Changes in OEM Purchasing Policy in Japan:  
Some Suggestions from an International Comparison of Financial Data

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Purpose of this Report

- Presenting the general characteristics of OEM purchasing policies and its changes after 90s in Japan
- Presenting some impacts of such changes on the automotive and auto-parts industry based on an international comparison of financial data
- Presenting some impacts on the relationship between OEMs and parts-makers in Japan
- Presenting the rationalization in Japanese auto-parts industry which advanced to cope with OEM purchasing policies and survive
- Finally presenting some issues based on the above
Changes in OEM Purchasing Policy in Japan

General characteristics of OEM purchasing policies in Japan

- Price of auto-part is decided through the continual negotiations to adjust target cost of OEM and quotation of parts-maker
- Usually requesting price down regularly from OEMs to parts-makers
- Support from OEMs to parts-makers for achieving target cost and cooperative problem solving between them
- In contracts between OEM and parts-maker there is room of ambiguity for continual KAIZEN
- OEMs make contacts with parts makers maintaining cooperation among different functional divisions (ex. purchase, design and production)
- OEMs inspect work processes and operation standards in details during their visits to parts-makers
Changes in OEM Purchasing Policy in Japan

Changes in OEM purchasing policies in and after 90s in Japan

- Early 90s
  - Rationalization after bubble economy: standardization of parts and reduction of purchasing cost
  - Development of relations between OEMs and parts-makers beyond KEIRETU
- From middle to late 90s
  - Construction of global purchasing data base
  - Introducing global sourcing strategy
- From late 90s to early 00s
  - Efforts for modularization
  - Global platform strategy and reducing the number of suppliers
  - Establishing joint worldwide purchasing organizations with foreign capitals
  - Introducing cost reduction programs by Toyota and Nissan
Changes in OEM Purchasing Policy in Japan

Two programs with big impacts
- Nissan Revival Plan (Oct. 1999)
  - 20% cost reduction over 3 years
  - Centralize parts and material purchasing
  - Reduce the number of suppliers: 1145 → under 600
  - Partnership with competitive global suppliers
  - Using common benchmarking tools with Renault
- CCC21 in Toyota (July 2000)
  - 30% cost reduction over 3 years (1 trillion yen)
  - Re-evaluating cost and benefit from design phase for improvement
  - Verification of competitors for comparison
  - From cost reduction based on comparison with existing models to cost reduction based on comparison with others
  → Shift to “most competitive cost in the world”
Changes in OEM Purchasing Policy in Japan

Reality of Japanese OEM purchasing policies in the world
- Price setting based on global benchmark and requesting quality equivalent to that of Japan in the world → Fusion between Japanese way of quality requirement and Euro-American way of price setting based on market competition

Some cases
- Gathering information globally using internet, then requesting cost reduction based on it (a case of North America)
- Requesting a 20% reduction from the price in Japan in spite of the same design and quality as in Japan (a case of China)
- Requesting price down based on global benchmark, but changing partner suddenly after presented lower price is very rare (a case of Japan)
International Comparison of Financial Data:
Impacts from Changes in OEM Purchasing Policy in Japan

Table 3-1  Operating income to net sales ratio and net income to net sales ratio in OEMs (consolidated)

Source:  Financial data of each firm.
International Comparison of Financial Data:
Impacts from Changes in OEM Purchasing Policy in Japan

Table 3-2  Operating income to net sales ratio in Japanese OEMs (consolidated)

Source:  Financial data of each firm.
International Comparison of Financial Data:
Impacts from Changes in OEM Purchasing Policy in Japan

Table 3-3  Operating income to net sales ratio in Euro-American OEMs (consolidated)

Source: Financial data of each firm.
International Comparison of Financial Data:
Impacts from Changes in OEM Purchasing Policy in Japan

Table 3-4  Operating income to net sales ratio and net income to net sales ratio in Parts-Makers (consolidated)

Source: Financial data of each firm.
International Comparison of Financial Data: Impacts from Changes in OEM Purchasing Policy in Japan

Table 3-5 Operating income to net sales ratio in Japanese Parts-Makers (consolidated)

Source: Financial data of each firm.
International Comparison of Financial Data:
Impacts from Changes in OEM Purchasing Policy in Japan

- International comparison of profit rate in Parts-Makers

Table 3-6  Operating income to net sales ratio
in Euro-American Parts-Makers (consolidated)

Source: Financial data of each firm.
American OEMs in extreme difficulty

- **Incentive (July 2004)**
  from *Nikkei* News Paper, 2004, 8.27.

- **Quality (Problems per 100 Vehicles for one model)**
  from *Consumer Reports*, April, 2004, p.17.

- **New purchase policies in GM and Ford**
  - GM gives suppliers tough terms that GM will switch suppliers after 30 days notice in case of the price higher than rival’s (*Automotive News*, Dec.1 2003)
  - Ford gives suppliers tough terms that Ford will deduct funds from a supplier’s account without notice, unilaterally charge suppliers half of a product recall’s costs and terminate a contract for “any or no reason” (*Automotive News*, Feb.16 2004)

### International Comparison of Financial Data: Impacts from Changes in OEM Purchasing Policy in Japan

<table>
<thead>
<tr>
<th></th>
<th>Brand of lowest incentives</th>
<th>Brand of highest incentives</th>
</tr>
</thead>
<tbody>
<tr>
<td>First</td>
<td>Mimi (BMW)</td>
<td>Cadillac (GM)</td>
</tr>
<tr>
<td>Second</td>
<td>Saion (Toyota)</td>
<td>Lincoln (Ford)</td>
</tr>
<tr>
<td>Third</td>
<td>Porsche (Porsche)</td>
<td>Jaguar (Ford)</td>
</tr>
<tr>
<td></td>
<td>Japanese: 8/10, European: 2/10</td>
<td>American: 9/10, European: 1/10</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Brand of smallest problems</th>
<th>Brand of largest problems</th>
</tr>
</thead>
<tbody>
<tr>
<td>First</td>
<td>Lexus</td>
<td>Lincoln</td>
</tr>
<tr>
<td>Second</td>
<td>Infiniti</td>
<td>Jaguar</td>
</tr>
<tr>
<td>Third</td>
<td>Honda</td>
<td>Hummer</td>
</tr>
</tbody>
</table>
Overview

Toyota, Honda and Nissan have achieved positive earnings after 2000

→ New OEM purchase policies in Japan such as CCC21 and NRP have produced the desired effect

Parts-makers in Japan also have achieved positive earnings

Profit ratios of Euro-American OEMs are in falling tone, especially American OEMs are in extreme difficulty

Profit ratios of Euro-American parts makers also are in falling tone

→ Because of the tough requirements of OEMs

Relationship of mutual trust between OEM and parts-maker is undermining. Ex. some parts-makers won’t sign the Ford contract (Automotive News July.19 2004)

Global competitions have become intensified

= “Japanese quality level and lowest cost in the world”
Relationship between OEMs and Parts-Makers in Japan

Table 4-1  Production cost to net sales ratio and material cost to net sales ratio in Japanese OEMs (non-consolidated)

Source:  Financial data of each firm.
Impacts on Auto-Parts Industry in Japan

Table 4-2 Ordinary income to net sales ratio in Japanese OEMs and Parts-Makers (non-consolidated)

Source: Financial data of each firm.
Impacts on Auto-Parts Industry in Japan

Table 4-3  Degree of dependence on main customer
by Japanese Parts-Makers (non-consolidated)

Impacts on Auto-Parts Industry in Japan

Analysis of Japanese Parts-Makers whose main customer is Nissan

Table 4-4 Shareholding ratio of Nissan in 35 firms

<table>
<thead>
<tr>
<th>Nissan’s shareholding ratio</th>
<th>1982</th>
<th>1989</th>
<th>1999</th>
<th>2001</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>50% or more</td>
<td>6</td>
<td>6</td>
<td>4</td>
<td>3</td>
<td>2</td>
</tr>
<tr>
<td>25% - less than 50%</td>
<td>20</td>
<td>18</td>
<td>17</td>
<td>9</td>
<td>4</td>
</tr>
<tr>
<td>10% - less than 25%</td>
<td>9</td>
<td>11</td>
<td>11</td>
<td>10</td>
<td>2</td>
</tr>
<tr>
<td>less than 10%</td>
<td>0</td>
<td>0</td>
<td>3</td>
<td>13</td>
<td>27</td>
</tr>
</tbody>
</table>

Note: 35 firms that Nissan’s shareholding is 10% or more in 1982.

Table 4-5 Some basic data in 73 firms

<table>
<thead>
<tr>
<th></th>
<th>1982</th>
<th>1989</th>
<th>1999</th>
<th>2001</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee number</td>
<td>1,012</td>
<td>1,068</td>
<td>1,004</td>
<td>914</td>
<td>813</td>
</tr>
<tr>
<td>Net sales (million yen)</td>
<td>33,541</td>
<td>41,866</td>
<td>44,921</td>
<td>46,366</td>
<td>49,313</td>
</tr>
<tr>
<td>Ratio of ordinary income to net sales</td>
<td>3.2%</td>
<td>2.7%</td>
<td>1.2%</td>
<td>3.2%</td>
<td>3.5%</td>
</tr>
<tr>
<td>Net sales per employee (million yen)</td>
<td>25.4</td>
<td>31.9</td>
<td>35.2</td>
<td>38.6</td>
<td>44.0</td>
</tr>
</tbody>
</table>

Source: IRC, *Nissan Group No Jittai*, 83, 91, 00, 02, 04.
Impacts on Auto-Parts Industry in Japan

Analysis of Japanese Parts-Makers
whose main customer is Nissan

Table 4-6 Transition of some basic data

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>1,000 or more (15 firms)</td>
<td>89.2%</td>
<td>93.0%</td>
<td>100.0%</td>
<td>94.7%</td>
<td>85.9%</td>
</tr>
<tr>
<td>500-999 (19 firms)</td>
<td>116.3%</td>
<td>122.6%</td>
<td>100.0%</td>
<td>88.9%</td>
<td>78.6%</td>
</tr>
<tr>
<td>100-499 (33 firms)</td>
<td>128.8%</td>
<td>135.6%</td>
<td>100.0%</td>
<td>95.7%</td>
<td>78.3%</td>
</tr>
<tr>
<td>less than 100 (5 firms)</td>
<td>144.4%</td>
<td>157.4%</td>
<td>100.0%</td>
<td>83.0%</td>
<td>76.5%</td>
</tr>
</tbody>
</table>

2. Transition of net sales (1999=100%)

<table>
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<tr>
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</thead>
<tbody>
<tr>
<td>1,000 or more (15 firms)</td>
<td>70.5%</td>
<td>86.4%</td>
<td>100.0%</td>
<td>107.0%</td>
<td>116.8%</td>
</tr>
<tr>
<td>500-999 (17 firms)</td>
<td>74.5%</td>
<td>95.9%</td>
<td>100.0%</td>
<td>96.1%</td>
<td>94.0%</td>
</tr>
<tr>
<td>100-499 (27 firms)</td>
<td>96.0%</td>
<td>115.7%</td>
<td>100.0%</td>
<td>94.1%</td>
<td>94.4%</td>
</tr>
<tr>
<td>less than 100 (2 firms)</td>
<td>99.1%</td>
<td>148.5%</td>
<td>100.0%</td>
<td>80.9%</td>
<td>65.0%</td>
</tr>
</tbody>
</table>

3. Net sales per employee (million yen)

<table>
<thead>
<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>1,000 or more (15 firms)</td>
<td>30.3</td>
<td>41.6</td>
<td>44.2</td>
<td>50.5</td>
<td>58.7</td>
</tr>
<tr>
<td>500-999 (17 firms)</td>
<td>23.6</td>
<td>29.2</td>
<td>35.7</td>
<td>39.4</td>
<td>43.5</td>
</tr>
<tr>
<td>100-499 (26 firms)</td>
<td>23.9</td>
<td>28.2</td>
<td>30.7</td>
<td>31.6</td>
<td>37.0</td>
</tr>
<tr>
<td>less than 100 (2 firms)</td>
<td>21.6</td>
<td>27.8</td>
<td>28.1</td>
<td>32.0</td>
<td>30.3</td>
</tr>
</tbody>
</table>

Source: IRC, *Nissan Group No Jittai*, 83, 91, 00, 02, 04.
Conclusion

Consequence of the change in OEM purchasing policy in Japan

- Global competitions intensified
  → “Japanese quality level and lowest cost in the world” is getting global standard
- Cutting down of profit ratio in American OEMs and introducing new purchasing policies
  → Escalation of tough requirements to parts-makers
- Continual rationalization in Japanese auto-pars industry and concentration of business to larger firms
  → Fear of hollowing-out in small and medium-sized parts-makers which have supported Japanese manufacturing industry
- Need for reconsidering ways of fair and trustful relationship between OEMs and parts-makers
  → Need for developing an argument globally