Case Study General Motors July 2020

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The case examines the failure to fundamentally address the reform of GM – and most notably the "legacy problem" following its collapse and nationalisation by the US government

Abstract

General Motors was once the pinnacle for industrial accomplishment, leading the automobile industry in market share for over 70 years. Early business strategies paved the way for this success, including; organisational structuring, marketing, and efficient production through economies of scale and scope. Over time, GM became comfortable and complacent in their market leader position.

They failed to heed the changes taking place in the automobile market, the overall economy and consumers. As a result, their technology became outdated and their manufacturing practices overly complex. They ignored growing issues of product quality and showed little concern in the face of rising costs and declining profits. GM continued to spiral downward until the final collapse in 2008-2009.

In 2009 the company made the largest ever filing under Chapter 11. It was taken into conservatorship (nationalisation). In 2013 it was re-privatized at a cost of $11.2bn to the US tax payer. Key issues were left unaddressed. Its commercial future remains uncertain in a difficult and highly competitive automotive market.

1. History of GM

The early days - life under William Durant

General Motors was founded in September 1908 in Flint, Michigan. The business was originally established as a holding company for thirteen car firms and ten parts-and accessories manufacturers. William (Billy) Durant formed General Motors out of a merger of these different entities. He planned to consolidate several autonomous auto and parts companies into one large firm. His aim was to achieve economies of scale while satisfying the growing consumer demand for automobiles. Durant had little or no interest in systematic management as the rest of the story bears witness.

The GM holding company was comprised of decentralised, independent manufacturers, with very little effective top level coordination. Each unit had its own administration and handled operations separately. Durant had knowledge of economies of scale but became too focused on the operations of each individual company within GM. There was otherwise no central policy making or administrative system to direct activities toward a common goal.

Durant ignored the need for internal reform. As a result, by 1922 GM was worth less than the sum of its individual parts. The auto industry and market experienced a steady increase from the early 1900's to 1920. The Inventory Crisis of 1920 caught Durant off guard. In the economic downturn, demand for autos decreased sharply leading to severe losses. Because his family had a large investment interest in GMs various allies stepped in to save the corporation. In the process, the business was reorganized. Durant was forced out of leadership..

Alfred Sloan takes the helm

As part of the reorganization, Alfred Sloan became the President and CEO of General Motors. Sloan worked to reform the corporation, and the changes he implemented led to improved performance. It caused GM to become a model for the multidivisional corporation and one of the largest and most successful enterprises of the twentieth century. One of the first changes implemented by Sloan in the 1920's, was restructuring the management and coordination of the firm. Sloan kept the operating divisions semi-autonomous, appointing decentralized managers for each unit. He also established a firm level management team. This top level management team was able to focus on policy making, coordination of divisions, and overall performance without becoming bogged down with the details of each unit's day-to-day operations.

This new model not only established a much needed structure, but also empowered and held accountable the managers of each division. GM referred to this form of corporate structure as "centralised control with decentralised responsibility". Being a holding company for multiple divisions of automobiles, GM produced many brands and styles of vehicles. Two developments that can be traced back to the Sloan years are market segmentation and production coordination/sharing among the GM divisions. In order to segment and fully exploit the auto market, GM created the idea of "a car for every purse and purpose". The corporation produced a variety of different cars which they hoped would appeal to all types of customers. The independent divisions formed an automobile progression or ladder of success.

The lowest and cheapest brand, Chevy, was targeted toward the first time buyer market or those individuals seeking an entry level vehicle; whereas the Cadillac division was a high end, luxury automobile line. The design was for customers to work their way through the ranks, purchasing a different GM automobile throughout their lives. The purse and purpose design kept the different GM divisions from directly competing for the same customers and helped to maximize profits. As a mass producer of autos this presented a unique opportunity for the company to exploit economies of scale and scope. The divisions produced different brands and models of vehicles but they were able to standardise common parts that were used across multiple lines. The sharing of parts in companies such as Chevy, Pontiac, and Oldsmobile reduced the cost of production. This offered GM a competitive advantage.

Sloan was also credited with establishing the annual model and styling changes of GM vehicles. This was an important business innovation in the 1900's interwar period. The annual model change was planned obsolescence, and encouraged customers to continue buying new models. Companies such as Ford were heavy on the manufacturing side of production and did not change their body styles frequently. GM made the model changes possible by keeping the main engines and mechanics the same and replacing cheaper parts, such as jigs and fixtures. This made the model changes less expensive and helped capitalize on consumer's desire for more modern and fashionable vehicles.

To celebrate their popularity and performance GM launched an intensive marketing campaign in the 1920's. When Sloan took over, the general public did not know much about the company. Over the next two years, a $600,000 marketing blitz introduced the company through radio and printed adverts. Due to its huge size, GM's marketing was focused on fighting the cold corporate stereotype and portraying itself as a warm, welcoming family. Each division was presented and showcased separately as part of the GM family portrait.

The size of GM became a positive characteristic because it signified strength and assurance. Sloan's marketing of GM became a hallmark of success and created internal cohesion of the divisions and a positive public image. In the 1930's, GM was the industry leader in sales for over 70 years. This feat was achieved through the production, management, and marketing.

2. The gathering crisis

The worsening outlook for GM

As GM grew and matured, the automobile industry faced increasing difficulties. The economy weakened. Customer preferences shifted. Apparent challenges, weaknesses, and vulnerabilities became evident within GM. The automobile industry is characterised by large fixed costs. The manufacturing facilities, inventory, and labour required to produce vehicles make up the major capital expenditures. Launch of a new car from design prototype, testing, evaluation, and manufacturing can take from three to four years. Fixed costs combined with this long planning horizon make new vehicle production risky. Cyclical changes in the economy can adversely impact on unsold stock.

Labour, in the form of wages, insurance and retirement compensation, make up a significant portion of GM's cost structure. There has been a long history of labour unions in the US auto industry. The majority of workers in the industry were, at the time, members of a labour union. Collective bargaining to settle terms of employment covering pay and working conditions in the normal practice. Unions and collective bargaining were of great importance to the survival of American industry. When the market weakens and costs need to be cut labour is first the feel the effects.

The retirement benefits paid to GM workers were an important part of the collective bargaining package and represent a significant cost to the firm. The automobile industry led the way for retirement benefits in the US and were known for their liberal early retirement provisions. Pension retirement policies tended to focus on length of service rather than a worker's age. GM's arrangement in the 1970's was known as "30 and out". This allowed workers to retire at any age and receive benefits as long as they had served for 30 years. As the automobile industry matured, GM's competitive advantage weakened. Strategies adopted in the 1920's weren't relevant to post-WW2 conditions.

Customer preferences changed as more options became available. Competition, advanced technology, and economic pressures affected the industry. The multidivisional structure that characterised the success of GM had its disadvantages. The decentralized units had a lot of freedom to decide how to employ their own resources and the tiered management structure limited communication. Top management became isolated and was not well informed about the divisional situation.

A powerhouse in the automobile market GM's innovation performance was lacklustre. The company experienced a loss of creativity with little technological advancement. The public began to notice that cars we beginning to look very similar. The parts sharing strategy used to reduce costs also backfired: customers were unwilling to buy a more expensive Oldsmobile if it was made with less expensive Chevy parts. These failures in the business model were kicked into the long grass by the notorious GM bureaucracy It is worth recalling what the redoubtable Ross Perot of EDS and a director of GM had to say about the GM bureaucracy in 1988.[1]

3. The failure of GM to renew and innovate

The impact of Japanese competition

As it stagnated GM made poor choices. Instead of admitting setbacks and addressing them management sought to justify them. A significant example was the introduction of the Corvair. This vehicle was produced despite well documented problems which were just ignored. Other countries also produced automobiles and employed production and management strategies of their own. In Japan, the production process was superior and labour costs were lower. So much so that the company cost of a small car was $2,000 less per unit than an American equivalent The Japanese manufacturers were committed to quality with their philosophy of "kaizen" or continuous improvement. When imports of their vehicles began to rise, they knew their competitors would eventually press for a protective "import tax" or similar.[2] The Japanese brought their production to the US in what came to be known as transplants.

Japanese automakers came to America and built transplant organisations in locations other than in the traditional industrial area of Detroit. They chose these particular locations to avoid union employment. The manufacturing facilities they ran were modelled after the plants back in Japan. They hired individuals who showed initiative, loyalty, and ability to work in teams. They provided wages and bonuses based on seniority, job performance, and team work. There were few job classifications and status distinctions compared to the American automobile industry. Employees were organised into work teams with shop floor leaders, where they would rotate tasks while planning and carrying out a production job from start to finish.

The Japanese gained significant market share through the type and quality of automobiles they produced. When oil prices began to rise in the late twentieth century, the smaller and more fuel efficient Japanese cars became popular demand. The reliability of the automobiles

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[1] In a wide ranging interview with Fortune in 1988 Perrot a former director of GM and founder of EDS spoke about the GM system as being "like a blanket of fog" which effectively prevented right-thinking people from solving the problems that they could see all around them.

[2] In fact the US government imposed VERs (voluntary exports constraints) in the 1980s on imports of the Honda Civic in a bid to protect the Big Three. Honda responded decisively by building a plant in the US.

was demonstrated by infrequent need for repair. The majority of automobile recalls in the US were made by American automakers. From 1973 to 1992, GM in particular lost more than $2.9 billion or 14% of its real market value due to recall announcements.

4. The crisis breaks for GM

The unsurprising event of bankruptcy

In, June GM filed for Chapter 11 bankruptcy protection. The company declared $82bn in assets and $172.8bn in debt, making it the fourth largest in US history. Chapter 11 bankruptcy refers to the eleventh chapter of the United States Bankruptcy Code. Chapter 11 bankruptcy is also called "reorganisation bankruptcy" and is typically filed when a business finds itself in financial turmoil but judges that there is a viable company that can be created. Chapter 11 bankruptcy is a costly process, both in terms of time and money. There are direct, measurable costs as well as indirect or lingering costs. The direct costs of Chapter 11 bankruptcy include professional fees, court costs, document preparation, and communication costs. In large organisations, the direct costs of bankruptcy are estimated to be three percent of the debtor's liabilities.

There is also a social stigma associated with bankruptcy that can affect a company's public image, consumer appeal, and future success. Within society, a feeling of resentment can build toward a business as citizens feel burdened to pay for company failures. Top level management often bears the brunt of this stigma and resentment. The full disclosure of company records and documents is another regrettable requirement of bankruptcy. It can result in loss of a company's proprietary advantage.

Government Intervention

In 2008, the US economy suffered a significant downturn and oil prices hit an all time high of $150 per barrel. American automakers turned to Washington for help. GM was given nearly $20m relief payment and a March 2009 deadline to restructure the organisation. On 30 March 2009 GM was still deep in debt and had failed to produce a successful viability plan to lawmakers. Rick Wagoner was removed from leadership and replaced by Fritz Henderson. Chapter 11 bankruptcy filings were soon to follow since the company could not survive without government support. The day GM filed for bankruptcy, the company share price plunged to its lowest value ever, 27cents. GM was delisted from the stock exchange and the US Treasury became 60 percent owner along with the Canadian government and the United Auto Workers Trust.[3]

The new GM is a much smaller organization. The business kept only four automobile divisions, Chevrolet, Cadillac, Buick, and GMC. Other planned reductions included reducing the number of manufacturing plants from 47 to 34. Employment was cut from 91,000 to 64,000. 2,600 dealerships were closed across the country. The company debt was slashed to $48bn.

5. What did conservatorship achieve?

[3] The view of the US Treasury was that the costs of nationalising and restructuring GM were significantly less than allowing its liquidation.

A verdict of the re-launch of GM

The GM bankruptcy, restructuring and subsequent IPO re-launch marks the biggest corporate re-launch operation ever undertaken. Ahead of it its entry into conservatorship GM had total net sales and revenues of $181bn and net losses of $38bn with sales revenues in decline during the two previous reporting years. The GM business was a large multinational business with significant business operations in Europe and many other parts of the world including China. An extract from GMs 2008 annual report sums up well the situation then facing the company.

> **In 2008, the global automotive industry continued to be highly competitive and was severely affected by the tightening of the credit markets, a recession in the United States and Western Europe and volatile oil prices and decreases in the employment rate. These economic factors had a negative effect on the automotive industry and the principal factors that determine consumers' vehicle buying decisions. As a result of these economic factors, consumers delayed purchasing or leasing new vehicles causing a decline in global vehicle sales. The principal factors that determine consumer vehicle preferences in the markets in which we operate include price, quality, style, safety, reliability, fuel economy and functionality. Our estimated worldwide market share was 12.4%, 13.3% and 13.5% in 2008, 2007 and 2006. Market leadership in individual countries in which we compete varies widely and we do not lead in every country.**
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> **The negative economic factors mentioned above had a significant effect on North America and our largest market, the United States. In addition to the economic factors described above, turmoil in the mortgage markets, resulting in reductions in housing values, and declining consumer confidence as a result of the declining household incomes and the United States recession contributed to significantly lower vehicle sales in the United States. Despite the adverse economic conditions affecting the United States in 2008, we have maintained the largest market share in our largest market, the United States, for 78 consecutive years.**

The question that remains is how far GM has addressed the fundamental issues that determine its viability in the US market. It is the third-largest business in the US with total net sales of $145bn in 2017 and dividends per share of $1.52. Despite the incentives that kept sales high during America's economic slowdown, GM is losing market share. Some of the key unresolved issues are as follows

- Market competition - GMs market share is continues to decline. Ford faces the same challenge. With every new non US car manufacturer selling into America – soon to include China - market share will continue to decline. Can this be halted and reversed?
- Health care - GM spends $5.2bn on health care for 1.1 million people, equal to $4,727 per annum per person. These huge health care costs have to be recovered in the price of every car sold. This "legacy" problem is fundamental to the US. Can US industry continue to bear these very significant costs?
- Pension cost – each car produced by GM carries a further $675 covering pension costs. Again these have to be recovered in sales. This again raises the question of sustainability?

Evaluating the case

1. What caused the decline and loss of the competitive edge at GM?

2. What were the principal weaknesses in GM's business model at different stages in the life of the company?

3. What do the terms "centralized control with decentralised responsibility" used by Alfred Sloan in promoting his ideas for re-organisation?

4. What does the slogan "a car for every purse and purpose" signify? What were the weaknesses in this as a marketing strategy?

5. How were GM caught by their policy of "common parts" for vehicles given the wide range of different brands?

6. Why were GM so slow to respond to Japanese competition in the US market?

7. Explain the reference to Japanese manufacturers commitment to *kaizen* or continuous improvement?

8. Why was the launch of the Corsair such an avoidable disaster?

9. Comment upon Ross Perot's description of the GM bureaucracy culture?

10. How did the 2009 bankruptcy and restructuring help the company to survive and thrive?

11. What are the key reputational risks associated with Chapter 11 protection?

12 What did GM do to improve sales?

13 What part did management style and focus play in the decline of GM?

14 What factors explain the sharp rise in American auto manufacturing compensation claims?

15. Given the market problems the US auto industry faces in general and GM in particular what are the long term prospects for the company?

16. How, in your view, can the legacy" problem of social welfare liabilities with US corporations ever be addressed satisfactorily?

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