

# *Toyota: Is the Party Over?*

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In March of 2007, *Fortune Magazine* was touting Toyota as "America's best car company." *Fortune Magazine* article by Alex Taylor III, March 7, 2007

Before year-end, Jim Press, President of Toyota Motor North America, defected to Chrysler. Shortly thereafter, Jim Farley, Lexus Division General Manager, defected to Ford.

Along the way, others such as Deborah Meyer, former Lexus Division Marketing Chief, also defected. Then, in November 2007 Jim Lentz, Toyota's new president told *Ward's Dealer Business* that Toyota's 2007 sales would fall below initial projections.

He blames this on the near-collapse of the new-vehicle market in Toyota's stronghold regions due to the housing slump, which dinged monthly sales in late summer and continues with no relief in sight.

"Today the market's down roughly 3%," Lentz tells *Ward's* in his office at TMSUSA headquarters in Torrance, CA. "If you look at Southern California, Northern California and Florida, those markets are off almost 10%. Those three markets also represent 25% of Toyota's business." *Ward's Dealer Business*, January 1, 2008

By October 2007, an *Automotive News* headline blared: "Consumer Reports says Toyota slips in reliability" and then quoted a Reuters report that said:

"Consumer Reports . . . was reversing a practice of recommending all new Toyota cars and trucks after two models earned below-average rankings in a closely watched reliability study. *Automotive News*, October 16, 2007.

By January 2008, San Francisco Bay Area Toyota dealers were lamenting that almost half of all the Toyota dealers in the San Francisco area were in the red for December 2007.

## **Continued Decline in 2008**

In January 2008, Toyota's sales were down 2.3% when compared with January 2007. Toyota Division (including Scion cars) was down 1.4% and Lexus was down 8.2%. *Detroit Free Press*, February 1, 2008.

Bob Carter, group vice president and Toyota Division general manager said ". . . there were soft spots in the brand's lineup in January. . ." *Automotive News*, February 1, 2008

The FJ Cruiser fell by 37%. The 4Runner fell by 25 percent. The Corolla fell by 18 percent. The Tundra sold 12,073 units in January, down 37.2 percent from the previous month. [There are no valid comparisons from January 2007 because the truck was just being launched that month.]

## Toyota's Plan

As far back as March 20, 2007 Mark Rechtin, of *AutoWeek* reported:

Toyota's California market share might be maxing out, and its prospects in the truck-happy heartland are still iffy.

...

To fuel growth, Toyota is giving incentives to dealers to build larger stores under its Image USA II architectural plan. The incentive is an increased allocation of hot models, such as Priuses, Camrys and FJ Cruisers. Toyota Division expects all dealers to renovate their showrooms by 2010 under Image USA II.

At the time of Mr. Rechtin's article, "The Portland region includes Alaska, Washington, Oregon, Idaho and Montana. Of its 73 Toyota dealers last year, 63 had completed upgrades under Image USA II. The Portland region was Toyota's fastest-growing in 2006, with a 22 percent sales gain."

### But the question arises: Have you ever seen an elephant fly?

In the 1990s "go-go" stocks would be bought and sold based upon theories of the "new economy" ["anticipated future" earnings], versus the old economy basis of "actual" earnings. The value of those stocks rose and rose until the realization set-in that the companies had to survive several years before the anticipated future earnings could ever be realized - and for that, the companies required actual earnings. When the companies could not produce real earnings, the bubble burst and Silicon Valley and the communities around it went into a recession.

It now appears the "new economy" philosophy of the 1990 decade may have infected the thinking of the automobile factories, distributors and dealers of the 21<sup>st</sup> Century.

Its [the new economy] philosophy permeates the 2007 Christmas Eve *Automotive News* article by Leslie Allen. Allen begins his article: "Silicon Valley Toyota dealer Adam Simms has a problem that thousands of fellow dealers would love to have. Call it an embarrassment of riches" and then goes on to state:

Simms' expansion is part of Toyota's facilities redesign program, called Image USA. Because Toyota does not plan to add dealerships but expects sales to keep growing, dealers have to keep up. Under the architectural plan, all Toyota dealers must upgrade their showrooms by 2010.

"Simms' Taj Mahal" Allen continues, "sits in stark contrast to the aging domestic dealerships that reside on Sunnyvale's main street, El Camino Real. In other words, even though he renovated his dealership in 2004 and expanded it this year, he's already out of room.

"Such is the life of a California Toyota dealer." *Automotive News*, December 24, 2007

"We're busting at the seams right now," says Simms. "Market share for Toyota in my market is about 32 percent of all the cars sold. That's sort of unbelievable." *Automotive News*, December 24, 2007

The word was there “unbelievable”, but was it understood? According to the *California Motor Car Dealers Association* publication: *California Auto Outlook*, Volume 3, Number 1 released January, 2008, in 2007 Toyota had acquired 16.1% of the new retail US market and 24.2% of the California market. That 8.1% spread represented “the widest spread of any brand” with respect to national market penetration versus California market penetration.

On January 4, 2008 the *Chicago Tribune's* Rick Popely reported: “Auto sales last year [2007] fell to their lowest level since 1998, with domestic automakers bearing the burnt of the decline.”

What these statistics and facts could imply is that dealers are investing in new facilities based upon a potentially false market. At this stage of the game we do not know what GM, Ford, Chrysler and the other imports will have for a sustained market share in 2010 and beyond. In football terms, we are at the beginning of the fourth quarter and there is a lot of ball to play.

At this moment in time, GM, Ford and Chrysler are rebuilding. The industry does not know where their respective market shares will be when those factories recover from their current crises. In the February 4, 2008 *Automotive News*, John K. Teahen, Jr. reported:

General Motors was the only one of the six largest automakers to report a year-to-year sales increase last month. GM's deliveries of domestic cars and light trucks rose 2.8 percent from January 2007. About 25 percent of GM's total sales were to fleets.

Losses were moderate for Toyota Motor Sales and American Honda, off 2.3 percent each. Sales of Ford Motor's domestic brands dipped 3.5 percent, while Chrysler's were off 12.1 percent, and Nissan North America sales slipped 7.3 percent.

If Toyota brand is to outsell Chevrolet this year, it will have to do so in February through December. January belonged to Chevrolet as it outpaced Toyota by 5,028 vehicles. Chevy almost doubled its year-ago lead: In January 2007, it topped Toyota by 2,657 units.

In addition to the possibility of the domestic brands reacquiring and/or stabilizing their respective market shares, the impact of other imports from countries such as China and India have yet to impact the American Market.

Another consideration is demographics. When, for example, China produces a quality vehicle, will customers of Chinese descent tend to leave the Japanese brands and to drive Chinese brands? What will happen to the demographics then? The domestics would probably remain stable and the Japanese brands would probably lose market share.

But the “Taj Mahal's” *Automotive News* describes are continuing to be created despite the lack of the final data necessary to support them.

The cost of building and remodeling Toyota and Lexus stores has soared over the past five years.

In southern California, for example, Dave Wilson spent \$30 million dollars on land in Newport Beach, to build a facility costing another \$30 million. *Ward's Dealer Business*, June 1, 2005. By 2007 the cost had swelled to \$75 million. *Automotive News* October 29, 2007

In San Diego, Dave Conant spent \$20 million to update his Toyota facility. *Automotive News*, December 24, 2007

In Boerne, Texas [outside San Antonio] the new North Point Toyota showroom "has a comfy service waiting area with a huge fireplace, plush couches, hardwood furniture and flat-screen TVs. It looks and feels more like a living room than a car dealership — a real change from the stereotypical sterile coffee lounge at many dealerships." *Automotive News* October 29, 2007.

In Fremont, Bernie Magnussen spent \$25 million to construct a new 80,000 square foot Lexus facility [five times larger than its previous facility] that has multiple lounges, a manicurist, pedicurist, PlayStation video games for kids and shuttle service to stores and restaurants. *Oakland Tribune*, October 28, 2006 The facility sits on about 7 acres of land.

In Oakland, Mike Kahn bought 7 acres of land across from the Oakland Coliseum and is investing \$30 million in a 200,000 square foot facility. He expects to increase his Toyota sales from 200 new per month to 400. *Oakland Tribune* December 7, 2007

Khan's expansion is particularly interesting because:

1. 8.72 miles south of Kahn, AutoNation is expanding Hayward Toyota to increase sales.
2. 12.19 miles south Fremont Toyota recently expanded its site to 10 acres and its facility to 110,000 square feet in order to increase sales;
3. 5 miles south of Fremont, Piercey Toyota leased 6.5 acres of land and constructed a new 70,000 square foot building and plans to retail 5,000 new Toyotas annually;
4. 13 miles west of the dealership, Daly City Toyota built a new five-story facility on 3 leased acres of land, expecting to double its sale. *Santa Cruz Sentinel* February 2, 2008

### **How are the Factories trimming dealers?**

Toyota has continually said it will not add new dealerships, but the ranks continue to swell. Rick LoFaso, national manager of market planning and facilities. Nationwide, told AutoWeek: "In major metros like L.A. and New York, land is more expensive, and we have to look toward alternatives to expansion," LoFaso says.

Witness the *Contra Costa Times*, October 14, 2007:

If given the green light, a proposed car dealership near Vasco Road and Interstate 580 would be one of the largest in the area, injecting at least \$1 million into city coffers.

The proposed Toyota dealership would be on 16 acres on both sides of Northfront Road, bordered by the freeway and Pleasant Way, a private street.

The site would be roughly the size of the entire Livermore Auto Mall, which includes Honda, Audi, Land Rover, Jaguar and Subaru dealerships, said Ben Murray, the chief planner on the project.

"We were told when the idea was first pitched that it would be the biggest dealership in Northern California," said Rob White, Livermore's economic development director. "I suspect it might end up being the biggest in the Bay Area."

It would include a service center with 55 bays, a detail shop and oil change facility. Combined, the buildings would be 115,000 square feet. Cars for sale would take up 715 outdoor parking slots. The two nearest Toyota dealerships, in Dublin and Tracy, are considerably smaller.

White said dealerships usually have an anti-competition clause that prevents another seller from offering the same brand within a 10 mile radius.

The Livermore site is about 10.5 miles from Dublin Toyota. "It's literally just barely over the line," White said.

See too: *San Jose Mercury News*, December 19, 2007.

### **Propinquity and Protests**

Mileage limitations be damned. Factories and distributors are putting dealerships wherever they want and the Dealer Boards and courts are backing them up. Protests do not help.

In California, for example, Fremont Toyota spent over \$6,000,000 expanding its land and facility and Toyota put a dealership 5 miles away. Fremont Toyota protested because California has a 10 mile law, but it lost its protest. It then sued in the California court system and lost its suit.

In Fremont Toyota's Petition for a Writ of Administrative Mandamus, it alleges that the Board acted in excess of its jurisdiction by improperly weighing the evidence supporting the Final Decision, and that the Board denied Fremont a fair hearing by upholding several allegedly erroneous ALJ factual findings. Fremont also alleges it does not have a plain, speedy or adequate remedy under the law, and lastly, Fremont seeks an independent standard of review of the Board's April 22, 2004, decision to allow a competitor 5 miles away. [Sacramento Co. Sup. Court No. 04CS00715] filed June 3, 2004. Fremont Toyota lost.

Volkswagen of America Inc. has won approval to open a dealership in Clovis, Calif., despite objections from a Volkswagen dealer five miles away. *Automotive News*, July 7, 2003.

The California New Motor Vehicle Board has refused a Los Angeles-area Honda dealership's request to block American Honda Motor Co. from relocating another store nearby. Although the move will bring Harbor City Honda to within 4.3 miles of Long Beach Honda, that distance is not unusual in a large metropolitan market such as Los Angeles, the decision said. *Automotive News*, October 13, 2003.

In Ohio, a three-judge appeals panel has upheld General Motors' decision to allow Auto World Chevrolet, of North Canton, Ohio, to relocate over objections by three competing Chevrolet

dealerships. The stores all are within 10 miles of the proposed relocation site. *Automotive News*, December 1, 2003

In Texas, the Texas Motor Vehicle Board on July 31 rejected Craig Huggins' challenge of plans by Mitsubishi Motor Sales of America for a new dealership in Grapevine, Texas, northwest of Dallas. The new dealership would be located within 10 miles of Huggins Mitsubishi. Both stores are in the Dallas-Fort Worth area. *Automotive News*, September 1, 2003

### **Who would buy these Taj Mahals if they were offered for sale?**

As of this writing, February 2008, most private and public buyers have withdrawn from purchasing Toyota and Lexus dealerships because: (a) the market is saturated and seems to have peaked; (b) the investment is too great for the potential return; (c) the multiples dealers are asking are unrealistic when the price of the facility or the cost of the rent is added to the package.

Gordon Stewart's Toyota dealership in suburban Birmingham, Ala., makes lots of money. But when Stewart sought to expand his private group of five dealerships, he chose to add a Chevrolet dealership in Georgia to his three Chevrolet franchises.

Stewart's group, based in suburban Detroit, isn't small. It ranks No. 112 on this year's *Automotive News* list of the top 125 U.S. dealership groups, with reported revenue of \$253.7 million in 2006. But even with those resources, Stewart says the cost of another Toyota dealership would be too steep.

A Toyota dealership's "blue sky" -- the value of the franchise but not including "hard" assets such as real estate, buildings or inventory -- routinely exceeds six times its net annual pretax earnings, Stewart says. A successful Chevrolet dealership's blue sky typically is three times net earnings.

"I can have a return in three years instead of six or more," says Stewart, who also has a Hyundai franchise and brokers other dealerships. *Automotive News*, July 30, 2007

Sonic also is cutting back on store acquisitions, buying dealerships only when they look like a bargain. *Automotive News*, January 14, 2008.

### **Conclusion**

When reading about Toyota, a number of thoughts fill my head. One cannot help but think about the 2007 New England Patriots. The similarity is that every sportswriter, newspaper, magazine, television and radio show in America talked about how it was the best team in history. It achieved the same aura of invincibility that Toyota now has. In the end it lost, as every team must if it plays long enough.

The secret in life is not "Not Losing." The secret in life is to minimize your losses when they come.

I wonder if Mr. Press read the book "Zurich Axioms", by Max Gunther. Mr. Gunther's father was a Swiss banker. In his book Mr. Gunther muses:

Consider the puzzle of Switzerland. This ancestral home of mine is a rocky little place about half the size of Maine. It has not one inch of seacoast. It is one of the most mineral-poor lands on earth. It possesses not a drop of oil to call its own, barely a bucket of coal. As for farming, its climate and topography are inhospitable to just about everything.

It has stayed out of European wars for 300 years, chiefly because, in all that time, there has never been an invader who really wanted it.

Yet the Swiss are among the most affluent people in the world. In per capita income they rank with us Americans, West Germans, and Japanese. Their currency is among the world's soundest.

How do the Swiss do it?

Mr. Gunther then went on to interview his father's business associates and wrote *The Zurich Axioms*, listing 12 major and 16 minor axioms to success. Two that seem to apply here are:

Chaos isn't dangerous until it begins to look orderly.

When the ship is sinking, don't pray. Jump.

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Mr. Pico has served as a court appointed "Consultant to Debtor" in bankruptcy cases, a "Court Appointed Mediator" in automotive disputes, the "Court Appointed Arbitrator / Appraiser" in partnership disputes, a "Court Approved Consultant to Receiver" in a check-kiting case, as a "Superior Court Mediator" in dealership/lender litigation and has been recognized as an expert witness on both State and Federal levels. He has consulted on upside-down positions of over \$50 Million, out of trust position of over \$4 Million and a bank overdraft of \$30 Million. Since 1972, Mr. Pico has completed over 1,000 automobile dealership transactions, whose combined values exceed One Billion Dollars. In 1986, he authored and National Legal Publishing Company published the nation's first book on Buying and Selling Automobile Dealerships. You can view his biography at <http://www.advisingdealers.com>.

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