RATTNER, WAGONER, AND HOW TO RUN A CAR COMPANY

I'm going to have a few follow-up posts about Steven Rattner's Overhaul generally and Saturday's book salon on it. But for the moment, I wanted to add something to two excellent reviews of it by Malcom Gladwell and Felix Salmon. Together, they both distinguish between the product GM makes and the debt it had. Here's Salmon:

> That Rattner's team managed not one but two insanely complex bankruptcies in a hitherto unimaginably short timeframe is a real and noteworthy achievement of the Obama administration. Rattner is right about that. But Gladwell's got a good point too. This kind of biz-school restructuring is easy to show off about. What's hard is making millions of cars which are so good that the picky US consumer will buy them rather than the incredibly well-made competition — and making a profit by doing so. Eliminating GM's monstrous debt burden by sending it through bankruptcy was a necessary step in getting there. But it's not at heart what managing a company like GM is or should be about.

And here's Gladwell making a point bmaz and I argued, that Rick Wagoner, whatever his faults, had done significant work to fix GM before the overhaul.

> Wagoner was not a perfect manager, by any means. Unlike Alan Mulally, the C.E.O. at Ford, he failed to build up cash reserves in anticipation of the economic downturn, which might have kept his company out of bankruptcy. He can be faulted for riding the S.U.V. wave too

> long, and for being too slow to develop a credible small-car alternative. But, especially given the mess that Wagoner inherited when he took over, in 2000—and the inherent difficulty of running a company that had to pay pension and medical benefits to half a million retirees—he accomplished a tremendous amount during his eight-year tenure. **He cut the workforce from three hundred and ninety thousand to two hundred and seventeen thousand. He built a hugely profitable business in China almost from scratch: a G.M. joint venture is the leading automaker in what is now the world's largest automobile market. In 1995, it took forty-six man-hours to build the typical G.M. car, versus twenty-nine hours for the typical Toyota. Under Wagoner's watch, the productivity gap closed almost entirely**.
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> **Most important, Wagoner—along with his counterparts at Ford and Chrysler—was responsible for a historic agreement with the United Auto Workers**. Under that contract, which was concluded in 2007, new hires at G.M. receive between fourteen and seventeen dollars an hour—instead of the twenty-eight to thirty-three dollars an hour that preëxisting employees get—and give up all rights to the traditional retiree benefit package. The 2007 deal also transferred all responsibility for paying for the health care of G.M.'s retirees to a special fund, administered by the U.A.W. It is hard to overstate the importance of that second provision. G.M. has five hundred and seventeen thousand retirees. Between 1993 and 2007, the company paid out a hundred and three billion dollars to those former workers—a burden unimaginable to its foreign competitors. In the 2007 deal, G.M. agreed to make a series of lump-sum payments to the U.A.W. over ten years,

> worth some thirty-two billion dollars—at which point the company would be free of its outsized retiree health-care burden. It is estimated that, within a few years, G.M.'s labor costs—which were once almost fifty per cent higher than the domestic operations of Toyota, Nissan, and Honda—will be lower than its competitors'.
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> In the same period, G.M.'s product line was transformed. In 1989, to give one example, Chevrolet's main midsize sedan had something like twice as many reported defects as its competitors at Honda and Toyota, according to the J. D. Power "initial quality" metrics. Those differences no longer exist. The first major new car built on Wagoner's watch—the midsize Chevy Malibu—scores equal to or better than the Honda Accord and Toyota Camry. **G.M. earned more than a billion dollars in profits in the last quarter because American consumers have started to buy the cars that Wagoner brought to market—the Buick Regal and LaCrosse, the Envoy, the Cadillac CTS, the Chevy Malibu and Cruze, and others**. They represent the most competitive lineup that G.M. has fielded since the nineteen-sixties. (Both the CTS and the Malibu have been named to *Car and Driver's* annual "10 Best Cars" list.)
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> What Wagoner meant in his testimony before the Senate, in other words, was something like this: "At G.M., we are finally producing world-class cars. We have brought our costs, quality, and productivity into line with those of our competitors. We have finally disposed of the crippling burden of our legacy retiree costs. We have expanded into the world's fastest-growing markets more effectively than any other company in the United States. But the effort required to bring about that

> transformation has left our balance sheet thin—and, at the very moment that we need a couple of years of normal economic activity to refill our coffers, auto sales have fallen off a cliff. Do you mind giving us a hand until things get back to normal?" [my emphasis)

Now, FWIW, I'm agnostic about keeping Wagoner on as CEO. Gladwell makes the same points bmaz and I were making. But I am utterly sympathetic to the notion that any CEO getting a bailout should be fired as part of the deal. The best solution, IMO, would have been to keep Fritz Henderson on as CEO. That's partly based on my impression—developed during my visit to GM's Tech Center just a few weeks after Fritz took over as CEO—that he had begun to implement the same kind of cultural change that I saw very quickly at Ford after Alan Mulally took over.

But neither Salmon's nor Gladwell's review mention two key details that I think are important to this debate. The first is Rattner's description of learning about the dire straits of the auto finance companies on **April 1, 2009**.

> I entered the byzantine world of the fincos the very next day, April Fool's Day, as it happened. We faced off in a Treasury Department conference room against an imposing lineup of businesspeople: the top management from Chrysler Financial, GMAC, and Chrysler, plus Steve Feinberg and the guys from Cerberus. They all knew more about automotive finance than we did. We were trying to fly solo without having taken flying lessons, and I hoped we wouldn't crash and burn.
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> Pretty quickly I discovered that the fincos posed a bigger problem than I'd imagined. Auto finance companise are a lot like banks, but there is one crucial distinction: Banks rely on deposits form consumers and businesses for most of the

> money they use for loans. Finance companies have no such depositors unless they happen to own a bank: instead they must depend on larger borrowings from banks and investors for the cash that they lend to car buyers (known as the retail trade) and auto daelers (known as the wholesale or floor-plan borrowers).
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> I began to understand how the collapse of the financial markets had created havoc for automakers. As a result of the credit crunch, both GMAC and Chrysler Financial had seen their ability to borrow form banks severely curtailed. To raise added funds in recent years, the fincos had also made heavy use of securitizations, in which their loans to consumers and dealers were bundled, sliced up like a layer cake, and sold off in tranches, typically to investment funds. This market, too, had imploded in 2008, cutting off another key source of funds. As a result of this, the fincos had drastically reduced lending to consumers and dealers, a major factor in the steep falloff of car sales. (145)

Well over a month after Rattner officially got started, he finally sat down with the fincos. Remarkably, Rattner emphasizes that he was out of his league discussing auto finance; nowhere in his book does he make such an admission about the car business, about which he was far more out of his league.

And Rattner describes learning, well over a month after he came on board, that one of the key causes to the auto crash was the Wall Street crisis.

Which is precisely what Rick Wagoner, Carl Levin, Debbie Stabenow and all the other Michiganders—the ones Rattner loves to mock—were saying back in November and December when they first came asking for money.

Rattner doesn't say it explicitly, but this is basically a concession that all those people he describes as morons were right.

Of course, Rattner either simply didn't know that this is what the entire debate was about (another problem having someone completely ignorant about the auto industry leading its bailout), or he chose not to believe it until a bunch of finance guys—guys like his fellow private equity guys at Cerberus—told it to him.

And then there's the second point, which I'll just touch on (hopefully, I can nudge bmaz to do a full post on it). As Gladwell and Salmon note, Rattner's book suggests the success of the BK overhaul equates to full success. It's true that it is a huge accomplishment. But it is very premature to judge the bailout in any case. That's partly because GM may still do things—like use taxpayer dollars to start importing cars from China—what will be devastating on many levels. More importantly, it all does come down to product. The products that are getting some kudos right now are Wagoner and Bob Lutz's products, not Rattner and Ed Whitacre's. And Whiteacre did at least two things that may have detrimental effects on product down the line, two or three years from now: he accelerated the development process beyond the Toyota standard that GM had already achieved (even while Toyota has slowed their own down in response to their quality issues). It remains to be seen whether GM can sustain its quality improvements with this accelerated schedule. In addition, Whitacre ousted Lutz, who even Rattner describes as one of the culturally important things GM had going for it.

Gladwell and Salmon are right: there's far more to running a car company than just finance. Because of that, it'll be a few years before we know whether Rattner's choices for CEO will end up undoing much of the work that Wagoner had achieved.