformance. Since the interests of Toyota and the French and Italian automakers intersect at this point, Toyota may be tempted to shift its strategy. What happens next will be followed with keen interest.

Notes

1. Begun in July 1997, D3 reduces sales and automobile taxes on cars with low toxic emission levels or low fuel consumption. It requires compliance with the Step 3 emission standard scheduled by the EU for 2000.