Daily Journal
LOS ANGELES
www.dailyjournal.com

MONDAY, AUGUST 2, 2010

PERSPECTIVE

Somebody Tell Them the Party's Over

By Jonathan Michaels

For a nation founded on innovation and deeply rooted in the entrepreneurial spirit, one has to wonder how they got it so wrong for so long. The Big 3 that is, now recognized by their new name, the Detroit 3. It is an odd paradox in a way, but just mentioning the names GM, Ford and Chrysler conjure a vast array of thoughts and emotions. Is it Henry Ford's invention of the assembly line? Is it the enormous pride that one exhumed in the 1950s when the family got its first Cadillac? Or is it the long, slow slide the Detroit 3 have endured over the past several decades from world domination to accepted irrelevance?

Looking at the Detroit 3 today, it is hard to imagine that when Bruce Jenner carried the United States to victory in the 1976 Olympics, 86 percent of all new cars sold in the United States were from the Detroit 3. Today, that number has been cut in half, replaced by companies that are leaner, better able to adapt, and better managed. Natural selection has taken over, leaving the once impenetrable stumbling toward extinction.

What is more disturbing than the situation they are in is how they got there. As the Detroit 3 were slipping into the abyss, those in command were celebrating glory days gone by, giving each other "attaboys" on a job well-done and passing out undeserved paychecks. Consider this. In 2008 — the year before the Detroit 3 flew to Washington D.C. in their private jets, looking for handouts — GM paid its CEO Rick Wagoner $14.9 million in compensation. His accomplishment? Presiding over a company who had just posted a three-year loss of $82 billion and whose market share had dwindled to a mere 19 percent.

Associated Press

An American flag flies in front of the General Motors Headquarters in Detroit, Mich.

Now, the country has given GM and Chrysler over $85 billion of taxpayer money to help them escape their self-created mess. For those wanting to keep score, that is $52 billion to GM, $15.5 billion to the privately-owned Chrysler, $15 million to GMAC and Chrysler Financial, and $5 billion to GM and Chrysler suppliers. So, the future of these companies has turned from an issue of national pride to one of genuine concern, as one wonders whether the United States will ever see a return on this enormous outlay of capital.

The answer to this question, and to a large extent the question of whether Ford can also be saved, hinges on whether the Detroit 3 will wake up from their decades-long slumber, and begin to actually compete in the new marketplace. To be sure, the Detroit 3 have turnaround plans. But, this is nothing new, and no one should be fooled or surprised when Turnaround Plan 2.0 is just as unsuccessful as the many plans that have come before it.

Some of the prior "sure-fire" turnaround plans that have been laid to rest: In 1979, Chrysler took a $1.5 billion handout from the government under the Chrysler Corporation Loan Guarantee Act. It was seeking to salvage its market share that had declined to a mere 11 percent. Yet, after implementation of the plan, its market share continued to decline, and today is only 8 percent. In 1985, GM rolled out its "Customer Satisfaction" turnaround plan that was sure to save it from continued market erosion. GM's market share at the time, 40 percent. Its market share today, 19 percent.

Even as recently as five years ago, the Detroit 3 had "new" turnaround plans that were sure to fix the damaged brands. In 2005, Ford rolled out the "Way Forward

Jonathan Michaels is the founding member of Michaels Law Group, in Newport Beach. The firm specializes in representing clients in the automotive industry. He can be reached at jmichaels@michaelslawgroup.com or (949) 581-6900.

Plan," in what it called "a historic moment for the company," where it committed itself to reinventing the Mercury brand and building cars that people wanted to buy. Five years later, Ford announced that it was eliminating Mercury and that its market share was down to 15 percent. In 2005, GM introduced its plan, called the Four Point Turnaround Plan, where it committed to strengthening its current brands and aggressively targeting key markets. Five years later, GM terminated three of its brands, Hummer, Saturn and Pontiac, and was surpassed by Toyota as the world's largest manufacturer — a title it held for nearly a century.

So, can the Detroit 3 escape the morass and return to world domination...or at least remain viable? Not likely if it is business as usual. At GM, Rick Wagoner was replaced by Ed Whitacre who has been making a variety of cuts. But, are those changes enough? Not according to one GM market executive who had the following to say: "The removal of managers and executives so far has been mainly at lower levels, thinning ranks and taking out layers. It's not replacing people who made the mess and created the culture."

Similar problems can be seen with how the Detroit 3 are approaching their product lineup and distribution systems. Take the following example: Lexus, a brand that was only introduced during the first George Bush presidency, outsells Cadillac by a margin of 2 to 1. But, what's even more surprising is the way it does it. Cadillac sells through a dealer network of 1,316 dealers; Lexus does it with 230.

Upon exiting bankruptcy last year, GM announced that part of its turnaround plan was to have Cadillac emulate the Lexus model, stating that it was looking to close 922 Cadillac showrooms and build a new sales and service network centered around urban coastal regions. However, only months into the plan, GM abandoned the effort, agreeing to keep the same Cadillac network that we have come to know.

If the Cadillac situation appears bad, GM's other brands are actually worse. Take Buick for instance, which has a dealer network of 2,369 showrooms, and which considers itself a competitor to Honda. The average Honda dealer in the United States sells 1,013 new Hondas a year. The average Buick dealer sells only 41. That is 41 new Buicks per year.

GM is not alone in its brand struggles. Ford, whose CEO Alan Mulally was famously quoted as saying that his Lexus LS430 was the "finest car in the world," is in an equally precarious position. Ford claims that the elimination of the Mercury brand will enable it to focus more clearly on its older sibling, Lincoln. Yet, one has to question whether the Lincoln dealers can survive without Mercury. Until now, most of the 1,221 Lincoln dealers have been paired with Mercury franchises, and Mercurys have been responsible for about half of the dealers' sales. Now, with that sales volume gone, the dealers will have to meet their same debt burden, yet with a substantially reduced revenue base - and these are dealers who were barely viable with the Mercury franchises.

As bad as it sounds, all hope is not lost, as the Ford, Chevrolet and Dodge nameplates still enjoy healthy sales. The United States buys about 1.4 million Fords every year, 1.3 million Chevrolets and 500,000 Dodges. These are very respectable numbers, considering that Toyota, the U.S. market leader, sells 1.5 million units. The problem is not that the Detroit 3 cannot build cars; it's that they can no longer support the multi-branded lineup that they enjoyed in years past. A Chevrolet-Cadillac-GMC-Buick lineup diverts precious resources away from what is viable and contributes them to endeavors that are not.

As one who spends a significant amount of time representing dealers in manufacturer-related litigation, it is painful to suggest that the Detroit 3 need to do considerably more to remain viable. But, this is a situation that has been 30 years in the making, and one which is now inescapable. If drastic measures are not taken now, there may not be another opportunity. As Albert Einstein said, "We can't solve problems by using the same kind of thinking we use when we created them."