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Diving Deep on Detroit's Deep Dive - Part II

As the sheets continue to be drawn from Detroit's various action plans and five-year futures, the lessons of thirty years' mismanagement spill forth unabated. Last month, we delved into several of the most salient factors but space constraints limited the scope of our analysis. We therefore present part two of our bullet-point analysis, delivered in the midst of re-org machinations from the perspective of an analyst all-too-familiar with the tired tropes of renewal platitudes.

Excessive debt lies at the root of all evil

Successful organizations can operate with budget deficits. Indeed, a certain amount of debt is needed in order to grow beyond the strictures of available capital. BMW was able to increase its manufacturing capacity in the mid-1960s through the acquisition of Glas, a small (but solvent and successful on relative terms) German vehicle manufacturer ideologically opposed to debt of any sort. Despite the fact that Glas' product was competitive, its conservative management strategy placed concrete limits on growth. An organization willing to take on reasonable debt loads may not have been swallowed and picked clean by a company more risk-positive.

Everything in life - and especially in an industry as complex as this - represents a compromise of some sort. Debt is necessary, but amassing

excessive debt based on questionable (or downright unrealistic) assumptions is dangerous. Detroit played fast and loose with credit, building itself an insurmountable pile of financial obligations while making few of the difficult decisions (e.g., increasing R&D budgets, standing up to labour demands, etc.) needed to bolster its revenue stream.

Predictably, Detroit ran out of cash - and upon doing so, more money was borrowed and more debts incurred. When the market collapsed, Chrysler and General Motors owed more money than they could generate quickly.

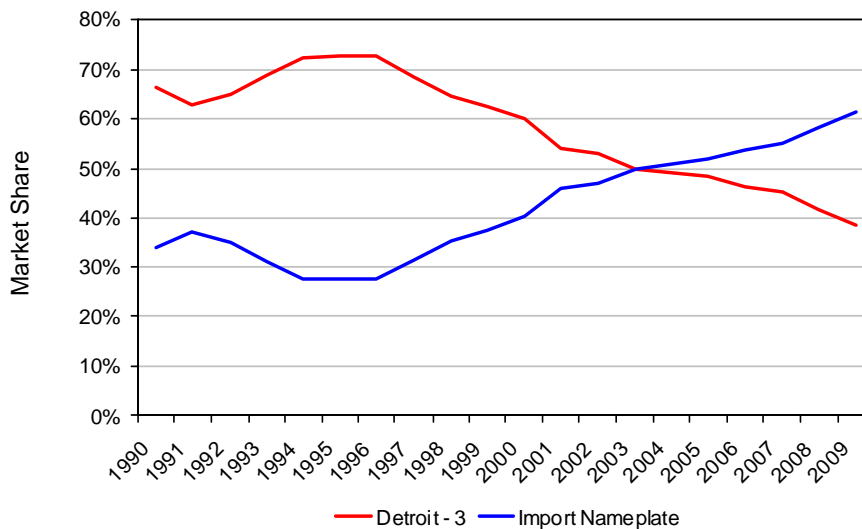
Lesson: Live within your means - take appropriate risks - make use of conservative assumptions. Never lever-up a cyclical business.

You can't escape your problems

Automakers the world over make use of certain hedging strategies to prop sales during slow periods. I have previously referred to these strategies as "safety valves," and for good reason; they exist to relieve financial pressure in crisis situations. The introduction and normalization of these devices for use in the course of regular business has had destructive and far-reaching effects. Consumer incentives, heavy fleet sales, leasing, extended model runs and dealer downloading each have the ability to

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Consumer Market – 1990 to 2009



Source: DesRosiers Automotive Consultants Inc, CVMA and AIAMC

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generate quick cash. When used together, they represent a powerful tool for crisis-avoidance.

They should never be used together.

They are the alcoholic's morning antacids, the battered wife's thick makeup and the diet Pepsi accompanying a fried chicken meal. They are the enabling factors that buoyed Detroit with sufficient energy to go about its daily business with a façade of normalcy. We knew of the shambolic situation concealed beneath but did little.

The very fact that these safety valves were being used in concert should have been warning enough.

Lesson: When the tide goes out, you discover who isn't wearing a bathing suit. If you have a serious problem, fix it!

Be careful what you ask for; you might get it!

The Detroit automakers have developed a reputation for employing short-term tactics where long-term strategy was (or is) needed. A representative example of this tendency - a bad habit whose fingerprints litter many of the past decades' decisions - exists in the American industry's 1980s lobbying efforts to force import-nameplate automakers onshore. Seeing themselves as burdened by direct labour costs, healthcare obligations and pension liabilities, Detroit wanted to level the playing field: "If only the import brands faced our issues, they wouldn't do as well."

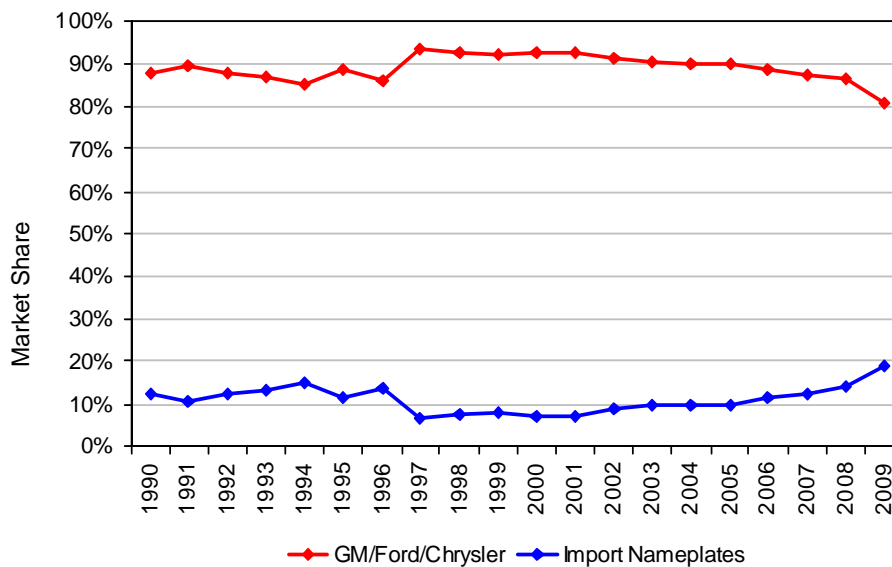
As a result of these efforts, European and Japanese brands established assembly plants in the United States, Canada and Mexico. Their growth was exponential and

Detroit's traditional market dominance was suddenly threatened, then toppled.

For the onshore production strategy pursued by Detroit's 1980s lobbyists to have worked, a number of shaky assumptions would need to have been borne out. Import-nameplate companies would have to have allowed unions to organize within their walls. Further, those same companies would have been required to demonstrate a remarkable degree of inflexibility, failing to adapt their research, design, production and distribution systems to the North American market. Finally, they would have needed to succumb to the above problems immediately, and those problems would need to have been reflected in the products they were selling.

None of those things happened. Import nameplate automakers built

Fleet Market – 1990 to 2009



Source: DesRosiers Automotive Consultants Inc, CVMA and AIAMC

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twenty-eight assembly plants in North America, many of which are now regarded as the most cost-efficient, high productivity facilities anywhere in the world. The creation of on-shore import nameplate production capacity has provided those companies with the tools to grow and conquer. Far from tying their hands, Detroit's "level playing field" lobbying helped sow the seeds of its own downfall.

Lesson: Don't force your competitors to make decisions that will ultimately hurt you.

Don't forget to take care of the entire value chain

Car manufacturers exist within a complicated value chain. They are dependent on parts suppliers to feed their factories and on dealers to sell their wares (nevermind finance their operations). In addition to all the bad practices

listed above, Detroit automakers have established a longstanding pattern of dealer abuse.

They blamed their dealers when cars didn't sell. They failed to support dealers in those situations, forcing them into disadvantageous agreements whereby large numbers of unpopular vehicles found their ways onto sales lots so that sufficient quantities of popular products could be secured.

Following that, they shrank the dealer body when faced with the spectre of bankruptcy.

With the Detroit OEMs now selling into smaller distribution networks, a situation has arisen where certain areas of the country lack manufacturer presence. Some customers no longer have a convenient place to purchase or service a new vehicle.

Ford is the best example of this trend. Throughout this period of tumult, Ford has capitalized on its strengths and delivered a solid recovery plan that appears to have placed it on footing more secure than its two Detroit competitors. Doing so, however, involved the elimination of dealers. Ford now has market potential greater than at any point in the recent past yet finds itself hamstrung by a smaller-than-ever dealer network. Many potential sales are being lost because no dealership is physically present to satisfy demand.

Lesson: Don't forget about the distribution channels. If there isn't a dealer to sell your vehicles, you won't be able to sell many vehicles.

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Detroit forgot the primary role of its dealers

It's easy to misunderstand the role of the car dealer. Most outside and many within the automotive industry view dealers as an OEM's retail sales channel. They see them as the automakers' public fronts, the contact points between individuals and massive corporations.

This view correctly describes a dealer's secondary role, but it does not address the primary function served by dealers in the modern auto industry.

Car dealerships exist to offlay the cost of capital (i.e., land, buildings, equipment, inventory, etc.) over a wide group of entrepreneurs. Dealers own their inventories, buying vehicles from manufacturers and providing them with the working capital needed to fund manufacturing and product design. Healthy dealers provide a steady income while stricken stores indirectly transfer their problems upwards.

Detroit OEMs forced dealers to undertake expensive image and technology programs. Unnecessarily large and frivolously posh, many of these renovations pushed local dealers into dangerous financial waters. Combined with the slim margins and declining market shares endemic during the 2000s, a significant number of Detroit's dealers were left bleeding. An obsession with the look of the dealer and the various trappings of its secondary role crippled its ability to

perform the function for which it is desperately needed. With poor dealers, the OEMs couldn't help but see poverty themselves.

Lesson: In most cases, the factory is better off with a rich dealer body.

A "build it and they will come" mentality

Further to the dealer problem, Detroit's mad scramble to shut the wide-swinging market share gates led to a profound lack of discipline with regard to the development of dealer locations.

"Facility availability" (i.e., location, image, etc.) became a driving force for the opening of new points. In previous years - nay, previous generations - the impetus for a new store swelled from local market dynamics rather than facility availability.

Opening extra dealers in markets already receiving adequate service may help short-term brand perception, but the long term effect only weakens the existing dealer body and works against the OEM.

Lesson: Overdealering weakens the automaker and its franchise holders. Dealer development should focus on better serving the existing customer base (i.e., maintenance, repairs, used vehicle sales, aftermarket parts, etc.) rather than focusing exclusively on driving volume.

Dealers changed but the old rules remained

The story of the North American car dealer is one of great intrigue and

length - and one to which I cannot do proper service in this article - so without discussing the minutia of retail politics, it's important to understand the ownership structure of the dealer body has undergone a shift during the several-decade period under discussion.

Whereas the majority of dealers used to be single-point stores owned by individual entrepreneurs, the network is now flush with multi-dealer groups. This is certainly a phenomenon of the modern with many of the problems attendant to systems where rapid change has been recognized but not suitably appreciated.

The entrepreneurial element which represented the old core of the dealer body is fast vanishing, but the old network's old rules - tailored to the peculiarities of small business - remain. Detroit has largely denied multi-dealer groups the tools needed to capitalize on their investments. New forms of ownership require a re-writing of the playbook. Larger organizations with broader reach and greater resources should be given more latitude.

Lesson: "Rules are for fools and fools follow rules." Single-point stores and dealer groups are very different entities deserving of their own management regimes. One rule does neither justice. **DAR**