Special Feature Article

An Era of Turbulence: Restructuring in the Parts Industry
~The Supply Chain at a Crossroads Amid Major Transformation~

"If we pursue economic rationality, supply chain restructuring is inevitable." This was a comment by Ken Kobayashi, Chairman of the Japan Chamber of Commerce and Industry, during its regular press conference in December 2024. At the time, mergers among domestic automakers were being discussed, and suppliers with existing business relationships were expected to be affected. As a result, attention focused on the message from JCCI, which represents small and medium-sized enterprises. Kobayashi continued:

"In times of change, there are various strategies—such as seizing opportunities to scale up and gain economies of scale. I hope related companies will consider these options proactively."

Japan's automotive supply chain is said to comprise around 70,000 companies. However, amid the dilution of keiretsu-based transactions, shifts in capital policies, technological changes such as electrification, and evolving social structures as well as economic and trade environments, its business model now stands at a crossroads. This article provides an overview of the industry entering an unprecedented phase of transformation and restructuring.

Headwinds in the Business Environment

According to a survey published by Tokyo Shoko Research in 2024, there are 69,860 Tier 1 and Tier 2 companies that do business with seven domestic passenger car manufacturers. Among these, manufacturers of automotive parts account for 20,892 companies—about 30% of the total—making it the largest segment. By location, Tokyo ranks highest, followed by Aichi, Osaka, Kanagawa, and Shizuoka, reflecting a concentration of supply chains in regions where automakers have their headquarters.

However, the deeper the tier, the harsher the business environment appears to become. In fact, the number of bankruptcies among automotive parts manufacturers in 2024 reached 36—the highest in the past decade (Tokyo Shoko Research). Most were small-scale bankruptcies with liabilities under 100 million yen. In addition to labor shortages and rising prices, the end of COVID-related financing has worsened cash flow, making conditions particularly severe for small and medium-sized enterprises.

That said, order trends are what directly impact business. In this regard, it is impossible to ignore that domestic automobile production has remained depressed since 2020, when the pandemic struck. Domestic production that year fell to 8.06 million units, dropping below 9 million for the first time in nine years since the Great

East Japan Earthquake in 2011. Production remained below 8 million units in 2021 and 2022, and although it rebounded to 8.99 million units in 2023, it is still far from the pre-Lehman Shock level of over 10 million units. In 2024, production stood at only 8.2 million units—a 40% decline compared to the peak of 13.49 million units in 1990—underscoring the hollowing out of domestic production. This impact is felt not only by small and medium-sized enterprises but across the entire supply chain, with suppliers focused on domestic markets facing the greatest challenges.

Restructuring Driven by Major Players

Leading this trend is the long-anticipated transformation of the automotive industry—often described as a “once-in-a-century” shift. While the slogan “CASE (Connected, Autonomous, Shared, Electric)” has now given way to “Software-Defined Vehicle (SDV),” with increasing focus on software rather than hardware, fundamental changes in manufacturing remain inevitable. These include the shift from internal combustion engines to electric powertrains, advancements in body technology, and the redefinition of cabin space.

Amid these developments, expectations for industry restructuring are rising once again. Professor Masao Hirano of Waseda University, a former McKinsey consultant with deep expertise in corporate management, notes: “It has long been pointed out that there are too many companies in Japan’s industrial sector.” He adds: “Even in the parts industry, there is a possibility that leading companies will be consolidated into just a few.” This suggests a potential reshaping of the industry landscape, centered on suppliers with strong financial and operational capabilities.

Currently, restructuring is becoming more visible in areas where future demand is expected to decline, such as piston rings, spark plugs, fuel tanks, and pumps. While the schemes vary—from mergers between Tier 1 suppliers to the transfer of competing businesses to rivals—the underlying strategy remains consistent: survival in a shrinking market.

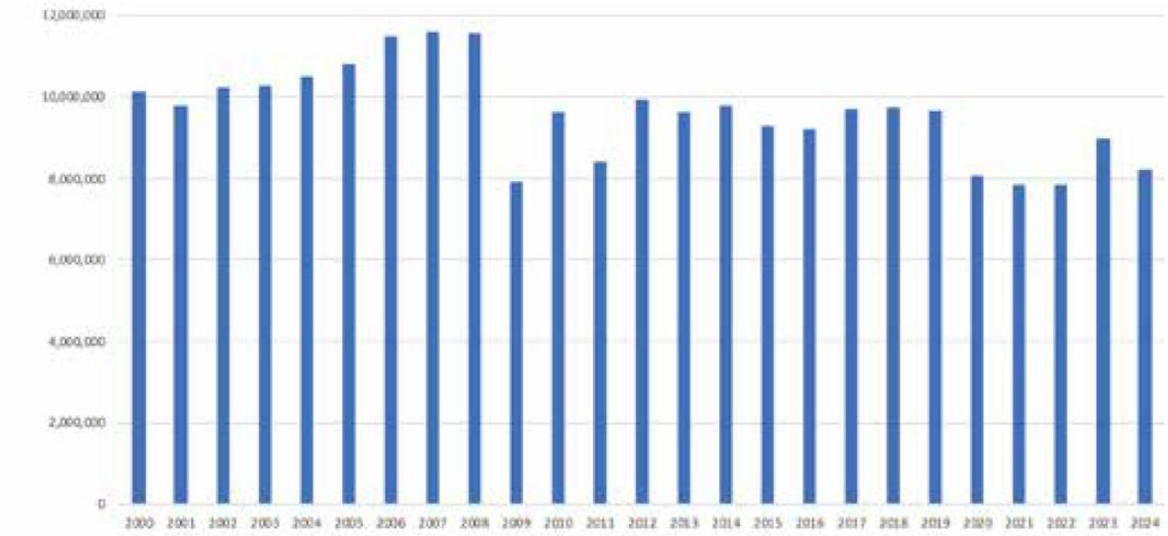
Generally speaking, when business consolidation occurs among companies in the same field and specialized products and technologies converge, suppliers can leverage economies of scale to enhance competitiveness. Their ability to make proposals to automakers and negotiate pricing also improves. If they can operate as quasi-“Tier 0.5” suppliers, it may mark a step toward horizontal specialization.

However, such strategies are typically feasible only for major suppliers with multiple competitive business domains. An executive at a Tier 2 supplier specializing in internal combustion engine components candidly admits, “To be honest, we’re a one-trick pony. We knew EVs would eventually replace our products, so we’ve been exploring new business areas, but nothing has really taken off. Starting from scratch with EV components means going head-to-head with cost-competitive Chinese manufacturers, and we simply can't compete."

While mergers and acquisitions are being considered, the same executive confides, "If small companies like ours merge within the same Tier, it may just be a numbers game. We're unsure of the best course of action, and so are our financial institutions." It seems that future-oriented restructuring is not easily penetrating the deeper layers of the Tier hierarchy.

Trends in Domestic Automobile Production Over the Past 25 Years

(Units: Vehicles)



Based on Statistics from JAMA

Shifts in Capital Policy Cannot Be Ignored

Japan's vertically integrated supply chain, often described as convoy-style, has traditionally been shaped by the preferences of automakers at the top of the keiretsu structure. As a result, it has remained largely detached from the kind of mergers and alliances commonly seen in Europe and the United States. While some independent component manufacturers have aggressively pursued M&A to significantly expand their business scale, such cases remain exceptions.

One key factor behind the shift in this long-standing tradition is the evolving trend in capital policy within the stock market. Since around 2018, Japan's Financial Services Agency and other authorities have clearly promoted the unwinding of cross-shareholdings. These policy-held shares, often retained under the pretext of stabilizing management, not only reduce capital efficiency but also negatively affect the perception of Japanese companies among foreign investors. In response to this policy, the automotive and component industries have seen a steady unwinding of cross-shareholdings in recent years. While the proceeds from share sales have been redirected toward growth investments and shareholder returns, the ties within traditional keiretsu structures have weakened. Conversely, this has increased the autonomy of suppliers, creating opportunities to explore new relationships with companies they previously had little interaction with.

Naturally, allowing shares to circulate without enhancing corporate value raises concerns, such as increased pressure from activist shareholders and heightened acquisition risks. In fact, in recent years, mid-sized suppliers have frequently attracted investor attention, including from overseas entities such as Chinese investment firms.

One supplier, previously known for its strong keiretsu ties, faced increased share purchases by investment firms as it moved to unwind policy-held stocks. The company's president remarked, "Even if they are activists, shareholders are still shareholders. We must listen to their opinions and provide appropriate returns." He also emphasized, "The essence of manufacturing must not be compromised. We will assert our position firmly through sincere dialogue."

Foreign Players Also Eyeing the Japanese Market

The emergence of new entrants into the automotive industry is likely to serve as an external catalyst for further restructuring. Jun Seki, CEO of Taiwan's Hon Hai Precision Industry (Foxconn), which aims to enter the Japanese market in partnership with domestic automakers, emphasizes the company's flexibility due to its independence from traditional keiretsu structures. He asserts, "Having worked with both automakers and component manufacturers, I've learned that it's cheaper when the vehicle is designed to fit the components. Standardizing user-friendly parts and using the same ones across models will also reduce EV costs."

A senior executive from a major supplier who attended Hon Hai's EV business briefing in Japan commented, "I felt that further standardization and modularization to enhance cost competitiveness, along with building a system for global supply, are essential." In fact, European players are already ahead in the area of system integration. For example, in control systems such as brakes, suspensions, and steering, mega-suppliers like Germany's Robert Bosch and ZF have moved integrated technologies into practical use. Additionally, renowned specialist manufacturers such as France's Michelin and Italy's Brembo have formed strategic partnerships. As systems become increasingly integrated, the demand for partners capable of rapidly and mass-producing standardized components reflects growing expectations for Japanese suppliers, who have long operated within the convoy-style framework.

The Global South is also drawing attention. Recently, India's Motherson Group has acquired several Japanese suppliers specializing in internal combustion engine components, thereby increasing its presence. While domestic news tends to focus on declining orders, Japan’s long-cultivated internal combustion technologies remain highly sought after in regions like India, where engine vehicles still have significant growth potential. Japanese companies in transition may appear particularly attractive to such players.

Each time automakers embark on management reforms and narrow down their procurement sources, or foreign mega-suppliers extend their reach into Japan, the landscape of Japan’s automotive supply chain undergoes significant transformation. As new changes unfold, further waves of restructuring are inevitable for companies striving to survive.