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Management Paper #3:

General Motors' 2009 Bankruptcy

General Motors (GM) is an American automotive company that was founded in 1908 by William C. Durant. It is headquartered in Detroit, Michigan, and it includes the brands Chevrolet (Chevy), Buick, GMC, and Cadillac. As of the end of 2020, General Motors employs 155,000 employees worldwide, sold 6,829,000 vehicles (in 2020), and had an annual revenue of $122.5 billion. GM is the largest employer in Michigan and has more than 4,200 car dealers in the United States. Since 2011, GM has invested more than $31 billion in U.S. facilities.

Despite its recent economic success, General Motors did not always flourish. Starting in 2005, GM stopped making a profit. From 2005 through 2009, GM lost over $90 billion. Finally, following the beginning of the Great Recession, GM filed for bankruptcy in 2009.

1) There are always multiple reasons a company has to file for bankruptcy. What were the top two reasons the company you selected had to file bankruptcy?

[1] The main reason General Motors had to file for bankruptcy was its lack of profit for a period of four years. Profit is measured "using the income statement. The income statement simply takes what you sold in a period and subtracts the costs in the business during the same period. If sales are greater than costs or expenses then there is profit. If sales are less than costs then there is a loss" (Berman and Knight).

The difficulty GM encountered involved its union contract (with UAW or United Auto Workers). When its sales started to decrease in 2005, it was not able to effectively cut costs due to the large number of fixed costs it incurred from this contract. It could not use layoffs to alleviate manufacturing expenses. "Closing a plant, for example, did not necessarily mean the workers lost their jobs. Company pensions and legacy health care costs were fixed as well. So when sales went down, many costs stayed fairly constant. And that led to losses." (Berman and Knight) Eventually, these losses became so excessive that, despite billions of dollars of government support, General Motors had to declare bankruptcy.

[2] Although not the main reason, a strong factor in the bankruptcy of General Motors was the Great Recession of 2008. It was, as they say, one more nail in the coffin. The Great Recession is often considered to be one of the worst economic downturns since the Great Depression of the 1930s. While many industries struggled, the auto industry was hit especially hard.

"Annual vehicle sales in 2009 had fallen to a staggering 10 million, a harrowing plunge for a market that had peaked above 17 million in prior years." (DeBord) After its own bankruptcy, Chrysler was merged with Fiat in a desperate rescue attempt by the Fiat CEO Sergio Marchionne. In order to avoid restructuring, Ford had to mortgage the company to raise $24 billion and its stock value fell below $2 a share. GM, already suffering losses, ended 2008 with $30.9 billion in debt.

2) What actions did Senior Management take to avoid bankruptcy?

As mentioned previously, GM had an ongoing contract with the UAW union. This contract ultimately made it difficult for GM to make the cuts necessary to avoid bankruptcy. However, in the years leading up to their bankruptcy, GM had made renegotiations with the Union in an effort to alleviate fixed costs. In addition to reducing its workforce by 143,000 employees, it was also able to "cut in half hourly pay for new employees and significantly scaled back the traditional retiree benefit packages that had been crippling the company, while also funding over $100 billion in unfunded retiree obligations". (Bigman)

In my opinion, however, GM's most ingenious move came after the point of no return. After the company realized that it couldn't financially avoid bankruptcy, it came up with the strategy that would ultimately save it. GM devised a plan to split into two separate entities - the "OldCo" and the "NewCo" - before filing for bankruptcy. The NewCo was a new company free of debt that would take on GM's best brands and operations The OldCo was the leftover part of the company that contained most of the liabilities. "All of the operational restructuring to make the new company profitable would also occur before a bankruptcy filing so GM could go through bankruptcy in a matter of days--not months or years." (Bigman)

In order to make this plan feasible and lasting, the company had to complete certain tasks. First, it needed an agreement with both the U.S. government and its board to put efforts behind the NewCo plan. Second, it had to get $40 billion to $50 billion in government funding. Third, it had to decide which brands to take into the NewCo and which to let go of. It chose to take Chevrolet, Cadillac, GMC, and Buick and to give up Hummer, Saturn, Saab, and Pontiac (although GM did bring back the Hummer in 2021 under the GMC brand). Finally, it had to choose a new CEO (Vice President Frederick Henderson took over from G. Richard Wagoner).

"On June 1, 2009, General Motors filed for bankruptcy in New York, with $82 billion in assets and $173 billion in liabilities. It was the largest industrial bankruptcy in history… New GM exited bankruptcy protection on July 10, 2009 - in a mere 40 days, as designed." (Bigman)

3) What were the major management actions you think their Senior Management should have taken to avoid bankruptcy?

With declining sales, an expensive union contract, and the effect of the Great Recession on the auto industry, I am not sure there was much GM could have done in the short run to avoid bankruptcy. To its credit, GM navigated the bankruptcy process expertly and actually came out of it as a stronger, more productive company.

In the long run, if GM would have reevaluated its business model, it might have been able to recover without resorting to bankruptcy. When GM was restructured into the New GM (NewCo), it cut Hummer, Saturn, Saab, and Pontiac from its brands. If these brands were considered enough of a liability to give up, it seems likely they would have been unprofitable for a while before the restructuring. Why didn't GM consider cutting these brands, or at least decreasing their production, in the years leading up to 2009? They started seeing declining sales as early as 2005. Could GM not have redirected the employees (protected by the UAW) and the funding going into these nonlucrative brands into the more lucrative ones?

Another possible flaw in GM's business model was the company's culture. Before 2009, GM was organized around conflict; division heads had to battle for resources. This created a tension-filled environment and led to more competition than cooperation. Competition is fine in moderation, but for a company to survive, employees and management must have some common goals to work towards.

4) What are the three most important metrics you think Senior Management needs to focus on to avoid bankruptcies?

[1] Senior management should remain conservative. This means they should take only calculated risks and formulate a budget based on realistic goals and scenarios. Managers cannot afford to be overly optimistic all of the time. A company must have built-in contingencies. "Don't assume every customer is going to pay. Don't assume every customer is going to stay." (Chernich).

[2] Senior management should prioritize debt repayment. Companies should try to avoid taking out loans, but if this cannot be avoided, companies should create a strategy for debt repayment. This entails prioritizing secured debt (e.g. a loan secured by a piece of equipment) and high-interest debt while bypassing unsecured debt (e.g. credit card debt).

[3] Senior management should eliminate unnecessary expenses. When checking bank and credit statements, management should look for costs that can be cut without hurting company efficiency. For example, check recurring charges. Is there something that is no longer needed? No longer being used? Senior management should ask themselves what items cost more than they are worth to the company.

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