Is Toyota navigating a road to success or steering towards its own downfall?

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Key Takeaways

- Toyota is leaning into its hybrid technology, betting that internal combustion engines still have an important role to play.
- Toyota's strong fundamentals and stock performance vindicate the company's strategy so far.
- Toyota does, however, need an effective EV strategy to compete with rapidly growing, emerging players like BYD.

On 28 May, a news article in the Financial Times titled, "Toyota bets on new line of combustion engines in challenge to Tesla." Having previously criticised Toyota's lack of progress on electric vehicles (EVs), my initial reaction to this headline was, is this Toyota's "Kodak moment"?

Kodak engineer Steve Sasson invented the digital camera in the company's labs in the 1970s. While Kodak's ethos of fostering innovation enabled this invention, the lack of foresight from its leaders, who worried about the digital camera cannibalising their existing business, quashed the idea and ultimately led to the company's downfall. Sasson later told the New York Times, "It was filmless photography, so management's reaction was, 'That's cute — but don't tell anyone about it.'"

One needn't be too imaginative to see the parallels with Toyota. The company is a behemoth in the automotive industry. Its Kaizen philosophy, which aims to ensure maximum quality, eliminate waste, and improve efficiency in both equipment and work procedures, has long been hailed in industry and academia as a blueprint for business success across sectors. However, despite being a pioneer in electric road transport with its hybrid cars, Toyota still lacks an effective EV strategy.

So, has Toyota lost its way, or does it have a strategy that will endure in the rapidly evolving and extremely exciting landscape of the automotive industry?

The focus on hybrids

Toyota's Chief Executive Koji Sato has stated that the new generation of internal combustion engines is designed to be used alongside batteries in hybrid vehicles. Toyota is not alone in this renewed focus on hybrids. In May, the Financial Times reported that executives from General Motors, Nissan, Hyundai,

Volkswagen, and Ford emphasised hybrids' importance at the FT's Future of the Car Summit. The president of Hyundai said, "Electric is still the future. But now we are seeing a longer transition."

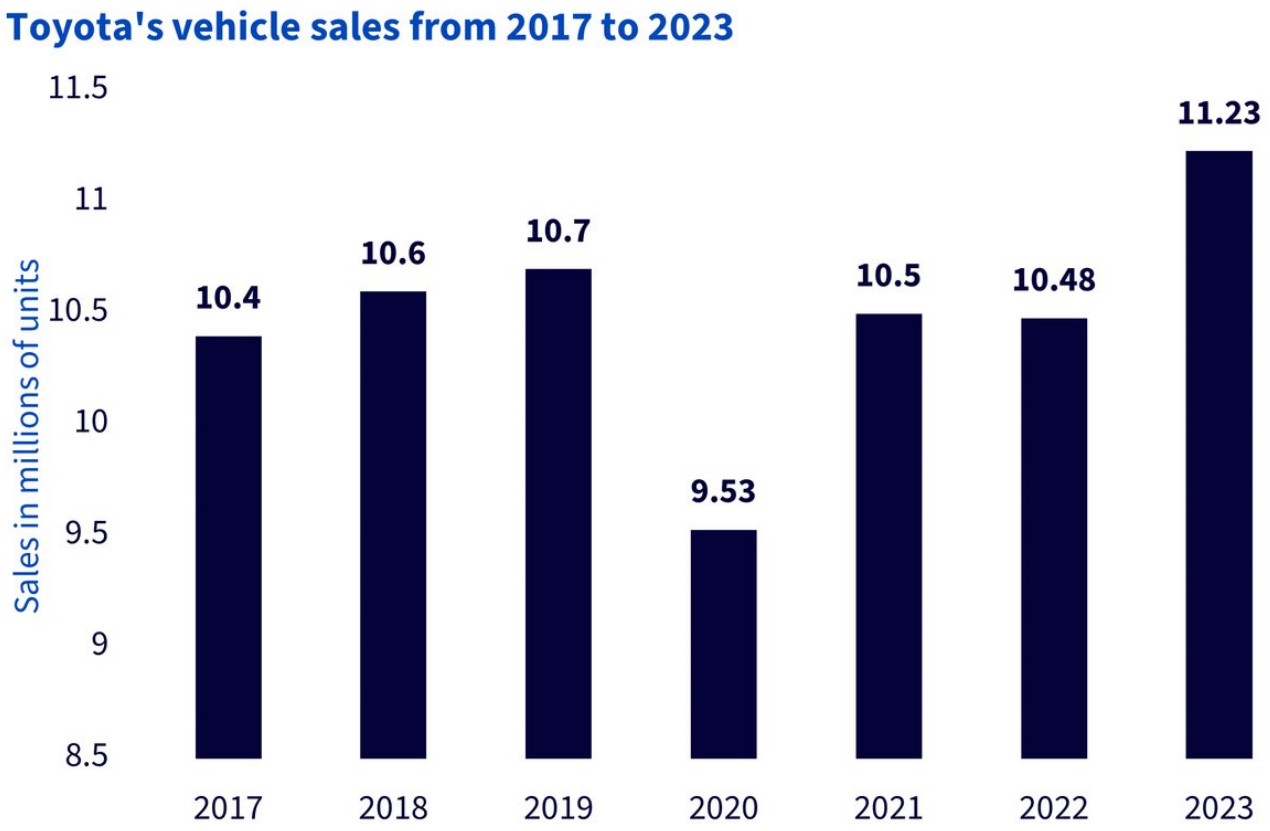
Even the new cool kid on the block, BYD, which is making waves globally with its EV sales, has just launched its fifth-generation dual-motor hybrid technology, claiming it can get 1,300 miles out of a single tank.

There is, however, an important distinction between BYD leaning in on hybrids and Toyota doing the same. BYD is clearly charging ahead with EVs at full throttle. In March 2024, among the top 10 plug-in EVs sold worldwide, seven were BYD models. BYD's foray into hybrids is one of the tools the company can use to expand into other markets worldwide after having established a strong presence in the local Chinese market.

In contrast, Toyota sold only 104,018 EVs between the Toyota and Lexus brands in 2023, accounting for less than 1% of the company's 11.23 million vehicle sales overall and an even smaller share of the nearly 14 million EVs sold worldwide. Toyota certainly did not rub shoulders (or bumpers) with BYD in the list of top EV models. However, Toyota's hybrid sales in 2023 were much stronger, tallying just over 3.4 million – a statistic that validates the company's effective strategy with the hybrid powertrain.

Business is strong

Toyota's vehicle sales were up in 2023 and have largely been steady in recent years, even in the pandemic-stricken 2020, which hit the automotive industry particularly hard (see figure below).



Source: Statista, Mar 2024.

The most recent earnings report for Toyota wasn't bad either. In the first quarter of 2024, the carmaker's revenue was up 14.27% year-over-year (yoy) and net income was up 80.65% yoy[1]. Toyota's share price also made strong gains in the first quarter, fuelled by a combination of healthy fundamentals and broader macroeconomic tailwinds for Japanese stocks.

Solid promises

Toyota has been working on solid-state battery technology for several years. Around June last year, it took the market by storm when it announced a technological breakthrough enabling the company to manufacture solid-state batteries at an industrial scale, overcoming a major hurdle that has hindered the technology's adoption in EVs so far. If Toyota can introduce an EV with a range of 750 miles and a charging time of 10 minutes in the next 2-3 years, as it claims, it could be a game-changer and potentially elevate Toyota to the leaderboard in the EV industry.

Toyota also became one of the early adopters of hydrogen fuel cell electric vehicles when it introduced the Mirai in 2014. A decade has passed, and hydrogen-powered cars have not taken off yet. But this could change, as many other carmakers are developing their own hydrogen powertrains.

Toyota's strategy, therefore, is clearly to diversify across different emerging automotive technologies beyond just lithium-ion powered electric vehicles.

The verdict

It would be extremely unfair to assert that Toyota is like Kodak in the late 2000s or Blockbuster in the early 2010s. Toyota continues to innovate, with its internal combustion engine vehicles and hybrids helping maintain its relevance in the automotive industry, and its business fundamentals remain very strong. However, in business, success cannot be taken for granted. Toyota still needs an effective approach to compete in the EV space, which is where the future lies. But to do so, it may need to go beyond its Kaizen philosophy of continuous improvement and instead employ radical thinking.

[1] Google Finance, June 2024.

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