WHERE SHOULD GENERAL MOTORS GO FROM HERE?

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CASE DESCRIPTION

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; organizational structuring, marketing, and utilizing efficient production through economies of scale and scope. Over time, GM became comfortable and complacent in their market leader position. They did not 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 As a result, their technology became outdated and their manufacturing practices overly complex and unconcerned with quality, all while costs increased and profits dwindled.

General Motors continued to spiral downward until their final collapse in 2008-2009. The company ended up in bankruptcy, but has made plans to reform and revive their business. This case is suitable for undergraduate or graduate business students. The case should require about one hour of outside preparation and one hour of class discussion.

CASE INFORMATION

General Motors Company was founded on September 16, 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 Company out of merger. He was a well known entrepreneur in the early 1900's who envisioned consolidating several autonomous auto and parts companies into one large firm to achieve economies of scale while satisfying the growing consumer demand for automobiles (Johnson, 1978).

Although Durant was a brilliant capitalist, he had no interest in systematic management. The GM holding company was comprised of decentralized, independent manufacturers with very little top level coordination (Marchand, 1991). Each unit had its own administration and handled operations separately. Durant had knowledge of economies of scale and he wished to utilize resources, but he became too focused on the operations of each company within GM. There was no central policy making or administrative system to direct the activities of each unit toward a common goal (Johnson, 1978). Durant ignored the need for internal reform and did not seem concerned for the corporation as a whole, As a result, by 1922 GM was worth less than the sum of its individual parts (Marchand, 1991).

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 (Norton, 1997). Because his family had a large investment interest in GM, Pierre du Pont and his allies stepped in to save the corporation. In the process, the business was reorganized and Durant was forced out of leadership (Marchand, 1991).

<u>Reorganization</u>

As a part of the reorganization, Alfred Sloan became the eventual President and CEO of General Motors. Sloan worked to reform the corporation, and the changes he implemented led to improved performance and propelled GM to become a model for the multidivisional corporation and one of the largest and most successful enterprises of the twentieth century (Norton, 1997).

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 semiautonomous, appointing decentralized managers for each unit; however, he also established a firm level management team. This top level management 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 "centralized control with decentralized responsibility" (Johnson, 1978).

Being a holding company for multiple divisions of automobiles, General Motors 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" (Raff, 1991). The corporation produced a variety of different cars which they hoped would appeal to all types of customers (Friedlaender, Winston, Wang, 1983). 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 (Raff, 1991).

Producing a mass number of vehicles also presented an opportunity for the company to utilize economies of scale and scope, and that is exactly what GM did (Friedlaender, Winston, Wang, 1983). The divisions produced different brands and models of vehicles but they were able to standardize 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 and offered GM a competitive advantage (Raff, 1991).

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 (Raff, 1991).

To finalize their popularity and growth, General Motors 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 designed by Bruce Barton introduced the company through radio and print ads. Due to its massive 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 and Barton's marketing of GM became a hallmark of success and created internal cohesion of the divisions and a positive public image (Marchand, 1991).

Age of Change

Beginning in the 1930's, General Motors was the industry leader in sales for over 70 years. This feat was achieved through the production, management, and marketing instituted in the early founding of the company. As General Motors grew and matured as a company, the automobile industry continued to progress, the economy suffered fluctuations, and customer preferences shifted. Apparent challenges, weaknesses, and vulnerabilities became evident within the company.

The automobile industry is characterized by large fixed costs. The manufacturing facilities, inventory, and labor required to produce vehicles make up the major capital expenditures. Launch of a new car from the 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 and can have a variable affect on the company's stock (Friedlaender, Winston, & Wang, 1983).

Labor, 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 labor unions in the automobile industry and the majority of workers in the U.S. are traditionally a part of labor unions. Union workers become part of an organization that utilizes collective bargaining to negotiate contractual terms of employment, regarding pay and working conditions. Unions and collective bargaining were, and still are, of great importance to the survival of American industrial corporations because without labor, companies would lose great sums of money very quickly (Harbison, 1950). When the market suffers and costs need to be cut, labor is first the feel the effects. Reduced employment and layoffs are directly linked to a downturn in production (Meyer & Quadango, 1990).

The retirement benefits paid to General Motors workers were a lucrative 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 U.S. and the private pensions became known for their liberal early retirement provisions. The private pension retirement policies tended to focus on length of service rather than a worker's age. GM's notable arrangement of the 1970's known as "30 and out" allowed workers to retire at any age and receive benefits as long as they had served for 30 years (Meyer & Quadango, 1990).

As the automobile industry matured, the relative value of information diminished and General Motors' competitive advantage weakened (Norton, 1997). Strategies implemented in the 1920's weren't relevant post World War II. Customer preferences changed as more options became available. Competition, advanced technology, and economic pressures affected the industry.

The multidivisional structure that characterized the success of GM had its disadvantages. First, the decentralized units had a lot of freedom to decide how to employ their own resources and the tiered management structure limited communication (Johnson, 1978). The top level management became isolated and not well informed with each division (Schwartz, 1991).

General Motors became a powerhouse in the automobile market, but then displayed lackluster innovation. The company experienced a loss of creativity with little technological advancement. The annual model change and laddered divisions converged and people took notice that the cars began to look the same. The parts sharing strategy used to reduce costs also backfired because customers were not willing to buy a more expensive Oldsmobile made with less expensive Chevy parts. In its stagnation, GM made poor choices and instead of admitting setbacks they justified and remained committed to bad decisions. A great example is the introduction of the Corvair. This vehicle was produced despite well known and documented problems (Schwartz, 1991).

Competition: Japan

Other countries also produced automobiles and employed production and management strategies of their own. In Japan, the production process was superior and labor costs were lower. So much so that the company cost of a small car was $2,000 less per unit than an American equivalent (Lieberman, Lau, &

Williams, 1990). Japanese had a strict commitment to quality with their philosophy of "kaizen" or continuous improvement. When imports of their vehicles began to rise, they knew their competition would carry an import tax. They brought their production to the U.S. in what came to be known as transplants (Florida & Kenney, 1991).

Japanese automakers came to America and built transplant organizations in locations rather than in the traditional industrial area of Detroit. They chose these particular locations to avoid union employment. The manufacturing facilities they ran were modeled after their sister 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 organized into work teams with shop floor leaders, where they would rotate tasks while planning and carrying out a production job from start to finish (Florida & Kenney, 1991).

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 was demonstrated by infrequent need for repair. A study by Barber and Darrough found that the majority of automobile recalls in the U.S. 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 (1996).

Bankruptcy

On Monday, June 1, 2009 General Motors filed for Chapter 11 bankruptcy. The company claimed $82 billion in assets and $172.8 billion in debt, making the filing the fourth largest in U.S. history. Chapter 11 bankruptcy refers to the eleventh chapter of the United States Bankruptcy Code. Chapter 11 bankruptcy is also called reorganization bankruptcy and is typically filed when a business finds itself in financial turmoil but feels there is a viable company that can be reorganized and succeed (Moulton & Thomas, 1993).

Chapter 11 bankruptcy is a costly process, both in terms of time and money. There are direct, measurable costs as well as indirect, lingering costs. The direct costs of Chapter 11 bankruptcy include professional fees, court costs, document preparation, and communication costs. In large organizations, the direct costs of bankruptcy are estimated to be three percent of the debtor's liabilities (Moulton & Thomas, 1993).

There is a social stigma associated with bankruptcy that can affect a company's public image, consumer appeal, and future success (Moulton & Thomas, 1993). Amongst society, a feeling of resentment can build toward a business as citizens feel burdened to pay for the company's failures. Top level management often bears the brunt of this stigma and resentment and turnover is expected. The full disclosure of company records and documents is another regrettable requirement of bankruptcy and can result in loss of a company's proprietary advantage (Payne & Hogg, 1994).

Government Intervention

In 2008, the U.S. economy suffered a significant downturn and oil prices hit an all time high of $150 per barrel. American automakers turned to Washington, D.C. for help with their struggles. General Motors and then CEO Rick Wagoner were given nearly $20 million dollars and a March 2009 deadline to restructure the organization. On March 30, 2009 GM was still deep in debt and had yet to produce a successful viability plan to lawmakers. Rick Wagoner was removed as the head of the company and replaced with Fritz Henderson. Chapter 11 bankruptcy filings were soon to follow as the company could not survive without government support.

The day GM filed for bankruptcy, company share price plunged to its lowest value ever, 27 cents. General Motors was delisted from the stock exchange and the U.S. Treasury became 60 percent owner along with the Canadian government and the United Auto Workers trust. The new General Motors has become a much smaller organization. The business kept only four automobile divisions, Chevrolet, Cadillac, Buick, and GMC. Other planned reductions included; the number of manufacturing plants to decrease from 47 to 34, employment cut from 91,000 to 64,000, and 2,600 dealerships closed across the country. The company debt was slashed to $48 billion.

QUESTIONS

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

2. What were the weaknesses in General Motor's model?

3. How will the bankruptcy and restructuring help the company to survive and thrive?

4. What can General Motors do to improve their sales?

5. What part did management style and focus have on General Motors decline?

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TEACHING NOTES

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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; organizational structuring, marketing, and utilizing efficient production through economies of scale and scope. Over time, GM became comfortable and complacent in their market leader position. They did not 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 and unconcerned with quality, all while costs increased and profits dwindled.

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QUESTIONS

Question 1: What caused the decline and loss of the competitive edge at General Motors?

Solution 1: There is no question that General Motors was a large and successful American company. When it rose to power in the 1920's, the company had developed solid business strategies and was generating a significant profit. The breakdown came when the company and market matured. GM held on to the same strategies from the 1920's and did not make significant enough changes or innovations. It took over 70 years before the company collapsed, proving how much money and market power was at stake. The company was alive many years past their prime.

The main setbacks for General Motors were its high costs, poor management, and lack of improvement. The semiautonomous, multidivisional structure worked in the founding and early history of the company, but the company grew too large. Top level management was out of touch and communication suffered. When profits were streaming in, no one was questioning the viability of each unit even though this should have been monitored. The pride and stigma associated with downsizing, impaired GM's ability to be lean and maximize profit.

Question 2: What were the weaknesses in General Motor's model?

Solution 2: The original GM business model valued inventory the same as cash, which might have been accurate in times when demand was unmet. As supply and demand converged however, the building inventory generated additional costs. Yearly model changes discouraged consumers from buying older models and much of GM's production ended up held in warehouses. Further, as GM continued the yearly model changes and divisional parts sharing, the public began noting that products looked alike from year to year and from line to line. No major innovation was taking place, only the body styles were slightly changing. Also, if a more expensive model vehicle was made with the same parts as a cheaper model vehicle there was no incentive to pay for a premium brand car.

As more Americans began owning automobiles, the novelty faded and priorities changed. After the Great Depression and World War II, consumers did not see the need to switch models as frequently as their money was better spent elsewhere. Additionally, other economic factors began contributing to consumer preference, including oil prices, competition, reliability, and quality. New auto companies, including Japanese companies, began selling in America and GM did little to change its manufacturing strategy. The Japanese superior information processing, inventory control, and quality operations overtook GM's control of market share.

The challenge of labor costs was somewhat self-imposed. Being the generous leader, General Motors set the standard for auto wages and benefits. Contracts continued to expand and when union unrest or strikes took place, the company was powerless to their demands, less they halt production.

Question 3: How will the bankruptcy and restructuring help the company to survive and thrive?

Solution 3: Reducing the size and scope of GM is certainly a positive step. Too many divisions, plants, product lines, dealerships, excess inventory, and employees is hard to manage and not profitable for the company. By scaling down and refining the business strategy, GM can decrease costs and make production changes, much like the proven Japanese model.

Reduction of the labor force and better, more realistic wage, benefit, and retirement negotiations can be reached. Quality should become a priority and each type of vehicle can have real modifications, in technology, efficiency, and styling. Future design can also focus on economic and market developments and shifts in consumer preferences. Fuel economy, environmental concern, and product quality are likely to be the relevant characteristics of the future automobile industry.

Question 4: What can General Motors do to improve their sales?

Solution 4: General Motors can and should make changes to their manufacturing and operations, but the real test will be if their vehicles sell. Without sales and market share, there is no profit and GM will never succeed. The legacy of complacency, resistance to change, and social stigma may stick with GM. The public may not accept the fresh from bankruptcy GM, primarily government owned. There are many options nowadays in the automobile industry and the pride, superiority, and obligation toward American made products is waning. Competition is tight and quality is commanded, further narrowing margins. Despite the large reduction in employment, many top executives will stay with GM.

Question 5: What part did management style and focus have on General Motors decline?

Solution 5: The unfocused management of General Motors and their deliberate resistance to change took this company from top to bottom. In an industry defined by high fixed costs, GM realized great success and profitability in its early years, but clung to old strategies for too long. The company was unprogressive and did not keep up with consumer preferences or worldwide economic influences. Size helped the company hold on as long as it did, but in the end the size became too overwhelming and expensive.

In order to prosper post-bankruptcy, the leadership of General Motors will have to make tough decisions. Already much of the manpower, product divisions, dealerships, and manufacturing plants have been cut. In order to regain consumer trust and ultimately money, GM must prove it has vehicles that are worth purchase and commit to furthering their automobile innovation to remain competitive and relevant in the industry.

BIOGRAPHY

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