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THE FALL OF GM

WHAT WENT WRONG AND HOW TO AVOID ITS MISTAKES

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eBook

OF ALL THE COMPANIES THAT TYPIFIED AMERICA'S RISE AS AN INDUSTRIAL SUPERPOWER, NONE WAS MORE SUCCESSFUL THAN GENERAL MOTORS.

What happened? Why has it fallen so far? GM at its biggest boasted some 600,000 well-paid employees. It will be left with something like 60,000 after it emerges from bankruptcy. How did that happen? Why did its stock price tumble from $96 per share at its height to 80 cents recently? Why did its market share shrink from one out of every two cars sold to less than one in five last quarter?

In postwar America, the common phrase "What's good for GM is good for America" symbolized GM. Its ingenuity allowed the company to create automobiles with great versatility under different brand names and with different configurations, yet keep them modestly priced. GM's product array allowed the company to grow almost continuously after the end of WWII. Demand for cars was insatiable. With its multiple brands, vast distribution, product lines and designs, GM quickly leapt into first place among the auto manufacturers with a market share exceeding 50%.

GM HAD A CLEAR SUCCESS FORMULA

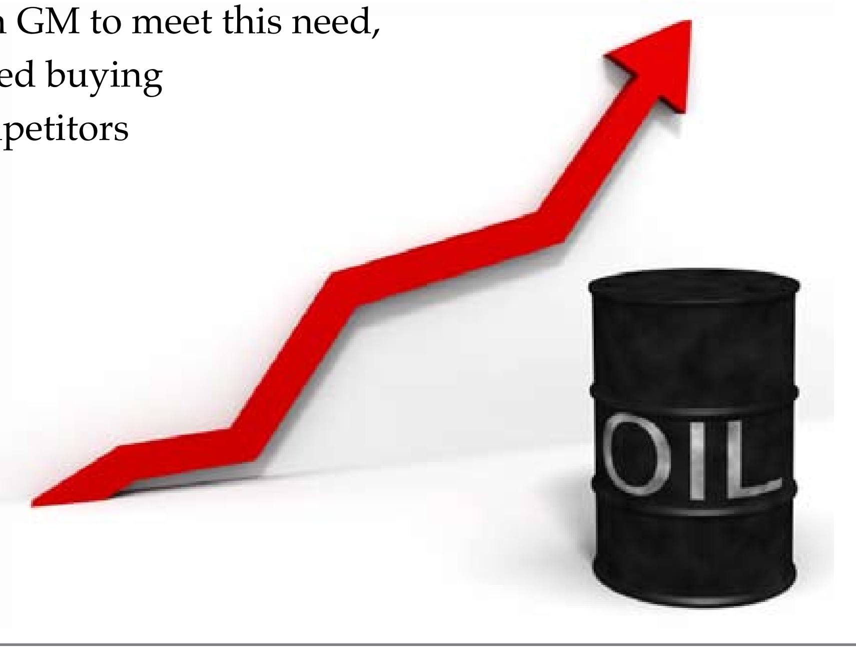
GM was a leader in paying its workers well, while still churning out a profit for investors due to rapid growth. The company also offered one of the country's most lavish health and benefit plans. During the 1950s GM management and workers were delighted to say the company had the highest paid employees in America. To make sure workers were available to return after shutdowns for model year changes, GM agreed to a groundbreaking union clause where they paid workers idled by shutdowns. In addition, GM offered strong pension plans with substantial retirement pay and full benefits for long-time employees.

This Success Formula enabled GM to dominate the industry. The company's identity, to be the biggest – the General – was wedded to its strategy of having the largest distribution and the widest product line. And the Success Formula worked, as year after year GM sold more cars than anyone else while producing excellent rates of return from the 1940s all through the 1960s and into the 1970s.

THEN 'SHIFT' HAPPENED

In the mid- to late-1970s, the price of oil suddenly skyrocketed. Prices which had historically been under $1.00/barrel in the 1960s, went to $3, $5, even $12 per barrel. This caused gasoline prices to rise from $.12, $.15 or $.18 per gallon to $.35, then $.50 and eventually $1.00 – a 5x to 8x price increase! Equally bad, limited supplies caused gasoline shortages to appear. Especially in major cities where gas lines formed as people waited hours to obtain gasoline for their autos.

Although GM had done nothing wrong, suddenly the company was in big trouble. Where speed and comfort once dominated the buying decision, suddenly gas mileage was a far greater determinant. With no products available from GM to meet this need, customers rapidly started buying cars from Japanese competitors such as Honda, Toyota and Nissan.



Compounding the problem of shifting customer expectations, the oil shock sent America into prolonged stagflation. Real economic growth stalled, yet prices went up. Where GM had sailed through earlier periods of economic weakness, suddenly customers were having sticker shock as GM passed along higher labor costs into its car prices. As part of its beneficial labor relations, GM had agreed that employee pay would increase automatically with the rate of inflation. But in the late 1970s inflation skyrocketed beyond 10%/year, driving wage rates to previously unseen levels, and sending American car prices to new highs. Customers who did not have inflation pay adjustments blanched at new GM car prices, turning increasingly to imports.

GM RESPONDED SLUGGISHLY

With slowing growth, GM was forced to close plants. But shutdown labor provisions meant that GM was still paying most workers, again pushing up the prices of cars even more. With lower sales came lower profits, and less money for R&D and product development, even as demand was shifting away from GM's traditional product line. With each year, GM grew further and further out of step with customer desires. GM tried to react with the introduction of the Chevrolet Vega, but the low margin for both GM and its dealers doomed the model's sales and it was quickly taken out of production.

Unfortunately for GM, the Japanese manufacturers took advantage of this shift. As sales increased they poured money into improving product quality. Long accused of shoddy fit and finish, during the 5 years following the oil shock these companies quickly transitioned to become market leaders in customer quality perceptions. They invested heavily in advertising, and were content to operate with profit margins of 1% - 2%, a fraction of the profits historically enjoyed by GM.

By 1980, GM was shell-shocked. Its growth had stalled, its profits had been eviscerated, its market share was declining, and its products were under attack for not meeting customer expectations. GMs labor relations were at its weakest ever, as the company tried to renegotiate its employee-favorable contracts with little improvement.

WHAT DIDN'T GM DO WRONG?

The company made the fatal mistake of assuming that people would always want to buy more cars, bigger cars and more powerful cars. GM locked-in on its business model, assuming that the future would be mostly like the past. The company's plans were built around the famous 7-year planning cycle developed to design and introduce a car. GM was unprepared for any shock that would change customer expectations, require a shortened design cycle, or cause revenue growth to slow.

With half the market, GM felt its competitors weren't terribly relevant. Focus was placed on internal operations while competitors introduced new innovations. GM felt there was always time to adopt any innovation later. Most importantly, GM ignored small car manufacturers believing they could not match the resources or capability of GM. GM leaders felt everyone else wanted to be GM, so there was no need to monitor those who made different cars, or operated with a different Success Formula. Honda, Toyota and Nissan weren't even on GM's competitive radar screen.

Where GM had once been the innovator, using its product variability to overcome Ford's standardization and rise to the top of the industry, it gradually killed off innovation by reinforcing its Success Formula. Trying to save its volume sales, its commitment to the vast dealer army, its belief in large, high powered vehicles with high gross margin, and its historical labor contracts all doomed GM to failure when the market shifted.

WHAT GM SHOULD HAVE TRIED

GM never undertook scenario planning to help it anticipate market shifts. By the 1970s the price of a new car had begun doubling ever 6 years. GM was exiting the economy-car market simply by ignoring it. GM was making the market of first-time buyers easily available for new competitors. GM just assumed everyone wanted to buy a GM car, so they never considered scenarios that would lead customers to a competitor.

The rise in oil prices might have been hard to predict accurately, but that energy costs were going to rise was well documented. Oil consumption exceeded domestic production, which had already led to increases in home fuel oil and electricity supplied by oil-fired generation facilities. But GM developed no future scenarios in which fuel prices would go up enough to affect car buying behavior. GM's labor contracts required GM to keep growing. GM failed to develop scenarios where changing market considerations led to lower growth rates and longer shutdowns. Had it done so, the impact of its employment agreements could have been anticipated, and GM would have been able to negotiate clauses better protecting the company from market shifts.

GM should not have been surprised by the advancing capability of Japanese manufacturers, nor their lower production cost, nor their willingness to operate on thin margins and high debt levels. Had GM paid serious, close attention to Honda and Toyota it would have seen their sales advancing, and customers (especially younger customers) being attracted to their smaller, more efficient cars. Had GM paid close attention to all competitors it would have seen the market vacancies it was creating, the strength of competitors filling those vacancies and the impending potential market shift.

GM also should have recognized the growing competency of offshore competitors, and met it head on with its own cars. GM and its dealers were so used to the old model of bigger cars and higher prices that the company did not aggressively try figuring out how a company could be profitable selling more, smaller cars at lower prices. GM should have 'Disrupted' its comfortable, cozy culture and used 'White Space' to test new ways of competing.

ONE OF GM'S LEADERS WASN'T SO DUMB

At least one executive at GM did recognize the company's dire circumstances in the 1970s. Chairman Roger Smith took quite a bit of heat from investors and public officials for GM's performance during rising oil prices. His decision to shut down entire factories devastated some Midwestern towns. After he closed the plant in Flint, Michigan, a future Oscar winning movie producer/director was created when Michael Moore pilloried Chairman Smith for his apparently heartless actions.

Chairman Smith did a lot more than just close plants. Acting on his recognition of market changes he purchased EDS, then the world's largest computer system integration company. His logic was that computer usage was growing and profitable and would be a much better business than making cars appeared to be. Similarly, he recognized the increasing use of electronics in cars and elsewhere, and the fast increase in air travel as deregulation changed the market. So he bought Hughes Electronics, the #1 supplier of cockpit electronics for aircraft and an overwhelmingly competent company in applied electronics.

Additionally, Chairman Smith set up a special multi-billion dollar fund to open a whole new GM division dedicated to competing with Japanese imports. He allowed the new division leadership to negotiate entirely new labor agreements, design entirely new cars and open entirely new dealers. If GM were to succeed making cars, Chairman Smith believed, the company must learn from the ground up how to make cars like the Japanese might – in the USA. He created Saturn.

Each of these projects, and certainly all of them together, offered the opportunity for GM to radically change and remain a powerful, growing company. But now, 25 years later, EDS and Hughes have been sold, and Saturn has been threatened with closure if its sale to Penke, or another buyer, is not consummated quickly. Why didn't these 'White Space' projects help?

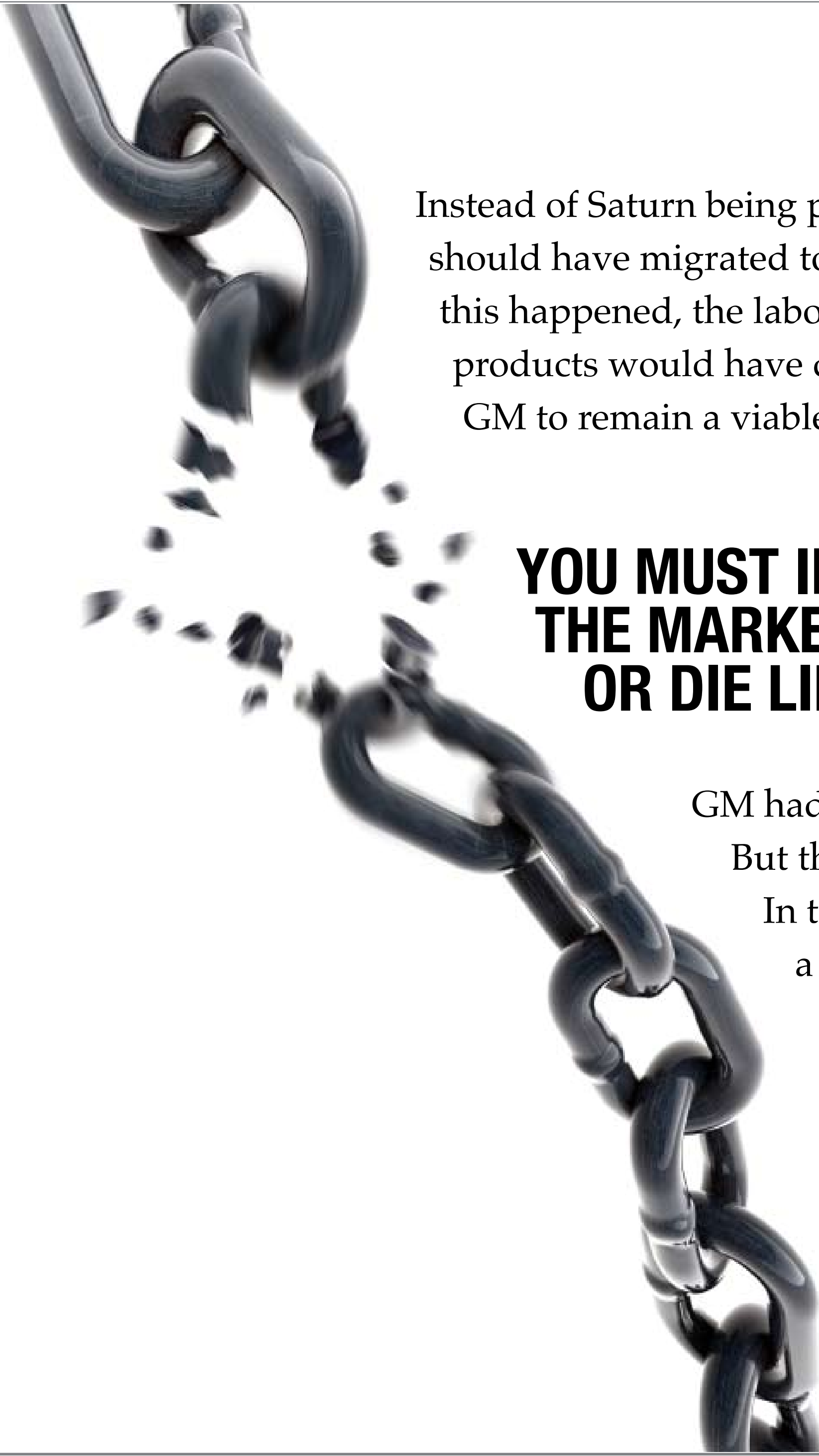
BUT IT WASN'T ENOUGH TO SAVE THE BEHEMOTH

First, the management team at GM never entertained scenarios that would have the car company doing poorly – much less failing. Because they never considered the environmental and competitive possibilities, they were never prepared for things to work out as badly as they did. No company can afford the arrogance of thinking their business is invulnerable. All leaders must develop and consider future scenarios which would turn the existing Lock-ins into problems that aid competitors.

Secondly, and most importantly, Chairman Smith never 'Disrupted' the auto company. While he set up new projects to help GM grow, he never went to the auto leadership and said "Given our current positioning in automobiles, when I leave GM the new Chairman will come from either EDS or Hughes." He never confirmed to the auto leadership "Bonuses will remain tied to growth, and that means the people who run Hughes or EDS will be the best paid in our company. And that's all for the better." He never caused the auto leadership to recognize that the future of GM could be something entirely different than cars by establishing an executive team to run the company dominated by executives from outside the car company.

Because he didn't disrupt GM, after he left the pull of the old Success Formula, so tied to the infrastructure and decision-making systems in GM, quickly eliminated the alternative businesses. Even though they were more profitable, growing faster and worth more money, GM auto leadership kept going back to the old core Success Formula, which led them to slowly sell off the other investments.

Had Chairman Smith been more Disruptive, the auto executives would have seen that they must dramatically change if they were to remain viable selling cars. And that could have precipitated an entirely different approach to the management of Saturn. Instead of a backwater operation of little interest, it should have reported to the Chairman and been the vanguard of change.



Instead of Saturn being pulled back into GM, the other divisions should have migrated toward behaving more like Saturn. Had this happened, the labor structure, dealer structure and car products would have dramatically changed – possibly allowing GM to remain a viable auto competitor.

YOU MUST INNOVATE, FOLLOW THE MARKET, AND CHANGE – OR DIE LIKE GM

GM had many opportunities to remain viable. But the company never overcame its Lock-In to early practices that initially made GM a role model for industrial America. It followed those practices until market shifts dramatically reduced returns, making them more anchor than oar. Yet it continued to follow them for the next 25 years, making the company less likely to succeed year by year.

The pull of Lock-In is dramatic. Hierarchy and culture are designed to reinforce what made the business initially successful. But it is certain that given time, the initial conditions which made the Success Formula so valuable will change. Then, the returns will decline. If the business keeps doing more of the same, working harder, better, faster and trying to cut costs, it will eventually fail. Even if it is the largest, most successful, most profitable, and highest paying auto company of all time.

The GM lessons are clear. All companies need to pay close attention to the dismal example GM set, adhering firmly to practices that first helped it succeed and then led to its destruction. The solution for GM would have been to use scenario planning to find new opportunities, then follow those scenarios to enter new businesses and improve their connection with customers. GM needed to obsess about competitors so that opportunities weren't left open for the taking, new products weren't ignored and market shifts would be detected early. GM needed to implement Disruptions that set a new course for the business, and caused both management and employees to seek new solutions. And GM needed to keep White Space projects alive, funded and closely monitored to help chart a course through fast shifting markets toward a business which is growing, profitable and exciting to work in.

What will your company do? Will you follow GM – or become a leader in innovation and growth year after year?

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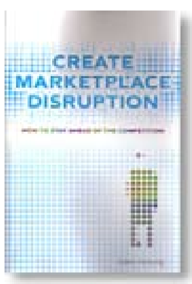

Adam's recently published book, Create Marketplace Disruption: How to Stay Ahead of the Competition (Financial Times Press, 2008), helps leaders and managers create evergreen organizations that produce above-average returns.