Case Studies on

US Automobile Industry

Edited by

Rajendar Singh Rathore

IBS Case Development Centre

IBSCDC

44, Nagarjuna Hills, Punjagutta, Hyderabad – 500082

IBSCDC
44, Nagarjuna Hills,
Punjagutta, Hyderabad – 500082
Andhra Pradesh, INDIA
Phone: 91 - 40 - 23435310/11, 23435393, Fax: 91 - 40 - 23430288
e-mail: ibscdc@ibscdc.org, support@ibscdc.org
Website: www.ibscdc.org

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Editorial Team: Shanul Jain and Deepa Verma

Visualiser and Designer: P. Damodara Siva Prasad

OVERVIEW

"The domestic auto industry is as healthy as it has ever been. The names on the plants are just changing."[1]

– Eric Noble, President of the auto industry consulting firm, Car Lab

The automobile industry has been considered as the main engine of industrial growth of the 20th century. It originated in Europe during the late 19th century. However, by the first half of the 20th century, the US completely dominated the global automobile industry through the invention of mass production technique. But, this market dominance could not be sustained for long as the western European countries and Japan became major producers and exporters of automobiles by the second half of the 20th century.

Though vehicles running on steam-power were produced earlier, the gasoline engine led to the origin of the automobile industry. The gasoline engine was developed and used in the automobile during the 1860s and 1870s, especially in France and Germany. Soon the British, Italian and American automobile manufacturers joined them. The automobile companies were small shops that produced few handmade cars. Out of these, only few survived while the remaining had to exit the market. The survivors were mainly from three categories – bicycle makers like Opel in Germany and Morris in Great Britian, builders of horse-drawn vehicles like Durant and Studebaker in the US and machinery manufacturers. The machinery manufacturers included marine engine manufacturers like Vauxhall of Britain, gas engine manufacturers like Daimler of Germany, sheep-shearing machinery manufacturer like Wolseley of Britain and woodworking and milling machinery manufacturers like Panhard and Levassor of France. However, Rolls-Royce of Britain and Ford of the US were exceptions with both the companies being founded as carmakers.

Though the European automobile industry ruled the world during the late 19th century, the revolution in the automobile manufacturing through the introduction of mass production method shifted the focus towards the US. Ford pioneered the assembly line mass production method that helped the car manufacturers enhance the production cycle as well as save on the costs. As a result, the price of the cars witnessed a steep decline. The price of Model T touring car fell from $850 in 1908 to $360 in 1916. If further fell to $290 in 1924. This faster and cost efficient manufacturing process made Ford the biggest manufacturer of vehicles in the world and accounted for 50% of the world's total production. Ford also hiked the salary of its employees to $5 a day for an

[1] "The Good News About America's Auto Industry", http://www.businessweek.com/magazine/content/06_07/b3971057.htm, February 13th 2006

8-hour shift compared to the prevailing industrial standards of $2.34 for a 9-hour shift. The success of Ford inspired many carmakers, which included Morris Motors of Britain. Soon players like Herbert Austin of Britain and André-Gustave Citroën and Louis Renault of France also came out with their low-priced cars in the 1920s, challenging the supremacy of Ford.

By the end of the World War I, Ford emerged as the dominant player in the global automobile industry and established its various production facilities across the world. The depression of 1921 transformed the American automobile industry with the dominating role being shifted to the Big Three – General Motors (GM), Ford and Chrysler. GM was established by William C Durant in 1908 and grew inorganically by acquiring various auto companies. In 1923, under the leadership of Alfred P Sloan, the company revamped its product line and soon became the largest US auto manufacturer. Chrysler was established in 1925 by Walter Chrysler and catered to all market segments under different price ranges. By 1929, the Big Three supplied three fourths of the motor vehicles in America. The number of automobile manufacturers in America also declined from 108 to 44 in less than 10 years. By 1939, the Big Three accounted for 90% of the total US automobile industry.

As the industry has grown significantly, a labour union – United Auto Workers (UAW) was founded in May 1935 in order to represent workers in the automobile manufacturing industry, However, initially the Big Three did not recognise them After a sit-down strike organised by the UAW, GM was forced to recognise the union in 1937. Soon, Ford and Chrysler too were forced to recognise the UAW as a representative of their employees. The World War II, however, halted car production and made them manufacture military related goods. After the war, the demand for cars too increased mostly due to the growing middle class segment. This encouraged the production volume for the carmakers, thereby offering them economies of scale. By 1950s, GM became the largest employer in the Western world and became the first US company to generate $1 billion a year. By 1960, GM enjoyed a 60% market share.

However, after the oil crises of the 1970s, the US automobile industry faced a major setback. With the OPEC nations cutting down the oil supply to the US, the oil prices increased by over 80% during 1973 and 1980. As the cars produced by the Big Three were not fuel efficient, the customers started looking for other carmakers. The US government's Clean Air Act of 1970 and Corporate Average Fuel Economy (CAFÉ) regulations of 1975 also enforced the carmakers to go for fuel efficient cars. This paved the way for the entry of Japanese automakers that were known for their lean production and total quality management techniques. They also enjoyed a cost advantage of $2,000 to $3,000 over the US counterparts as the Yen traded at a low rate. These foreign automakers were also offered investment incentives worth $500 million to $1 billion in the 1980s.

Apart from fuel efficiency, the low price and high quality of the cars attracted the Americans, who began shifting their loyalty to the Japanese carmakers. This rising demand increased the Japanese car imports that reached 1.5 million cars by 1978. The success of the imports encouraged the Japanese carmakers to set up their manufacturing facilities in the US. Honda established its production facility in 1982 followed by Nissan in 1983 and Toyota in 1984. Apart from Japanese, many European automakers too established their presence in the US. Korean automaker, Hyundai catered to the entry level car segment, while BMW and Mercedes served the luxury car segment.

By the end of 1980, the Japanese carmakers captured 30% of the US automobile market, resulting in a total combined loss of $4.2 billion for the Big Three. Chrysler was on a verge of bankruptcy and had to seek government assistance. To safeguard the interests of the US carmakers, the government also imposed Voluntary Export Restraints on Japanese imports. To improve their product quality, design and durability, the Big Three also invested $69 million in their R&D. However, they could not meet the high standards maintained by the Japanese manufacturers.

With the SUV craze in the US during the 1990s, the Big Three started capitalising on it and enjoyed a 90% market share. However, soon the Japanese carmakers forayed into the market and became successful with their quality models. This again brought down the profitability of the Big Three. The weak performance and continuing losses led to the acquisition of Chrysler by German automaker, Daimler-Benz to form DaimlerChrysler in 1998. Ford witnessed a loss of $5.1 billion in 2001 while GM witnessed a decline in its profits. The terrorist attack on the US on September 11th 2001 also added to the woes of the US carmakers as their sales plummeted.

As a result, the American carmakers were forced to increase their promotions and offer incentives. GM rolled out various campaigns and offered incentives like cash back schemes and interest free loans. They also began offering discounts up to $2,000 to $3,000 per vehicle. On the other hand, the Japanese carmakers enjoyed strong sales without any discount offerings. The Big Three resorted to downsizing their operations and layoffs in a bid to cut costs. The auto related jobs decreased by 21% during the period 2000 to 2004. GM alone planned to shut down 12 of its plants and lay off 30,000 of its employees by 2009, while Ford anticipates closure of 14 factories and 30,000 layoffs by 2012. Even Chrysler has plans of closing down 6 factories and laying off 45,000 employees. Despite the layoffs, the Big Three had to face the legacy costs such as the health care costs that were much higher than those of its foreign competitors.

Thus to regain their lost status, the Big Three began positioning themselves as 'American' so as to grab consumer loyalty and higher sales. However, Japanese carmakers like Toyota too followed suit and started projecting themselves as good American citizens and rolled out campaigns underscoring their contribution to the US economy. With most of the companies promoting themselves as American, it became very difficult for the consumers to differentiate between domestic and foreign carmakers, as foreign carmakers like Toyota established their own manufacturing facilities in the country employing US employees and American carmakers outsourced their manufacturing activities to low cost countries like China.

The US carmakers were also affected with the industry's plight – the credit crunch in the US, the declining consumer confidence, the rising petrol prices in mid-2008, the growing environmental and safety standards and the growing cost of raw materials. These factors had a major detrimental affect on the US carmakers, thereby forcing them to go for huge layoffs. Since 2005, the Big Three laid off over 150,000 employees. On the other hand, the Japanese carmakers have begun gaining a strong foothold in the US market. Toyota overtook GM and became the No. 1 selling auto brand in the US.

Though the Big Three have taken various cost cutting measures after much bargaining with the trade unions, it is unlikely that the carmakers will be able to come out of their spiralling costs and see a positive affect on their bottom line by 2010. It is also unlikely that the US carmakers will be in a position to fulfil the growing demand for fuel efficient cars by 2010.