The Rise and Fall of the American Auto Industry: A Brief History

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It was the grandfather of my late uncle, a successful owner of a Detroit printing business in the late 1800s, that told the story of a young neighbor man who came to his door one night to ask if he could use his old woodshed to build a "quadacycle." Since the older man had recently converted his furnace to use coal instead of wood, the small brick building was sitting empty, except for a few garden tools. Probably out of a combination of neighborliness and curiosity, the request to use the brick shed was granted.

At first, the quadacycle, like an ordinary bicycle, was powered by peddles. But this was just to be the frame for the invention that the young man intended to build. Partially because of the unusual noise, everyone in the neighborhood knew that the young man had been working on a device he call an "internal combustion engine" that would be used to power his quadacycle.

The doors on the brick shed were relatively narrow. By the time the young man equipped the quadacycle with his new internal combustion engine, the entire rig had become too cumbersome to disassemble and move though the small door. Hence, he requested permission to widen one of the doors so that the new vehicle could easily enter and exit. This request was also granted.

Every night after working a full day at one of Edison Electric's numerous Detroit power stations, the young man would refine his invention by driving up and down West Grand Boulevard in the swanky Detroit neighborhood. In 1903, the young man quit his job at Edison to form a company to manufacture quadacycles for anyone interested in a "horseless carriage." Even the casual observer of the history of automobiles probably knows that the young man's name was Henry Ford.

In the early twentieth century, automobiles companies were popping up everywhere in both the United States and Europe. Indianapolis was the center of the fledging industry, and the number of automotive firms that were forming numbered in the hundreds. After some considerable ups and downs, both conceptually and financially, Henry Ford began manufacturing the Model T in 1908. This inexpensive car would soon give Detroit the nickname of the Motor City. Although numerous automobile companies were formed in Indiana, the combination of mergers and bankruptcies in the Great Depression would eliminate most of them. Even the South Bend firm of Studebaker would eventually fall victim to competition from the Michigan firms that would one day pick up the tagline of the Big Three.

In Flint, Michigan, William C. Durant created an automobile holding company in 1908 that he called General Motors, which initially owned only the brand name of Buick. Durant was one of the original "wheeler-dealers," and soon gobbled up other companies such as Cadillac, Oldsmobile, Oakland (later called Pontiac), as well as the Rapid Motor Vehicle Company, which would eventually become GMC Truck. Not unlike flimflammers of today, Durant overleveraged the company, and an
unexpected slump in car sales resulted in the banks seizing controls of the fledgling General Motors Corporation in 1910.

Durant was undaunted. With Louis Chevrolet, he formed the very successful Chevrolet Motor Company, and secretly began acquiring stock in General Motors. Although he regained control of General Motors and merged Chevrolet into the new enterprise, another slump in automobile sales combined with overleveraging would again cost him control of the company.

The savior of the company turned out to be a well established gun powder and chemical company by the name of DuPont. Initially, Pierre du Pont sat on the company's board, but was asked to take over as the firm's president in order to get the company back on track. Since the du Pont family now had well over 100 years of experience managing business enterprises, it is not a surprise that the du Pont family leadership was able to form the foundation of the world's largest automobile company in only a few years. Although Pierre du Pont remained chairman of the General Motors board until 1929, he installed the legendary Alfred P. Sloan as president in 1923. The du Ponts remained instrumental in the guidance of General Motors until anti-trust forced the DuPont Company to divest in the early 1960s.

Under the guidance of Alfred P. Sloan, the company expanded worldwide, and made numerous acquisitions of firms that made automotive components, as well as Electro-Motive diesel engines and even Frigidaire kitchen appliances. Sloan also assimilated the dramatic shift in automotive labor when the United Auto Workers was recognized in 1937. Despite the success of the Ford Motor Company's Model A and the shakeup of the Great Depression, General Motors was soon to emerge as the leading manufacturer of automobiles.

In the Second World War, Ford, GM and Chrysler and the American automobile industry played a pivotal role in helping the United States and its allies to achieve victory. Even the Japanese could not believe that the American automobile industry could, in a matter of months, begin manufacturing trucks, airplanes, and tanks in phenomenal quantities.

Since no domestic cars were built during the war years, the post-war car market was bound to be very good. The New Deal had resulted in thousand of miles of new roads being built, and Americans began to travel more and more by car. Since the rest of the world had been devastated by war, the Untied States would enjoy about 20 years where the term "foreign" competition would not have to be taken seriously. William Edwards Deming, who had been credited with numerous improvements in quality control and production technology during the war, found himself largely ignored by the Big Three. Post-war demand for automobiles was skyrocketing, and formal systems for improving quality just didn't seem to be important. Deming's migration to Japan, where he found and eager audience, would one day come back to haunt and plague the American auto industry for years to come.

In 1949, a newly designed Ford would turn the heads of the motoring public. Although there was still a flat-head V-8 under the hood, the newly designed body style created a revolution in automotive design. General Motors and Chrysler also began hiring the top auto designers of the world. Thus began an annual competition among the Big Three to introduce updated designs that tapped into the concept of fashion. By the late 1950s, there was such a fever over the new designs that new models
were often shipped with plastic covers. Dealers hid their cars for the public until "showroom day." Beginning in September, each of the new models would be introduced. In every showroom, there was coffee and doughnuts, as well as four color literature announcing the new features of every model. The showrooms were jammed with new customers eager to get a glimpse of what innovations the new model year had brought. In the automobile business, these were exciting times.

In general, the exterior appearance of most cars changed dramatically about every three years. The "off" years usually saw minor changes in grills, taillights, and other trim. The goal was to provide an annual "new look" but make the dies last long enough to redesign and retool for another major change. This practice continued until the early 1970s, when General Motors announced a major layoff at the GM Technical Center stating that the company would now deemphasize the concept of annual change. In fact, GM would eventually stretch some body designs into lasting for as long as twelve years. Since cars were still selling very well in the late 1970s, the move seemed to be correct.

In the 1950s, car production was fairly simple. Engines and transmissions were mounted on frames, and bodies were dropped on each unit. Fenders, hoods, and bumpers were mounted. The cars were driven on to car carriers, and were shipped all over the country. To save transportation costs, auto plants sprung up in places such as Georgia, Missouri, and California. Regardless of the brand, the manufacturing costs for all of these cars turned out to be fairly low because of the simplicity. General Motors made about three cars beginning with the Chevrolet, which they dressed up to be a low-end Pontiac, Oldsmobile, and Buick. A larger version was added, which they called a Buick Roadmaster and an Oldsmobile 98. The luxury car, built on a completely separate frame, with a super-large engine, was the Cadillac, and the name became symbol of automotive prestige. Parts were simple. Components were simple. Assembly was simple. All cars were rear wheel drive. Except for shifting chromium rocker panels and trim, everything in the industry was simple. With demand constantly expanding, who could ask for anything more?

The so-called compact car concept can probably be credited to George Romney's Nash Rambler, which carved out the first market niche for American economy cars. In 1960, General Motors bowed to the up-and-coming success of the Rambler and the German Volkswagen, and introduced the first rear engine car in the company's history. Unfortunately, the Corvair was introduced long before all of the components and assemblies could be thoroughly tested, and the car was plagued with mechanical problems from the very beginning. The engines were not properly cooled, and even slight overheating resulted in the cylinder heads warping. However, the buying public in the early 1960s was quite forgiving of mechanical problems IF the design of the car was what they wanted. There were also no high-quality alternatives, given that the quality levels of all of the Big Three were perceived to be similar. Indeed, appearance was often more important than function. Furthermore, the mentality of the day was that cars should be traded every three years or so, and that any problems would soon belong to someone else. For the Corvair, a best-selling book by Ralph Nader exposed a critical design flaw in the rear suspension that would cause the car to flip over under somewhat minor stress. By the time the problem was corrected in the 1964 model year, the car's reputation was tarnished beyond repair.

The post-war period also saw an attempt by an outsider to enter the industry. Henry J. Kaiser, who had made millions building warships, formed a company called Kaiser-Fraser, and manufactured cars at Willow Run beginning in 1946. Although the Kaiser Aluminum Company, also formed in 1946,
was successful and could feed cash to prop up the marginal automobile venture, production was
discounted in 1955 with little fanfare. The 1950s also claimed victims with venerable names like
Hudson and Packard. The end of the 1950s and early 1960s also witnessed the decline and eventual
extinction of Studebaker. As the survivors, The Big Three were beginning to feel that they could stay
ahead of almost any new challenger that might come their way.

Granted, 1958 was also the year that Ford introduced the Edsel. Although often sited as one of the
major flops in automotive history, the car was actually built on a Ford body shell and probably cost
more money to market than to build. The total loss was estimated to be $350 million, a drop in the
bucket by today's standards. The buying public balked at the "horse collar" front grill, but the upscale
customers, who often ordered cars with automatic transmissions, balked at the poorly-designed
pushbutton transmission that some said was almost impossible to repair. Some people who
remember the car still believe that it was the push-button transmission that may have been the car's
heretofore unrecognized downfall.

An important lesson learned from the Edsel was that automotive design could make or break the sales
for just about any car. Although this lesson would be forgiven in less than three decades, for the
1960s, it drove the introduction of a new generation of compact cars for each of the Big Three. Even
the full sized models for Fords and Chevys became smaller and sleeker.

To the delight of the automakers, the baby boomer generation fell in love with cars. The culture of
popular music also featured "Top 40" hits that praised Corvette Stingrays, GTOs, Chevrolet 409s, and
of course, Cadillacs. The culture and the marketing became intertwined to the point that no kind of
advertising budget would ever be able to match it. Some say the auto industry was floating on
cultural air.

And then there was the Mustang. Lee Iacocca's leadership a Ford brought forth a new generation of
inexpensive sports cars, which spawned competitive models like GM's Camero and AMC's Javelin.
Although these cars were new from the ground up, the standard cars were given a strong sports
appeal by adding massive engines. Hence, the term "muscle car" came to mean a regular Ford,
Chevy, or Plymouth with high compression engines producing as much as 400 horsepower. The
Dodge Charger, the Oldsmobile 442, and the Pontiac GTO were typical entries in his field. For the
manufactures, these high priced versions of otherwise standard cars were highly profitable. And of
course, the baby boomers loved them. At about $4,000, a GTO was still affordable, even by today's
standards.

In the mid-1960s, the auto industry also took little note of a small motor bike that was starting to find
its way into the American market from a company that no one knew called Honda. The 47cc Honda
50 motor bike got excellent gas mileage, but unlike the larger and bulkier American made motor
cycles, was far more reliable and could go for hundreds of miles with little or no repair. A hit song
by the Hondels helped to immortalize the Honda name. Indeed, 60 million Honda 50 bikes have been
sold worldwide for over the past 50 years.

In the early 1970s, the Japanese decided to capitalize on their franchise for quality and set up their
motor bike dealers to sell a four wheel automotive version of the Honda which they called the Civic.
When the cars first appeared in July of 1972, many people laughed, although they also knew that the
car would probably be very economical and very reliable. The new entry into the American market began selling rapidly, and the company immediately started upgrading the car in terms of size, features, and model offerings almost from the beginning. Not to be left behind, Toyota, which had primarily sold cars only in the California-Oregon market, now started selling to the entire nation as well. Other manufacturers, like Datsun and Subaru, followed close behind. From a business standpoint, the Japanese brands sold as fast as they could be delivered to the dealers. The Japanese became very profitable, and nearly all the firms began accumulating huge war chests of cash which they used for product improvement and more research and development.

Initially, this new competitive challenge to the dominance of the Big Three was not given much consideration. Although General Motors once had well over 60% of the market on a percentage basis, the rapidly expanding market resulted in the number of units sold by GM continuing to climb, even though the market share was falling. All of the European and Japanese cars were imported, and were not as cheap as many of the lower end domestic models. The American climate, especially in northern states where salt is used extensively, caused the vehicles to rust profusely. The manufacturers left the dealers with only a slim margin, and many potential customers were put off by the unwillingness of the salespeople to grant even minor discounts from sticker price. However, brand leaders like Honda and Toyota were undaunted, since many dealerships were able to sell every car that the company could deliver. In fact, it would be well into the 1990s before the supply of cars would eventually catch up with demand to the point that these dealers would actually have a selection of cars on their lots.

Beginning in the 1980s, the Japanese auto manufacturers encountered another problem that was at least in part the result of their own success. The Japanese currency, the Yen, was starting to rapidly escalate in value. In the space of a few short years, the import price for cars sold in the United States had doubled for no other reason that escalation of the value of the currency. Despite cries from Japanese activists that Honda and Toyota were exporting their jobs to the Untied States, these firms began building massive production facilities in places like Ohio, Tennessee, Alabama, and Mississippi. Needless to say, this migration continues to this day.

For General Motors, attempts to launch new models to meet market demand turned out to be half-baked. The energy crunch of 1980 made the infamous General Motors X cars the hot sellers of the day. Unfortunately, like the Corvair from twenty years earlier, the engineering process was rushed, and resulting cars were marginal in quality. The economical 1984 Pontiac Fiero sports car came to the market just in time for the oil crisis to subside, and the decision to equip the vehicle with a larger engine resulted in fires which destroyed the car. Sales fell precipitously, and production was ended in 1988 when only 26,000 units were sold.

On a more successful note, the 1985 Saturn was a quality vehicle originally built in a plant completely separate from all other GM operations. Although it was one of the few brands ever launched that actually took market share away from Japanese competitors, the market for small cars was then fading, and the brand never gained traction in the marketplace. Unlike other GM cars which shared sheet metal and other components, Saturn could not harvest the corporate cost advantage. To make matters worse, GM insisted that each dealership be a stand-alone unit away from what was often the owner's other GM dealership. Hence, the age-old marketing strategy of selling the younger
people low margin small cars and moving them up to high margin big cars in later years could not play out. GM now plans to sell or terminate the Saturn division by 2011.

Lurking in the background for the Big Three was the problem of the creeping dominance of the United Auto Workers. In defense of the union movement, even the most cynical pundits of today are forced to admit that it was the American unions that created the middle class as we now know it. In fact, the industrialization of this country was probably aided by unions forcing management to recognize the value to the men and women who build our products. They also were instrumental in raising safety standards and improving working conditions. The unions of the 1950s and 1960s were far more militant, and numerous days were lost to strikes. Today, the majority of labor and management problems are solved by mutual cooperation, and strikes are rare. Also, the percentage of manufacturing workers represented by unions has steadily declined for the last fifty years. Because of enlightened management, the workers in many firms feel that union representation is unnecessary. In the case of Japanese firms, managers at all levels are expected to treat every employee with respect. Furthermore, with a couple of exceptions, the Japanese plants are non-union.

It was in the late 1950s and up through the 1970s that turned the tide of the UAW against the Big Three. Auto plants are especially capital intensive, and shutting down for even a few minutes can be very costly. Hence, extensive strikes, even in the 1960s, could cost General Motors billions of dollars. Although auto workers were well paid in the 1950s, their pay was not considered by many observers to be out of line with the wages of other unions or other professions. Many industries were expanding, but others like the railroads had peaked out. The auto industry, in part spurred on the urban sprawl and the completion of many sections of the interstate highway system, grew faster than most. The high profits for the auto companies made them easy targets for the UAW. The union management knew that plant managers could not afford to shut down their plants for very long, and that the American love affair with the Automobile would allow the additional costs to be passed along in the form of higher and higher prices. The concept of "pattern bargaining" emerged that allowed the UAW to strike one of the auto companies, secure a contract, and then demand a similar contract from the other two firms. Not only did wages escalate to very high levels, the union dreamed up new benefit packages which included things like eye care and dental care.

Perhaps the most costly side benefit of all was sometimes called the Supplemental Unemployment Benefit Fund, also known as the SUB fund, which required the auto firms to place an extensive amount of money in a fund that the union would use to pay unemployment benefits to laid-off auto works that would bring them to within 95% of their regular pay for six months, and up to 70% for another six months. Under these circumstances, a layoff was greeted with joy, and was treated like a paid vacation. Another concept, the "Jobs Bank," calls for workers to punch in at a given plant location and sit in a vacant room for an entire day working crossword puzzles or reading books, even though they are still receiving their usual pay. At some locations, this can amount to as many as a hundred workers sitting around at full pay doing nothing until some type of job eventually becomes available, if then.

Besides avoiding strikes, part of the reason for these kinds of concessions was caused by the shrinkage of the size of the automotive workforce itself. The UAW lost almost 500,000 jobs in the late 1970s and early 1980s, partially because of the recession but more importantly because of automation and outsourcing. The labor contracts shifted from the goal of raising pay and benefits to
a new objective of saving jobs, even if it turned out to be paying people to not work. Hence, the union hoped to stem the tide of job losses by making outsourcing and automation very costly. Obviously, it didn't work.

Hindsight is always easy. In retrospect, some observers blame the auto industry executives for granting these kinds of concessions, knowing full well that they were paving the way for competitors such as Honda and Toyota to make inroads on cost competitiveness. Others note that the top executives that were making these concessions were often close to retirement, and were more concerned with avoiding a strike and just getting some kind of agreement signed. The bill for these concessions would not come due until after their retirement, and would then be someone else's problem.

Legacy costs, as we now call them, were starting to pile up. The same context of "kicking the proverbial can down the road" should be attached to the concept of the "buy-out." Prior to the 1970s, most people expected to work to a usual retirement age, such as 62 or 65. At that time, they would receive a pension, and in many industries like automotive, a continuation of their medical benefits.

In 1973, when the first oil boycott sent auto sales down dramatically, the auto executives wanted to get as many auto workers off their books as possible. GM and the UAW negotiated what become know as the "thirty and out" program, under which workers could retire with full benefits after thirty years of service regardless of age along with a complete medical and dental insurance package. If the employee started work directly after high school at the age of eighteen, the program allowed a forty eight year old retired worker to search for another part or full time job knowing that the medical bills for his/her entire family would be covered. If they had already paid for their homes were frugal, the retirement pension was enough that no additional income was necessary.

In the early 1970s, health care benefits for a forty eight year old worker and his or her family would cost only a few hundred dollars. It is hard to tell if these executives could not see the coming escalation in medical costs or if they just thought that it would be a problem for future management to deal with. Needless to say, neither the pensions nor the medical costs were funded or managed by any type of outside management group, such as the TIAA-CREF pension fund enjoyed by many university employees. Indeed, all of these costs would have to be paid by then-current revenue from the firm. At the time, this did not seem to be cause for concern, given that General Motors was still the largest company in the world.

Many years later, the world had changed. Demographically, people began to live longer, and many of those people that took the "thirty and out" offer 35 years ago are still living and still expecting their pensions and medical costs to be covered, just as they were promised. Today, the Big Three generally have about three retirees for every person working. All of these pensions and health care benefits must be paid from current revenues. The legacy imbalance is crushing, and even the union executives now says that they should have demanded some kind of a pension program be established and funded outside of the industry. But those union officials that did not demand external funding are also retired, leaving the current union managers to sort it out. Apparently, union officials also learned the art of kicking the can down the road.
Another legacy issue is quality, or rather, the lack of sufficient quality to meet the demand of the marketplace. Once the foreign nameplates began to cut significantly into the Big Three because of the demand for better quality, the concept of quality improvement took on a whole new meaning. Of course, lip service was always paid to quality, dating all the way back to the Model T. But when push came to shove, quality took a back seat to getting the cars out the door right up to the late 1980s. Furthermore, quality was consistently inconsistent. The first cars of any production run were often very poor, because new people and new equipment had to be adjusted to the new model year. Absenteeism on Mondays and Fridays of regular work weeks resulted in untrained substitutes performing too many critical functions. As long as the car would run, it was not uncommon to ignore a major flaw and leave it for the dealer to figure out before the customer took delivery. The dealers did not object, because warranty work paid well.

There were many culprits of poor quality in the peak of the automotive boom. At the top of the list was the sourcing strategy of the auto firms themselves. Every contract for auto parts began with price. Granted, some consideration was given to the capability of the supplier to manufacture the product, and some consideration was given to their apparent attention to quality. Even to this day, the Big Three too often begin with the supplier who offers the lowest price, and follow up by trying to pressure them into delivering a high enough quality to meet their needs. In contrast, a Japanese or Korean manufacturer begins with the firm who offers the highest quality, works to improve the quality even more, and then works toward reducing the cost below the level paid for a similar component purchased by the Big Three. Furthermore, a Japanese firm brings a supplier on board with the intention to do business with them for the foreseeable future, providing that management is willing to constantly change, upgrade, and stay ahead of the competition. Although recessions are difficult times for everyone, they expect their suppliers to be profitable over the long term, and they will not consciously try to take that profitability away. They will drive some managers crazy turning their plants upside down looking for cost reductions, but as long as management grits their teeth and cooperates, the relationship will continue. If, after a thorough and exhausting investigation, the Japanese engineering team finds nothing, they thank their hosts cooperating, and go home. Their purpose was never to take away the firm's profitability or even worse, force them into bankruptcy. It goes without saying that they will also NEVER sacrifice quality for price.

However, most of the blame for poor quality must still be leveled at the upper management of the automotive firms themselves. When profitability began to slip in the 1980s, the practice of some of the firms was to call a mass meeting of all of their suppliers and announce that they were expected to submit plans for huge price reductions within 30-60 days-- or face termination. Having been threatened by the potential for bankruptcy, many firms complied, and hoped that they could somehow figure ways to survive. For several years, the strategy worked, and the auto executives congratulated themselves on having accomplished some significant cost savings. But unlike their Japanese counterparts, they were not managing their suppliers, they were bullying them. Although these same managers will not admit it, this hard-ball practice also resulted in exacerbating quality problems.

Thus began a period of consolidation of automobile parts suppliers which continues to this day. One supplier once quipped that the Big Three Auto companies will one day do business with the Big Three parts suppliers. However, those firms that got on board with the Japanese and Korean transplant companies early in the game are those that are best positioned to weather the storm.
In the early 1970s, a marketing executive for General Motors was quoted as saying that he felt that marketing had reached its apex as far as influence over the company. His caution, which turned out to be well-founded, was that he was not sure how long this level of influence could be maintained. Being a marketing person, he could probably see the storm that was coming. Within a few years, the auto industry which had once prided itself in tapping the imagination of the consumer had begun to systematically throw almost every principle of basic marketing out the window. The exception was advertising, which they thought could solve all or most of their problems.

Looking back at the heyday of the automobile industry, one marketing principle was the notion that for every model year there should be some kind of a new look, even if it only took the form of changing the grill and taillights. Granted, Volkswagen had built a franchise around keeping the same look year over year. However, this was not the American strategy, and the decision to eliminate style changes may have reduced production costs at the expense of sales.

A second marketing problem related to crowd-pleasing designs. Many cars that were introduced in the past were an instant success because everyone wanted one. The Chrysler Cordoba, the 1988 Lincoln Continental, and the Corvette Stingray are just a few examples. Somewhere along the way, test marketing for design may have been eliminated. However, a more likely scenario is that the test results were handed to the upper level auto executive who promptly threw them in the trash and proceeded to build what he or she thought the market would want. Lee Iococca and Robert Lutz were a couple of auto executives that possessed a gift of knowing what would sell. All the rest of the executives should have trusted their marketing research, or better yet, called for more.

The demand for better fuel economy also played a major role in automotive design. At highway speeds, gas mileage for any moving vehicle is heavily influenced by wind resistance or "drag." Automotive designers all over the world began using wind tunnels to test the efficiency of new designs. An unintended consequence of these aerodynamic tests was that all of the cars began to acquire virtually the same aerodynamic profile. There was little room left for the creativity which the designers had used for many years to distinguish one brand from another. The Detroit Three, who had built cars on a very few platforms in the 1950s and 1960s, tried to create new designs, but they tended to all come out looking the same. Hence, the term "cookie cutter" design was coined to denote customer frustration over distinguishing one brand from the next. Furthermore, some of these cars were built on completely separate platforms each of which cost millions or even billions to design and tool, even though the customers saw them as virtually identical cars.

For the past fifty years, marketing analysts have utilized a mathematical tool called a Markov chain analysis. It was primarily modified in the late 1960s to analyze brand switch behavior among customers of all types, including automotive customers. Although much has been written about this subject, it is sufficient to say that some automotive brand loyalty is actually passed on to succeeding generations. In Lansing, Michigan, there are families of people that only drove Oldsmobiles for 80 years-- until the brand was discontinued. Some General Motors managers had the audacity to believe that all or most of these people would robotically begin buying Buicks. While some loyal Olds customers did buy Buicks, they were forced into making a brand change decision for the first time in their lives.
Model names within brands also have significance, such as Bonneville, LeSabre, Lumina, Fury, and Thunderbird. All of these brands had a loyal following, and these owners were eventually forced into a brand switch mode. New names can be developed, but some buyers will have to see the brand for years before they will consider it as an option. Despite spending millions of dollars to show Tiger Woods driving a Buick Rendezvous, a potential new buyer will now have to roam the dealer lots and try to figure out what name the corporate people have picked to call the current version of ostensibly the same vehicle.

It almost goes without saying that the quality of American cars has improved tremendously in recent years. In fact, some brands are probably fully justified in claiming that they are now at the same quality level as their foreign nameplate competitors. However, the marginal improvements in quality that were evident in the 1980s were vastly overblown by the automotive advertising. One observer noted that a 10% improvement in quality was often accompanied by a 100% increase in advertising to tell you about the improvement.

Another culprit of the times came from the American financial system itself. Historically, large blocks of stock were held by members of the founding families, as well as a handful of institutional investors. Disgruntled investors would wage proxy fights to influence corporate policy or gain control of the company. In both good and bad times, stock ownership remained relatively constant.

However, the rise of managed pension funds, mutual funds, investment trusts, and other financial entities changed the landscape of corporate America. Most financial institutions had a policy maintaining a very broad portfolio, and not owning more than a small percentage of any one company. Seldom did these institutional investors look very far beyond the quarter-to-quarter performance of the stocks they were holding. Only on rare occasions did these money managers attempt to influence corporate policy. Instead, a bad quarterly report, unless otherwise explained, would cause the financial institute to simply dump the stock with little or no fanfare. The sale of a large holding would cause the stock to drop sharply, raising the attention of the rest of the investment community, and putting pressure on the CEO to rectify the situation. As the number of financial institutions grew, corporate America found itself increasingly trapped by a quarter-to-quarter mentality.

In the auto industry, the quarter-to-quarter mentality often resulted in production runs being shifted forward and backward in order to influence quarterly performance or sales results. Even though product quality might be at stake, this also resulted in decisions not to correct errors in materials, equipment, or product engineering because of the additional cost it would bring to the current quarterly statement. Indeed, the performance measurement for most managers at all levels in American industry became increasingly tied to quarterly performance. American managers are probably becoming very envious of their Japanese counterparts who are judged by longer term parameters.

In the 1990s, many Americans tried to stay loyal to the American nameplates. However, the domestic content of American cars continued to fall, and the foreign nameplates were actually the cars that could claim to have the most America content. Compounding the perception problem was the fact that altogether too many domestic brands in the 1980s and 1990s had significant engine and drive train problems that would always seem to occur just a few weeks after the end of the warranty
period. These problems may have been tolerated twenty or thirty years ago, but with many cars now costing as much as 40% of the value of the house and garage where the are parked, the consumer started listening to their friends and neighbors who drove other, more reliable brands. And the Markov brand switch? Once the change is made and the consumer is happy, it is almost impossible to get these consumers back in any significant numbers. Hence, many Honda and Toyota owners have become brand loyal, and will not even consider shifting back to a domestic nameplate.

No discussion of the woes of the auto industry would be complete without a discussion of financing. In the early days of the industry, there was no such thing as a standard automobile loan. Automobiles were considered luxuries, and could only be afforded by a few wealthy people. Henry Ford's Model T allowed less wealthy people to simply save enough money to buy a car. At its peak of popularity, a Model T sold for as little as $250.

Organized auto financing first appeared in the late 1920s, but was still not widely used or widely available to most people until the late 1940s. Typical contracts though local banks, Ford Motor Credit, or GMAC were for a maximum of three years, and typical interest rates were 6%. Since most cars in the early 1970s sold for under $4,000, the resulting payments were not excessive. Furthermore, the three year contract for many customers was consistent with the perceived life span of the car for people who preferred to have an up-to-date model. The value of the used car was usually sufficient for the down payment. And yes, down payments were always required.

As prices for cars escalated, the payments became harder and harder to make. The traditional 6% interest rates were gone. The finance companies began stretching contracts to five years and beyond. Finance charges began to vary with the creditworthiness of the borrower, and a new class of sub-prime auto loan customers evolved who were willing to pay very high rates of interest just to have transportation. The old concept of trading cars every three years was gone for most people, because the value of most cars at the three year point of a five year contract was less than the amount owed. Rolling the balance due into a new auto loan could sometimes be done, but often the customer did not notice that they were now being charged a higher rate of interest. Furthermore, the resulting payment was now starting to become very large, and defaults became more prevalent.

In the context of trading cars, another major cost factor relates to depreciation. One of the problems that put American Motors and Studebaker out of business was the fact that their cars had a much lower value on the used car market that their Big Three counterparts. The sticker prices for cars are set by the manufacturers, but values of used cars are set by the marketplace, usually though automobile auction houses all over the county. The widely-referenced NADA Blue Book as well as other reporting services try to estimate the value of these vehicles based on the stream of regular reports from these auction houses.

Throughout the 1960s and well into the 1980s, General Motors won the battle for used car valuation. Used Toyotas and Hondas rusted profusely, and resale values were low. Owning a car that was preferred by the used vehicle marketplace would usually mean that the total cost of ownership would be less, especially for customers who planned to trade frequently. For fleet buyers who may be turning several hundred cars per year, the cost of depreciation could amount to hundreds of thousands of dollars per year. For individuals, it could be the difference between buying or not buying a new car. Consumers began to learn that some cars brands were simply bad investments.
Needless to say, the domestic brands have been slipping in value for years, and the Japanese and Korean nameplates have been gaining. With the current woes of the domestic industry nameplates, these differences will become even more pronounced. But markets are markets, and short of asking the government to buy up large quantities of domestic used cars, there is little that can be done to reverse this trend.

According to recent reports, auto sales for the industry are now at a 27 year low. Since these numbers include the Japanese and Korean nameplates, the situation for the domestic firms is even worse. According to the latest congressional testimony, the automakers now perceive the 2009 auto/light truck market to be about 10.5 million units, down from 2008's abysmal 13.2 million units and 2007's less-than-stellar 16.2 million units. Not even the most pessimistic of forecasts predicted that auto sales would ever fall this low under almost any circumstances.

The basic reasons for these weak sales have been widely publicized. In addition to a serious crackdown on credit by nearly all of the financial institutions, record low consumer confidence continues to keep shoppers from the showrooms. Other potential consumers are in trouble with their home mortgages, which makes an automobile purchase out of the question. For customers who do have good credit, the threat of future unemployment causes potential buyers to be skittish. The only good news is that the lack of sales will create at least some pent-up demand that will eventually be unleashed, as long as the number of miles driven continues to hold at present levels. For people who continue to drive 20,000 miles per year, buying a new car cannot be put off forever. The question, of course, is when this will occur.

Will the domestic companies survive? This is difficult to predict, because this recession is just beginning. Chrysler has been forced into bankruptcy, partially because of the lack of brand acceptance in the marketplace, the absence of new vehicles in the pipeline, and the current unprecedented number of unsold units sitting on dealer lots. To make matters worse, Chrysler's parent company, Cerberus, refused to add funds to support the company, and has virtually agreed to relinquish its ownership. The impact of Chrysler's pending sale to Fiat is yet to be seen. The odds are rising that the company will quietly disappear into the annals of automotive history.

The General Motors bankruptcy is a slightly different situation. For one thing, it is a publicly held corporation, and is therefore subject to more scrutiny. It is also much larger, more diversified, and more spread out all over the world. Given that the Chevrolet division constitutes 61% of the firm's sales, the firm will probably be able to reorganize around a smaller number of Chevrolet vehicles and continue to operate as a smaller firm. However, the bankruptcy must successfully shake out all of the firm's legacy costs, the primarily pension obligations, and the corporate bonds. A major complication is that some of the bonds are presumed to be "secured" by the hard assets of the company, which could leave very little money for the other claimants if the bankruptcy court upholds the claims. The Obama administration is proposing an additional $30 billion to make it all happen. This is in addition to the $19 billion that GM has already received. Undoubtedly, even more money from Washington will be requested over the coming year.

Outside of Michigan and the rest of the auto belt, there is little or no sympathy for the fate of the American auto industry. Until recently, few people outside of the industry were aware of the
massive retirement, healthcare, 95% unemployment benefits, and "jobs bank" programs that were being afforded to the auto workers up until just a few months ago. American workers from all walks of life and from many industries resent the thought that they should somehow have to pay to bail out an industry that destroyed itself.

States like Washington endured hardship many times when sales for Boeing fell because of rising fuel prices or recessions, and there was never a massive federal program to bail the industry out. The collapse of oil prices in the 1980s put Texas, Louisiana, and Oklahoma into a recession, and again there was no massive federal program to bail the industry out.

The Ford family, which still controls the company, has resisted the temptation to take federal money. However, cost-cutting has proved to be effective, and the cash provided by the liquidation of assets seems to be supporting the company, at least for now. Both Ford and General Motors will, indeed, probably survive, but only after shaking out their legacy costs and reducing their product lines to match the 2009 markets.

Finally, it is interesting to look up Studebaker on the web. Indeed, the company never completely disappeared, but has metamorphosized into a privately-owned leasing firm. Even the Cord Automobile Company has a new owner. Some names will never die.

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Note: The analysis and opinions expressed in this article are those of the author and do not necessarily reflect the views of Grand Valley State University.

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