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Essay

How Detroit Drove Into a Ditch

The financial crisis has brought the U.S. auto industry to a breaking point, but the trouble began long ago. Paul Ingrassia on disastrous decisions, flawed leadership and what the Motor City needs to do to survive.

By PAUL INGRASSIA

With little fanfare, a new car factory opened in America earlier this month. The new Honda assembly plant in Greensburg, Ind., will produce 200,000 compact Civic models annually after reaching full capacity late next year. The contrast couldn't be starker between Detroit's woes and the continuing U.S. expansion of Japanese, German and Korean car companies -- in both market share and manufacturing capacity. There are two American auto industries, one generally thriving and the other drastically shrinking.

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Ron Kimball Photography

The shrinking is accelerating dramatically. Just yesterday Chrysler said it would ax 25% of its white-collar employees, about 5,000 people, next month. General Motors is cutting thousands more jobs and a variety of management benefits, including matching contributions to retirement savings plans. The two ailing car companies are exploring a possible merger in hopes of reaping the synergies that so infamously eluded the DaimlerChrysler union a decade ago. Last summer GM sought to merge with Ford, only to be rebuffed. Billionaire investor Kirk Kerkorian started selling his stake in Ford last week after the value of his investment plunged by two-thirds since he bought the stock last spring. All this indicates the extent of Detroit's desperation. The Detroit Three (no longer the Big Three) are adamantly denying bankruptcy rumors, but there's no denying that their very survival hangs in the balance.

This situation doesn't stem from the recent meltdown in banking and the markets. GM, Ford and Chrysler have been losing billions since 2005, when the U.S. economy was still healthy. The financial crisis does, however, greatly exacerbate Detroit's woes. As car sales plunge -- both in the U.S. and in Detroit's once-booming overseas markets -- it's becoming nearly impossible for the companies to cut costs fast enough to keep pace with the evaporation of their revenue. All three companies, once the very symbol of American economic might, need new capital, but their options for raising it are limited.

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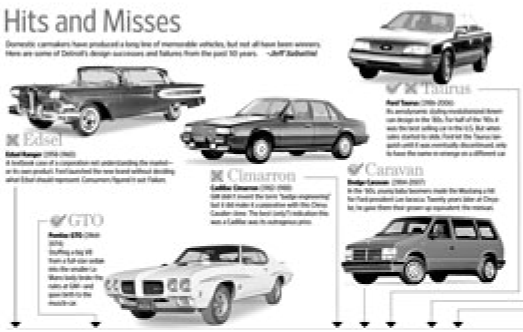
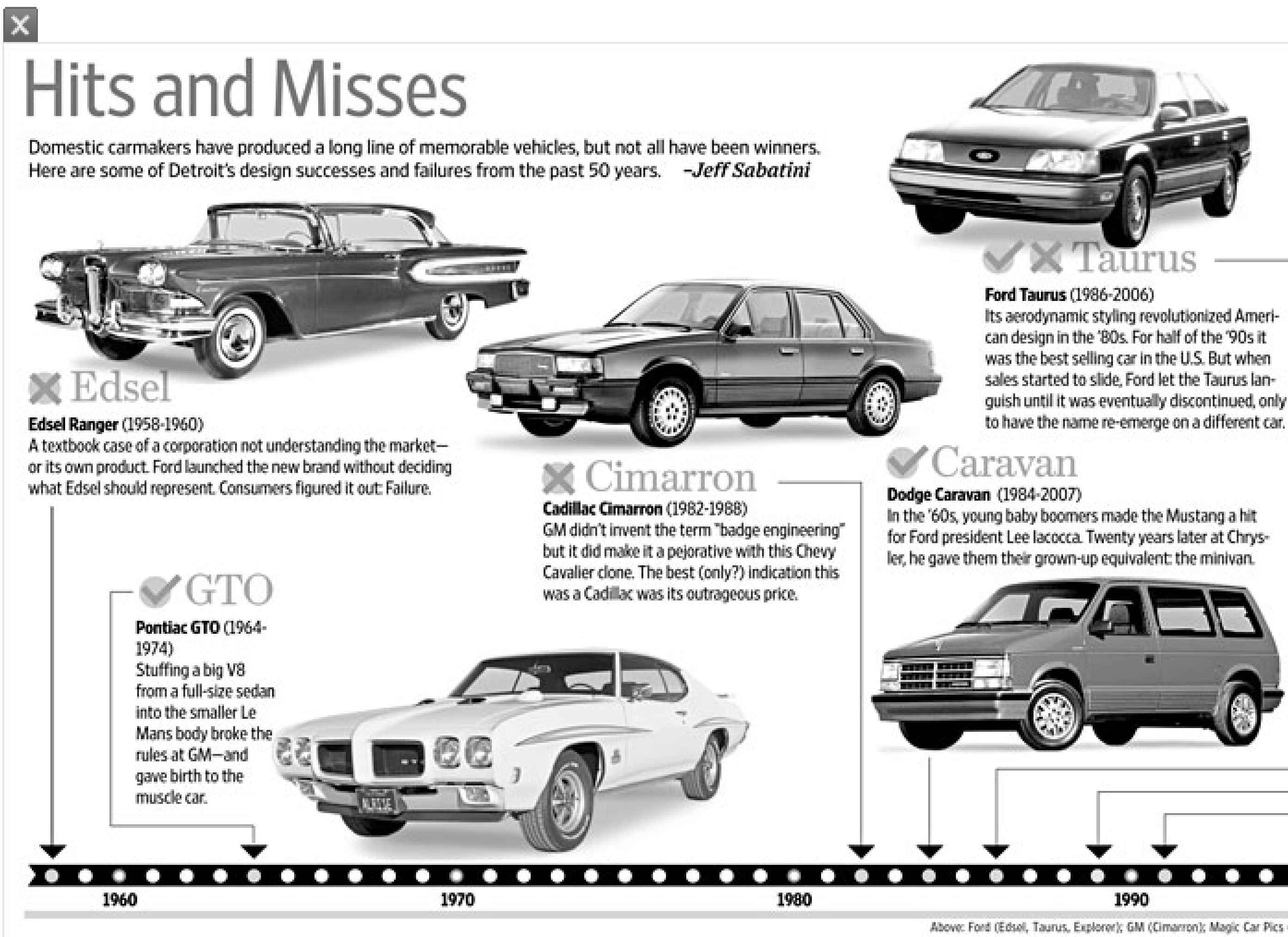


Domestic carmakers have produced a long line of memorable vehicles, but not all have been winners. Enlarge the image to see a chart of some of Detroit's design successes and failures from the past 50 years.



In all this lies a tale of hubris, missed opportunities, disastrous decisions and flawed leadership of almost biblical proportions. In fact, for the last 30 years Detroit has gone astray, repented, gone astray and repented again in a cycle not unlike the Israelites in the Book of Exodus.

It wasn't that American auto executives were always malicious and stupid while the Japanese were always enlightened and smart. Japanese car companies have made plenty of mistakes, most recently Toyota's ill-timed move into full-sized pickup trucks and SUVs. But just as America didn't understand the depth of ethnic and religious divisions in Iraq, Detroit failed to grasp -- or at least to address -- the fundamental nature of its Japanese competition. Japan's car companies, and more recently the Germans and Koreans, gained a competitive advantage largely by forging an alliance with American workers.

Detroit, meanwhile, has remained mired in mutual mistrust with the United Auto Workers union. While the suspicion has abated somewhat in recent years, it never has disappeared -- which is why Detroit's factories remain vastly more cumbersome to manage than the factories of foreign car companies in the U.S.

The result of this burden, and of other failures, has been catastrophic. Because of it, Detroit remains saddled with a cost structure that prevents making profits on any vehicles besides gas-guzzling trucks and SUVs. That was fine during the SUV boom, just as owning Enron stock was terrific until that infamous company crashed. But then Enron stockholders who hadn't diversified their portfolios were wiped out. Now Detroit lacks a diversified source of profits -- i.e. small cars, midsize sedans, etc. -- and is scrambling to avoid a similar fate. It's highly unlikely that all three companies will survive.

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Associated Press

Workers at a General Motors plant assemble the Pontiac Solstice in 2005.

Two incidents in 1936 and 1937 formed this lasting labor-management divide: the sit-down strike at GM's factories in Flint, Mich., and the Battle of the Overpass in Detroit, in which Ford goons beat up union organizers. But the United Auto Workers prevailed, and as the GM-Ford-Chrysler oligopoly emerged in the 1940s, the union gained a labor monopoly in American auto factories. As costs increased, the companies routinely passed them on to U.S. consumers, who had virtually no alternatives in buying cars.

That's how things stood entering the 1970s, a decade that brought America Watergate, defeat in Vietnam, two oil crises, inflation, stagflation, the Iran hostage crisis and malaise. (Not to mention "The Brady Bunch" and bell-bottom pants.) In Detroit, amid worker alienation and the "blue-collar blues," Chevies, Fords and Plymouths rattled, rusted and rolled over -- and those were the good ones. The Ford Pinto's gas tank was prone to explode into flames when the car was hit from the rear, making the Pinto the poster product for corporate callousness. In 1978, after three Indiana girls burned to death when their Pinto got rear-ended, Ford became the first company to be indicted for reckless homicide. The company later was acquitted, but public opinion judged the Pinto guilty.

For all the Pinto's infamy, perhaps no car better captured America's decade-long haplessness than the pug-ugly AMC Gremlin, which debuted in 1970 and died -- mercifully -- in 1980. The Gremlin's shape, fittingly, was first sketched out by an American Motors designer on the back of a Northwest Airlines air-sickness bag. On Aug. 20, 1979, 18-year-old Brad Alty, fresh out of high school in Mechanicsburg, Ohio, was driving his Gremlin to work when the car broke down. He was two-and-a-half hours late to his first day on the job at a new motorcycle factory that Honda Motor was opening in central Ohio.

For the next few weeks, Mr. Alty and his 63 co-workers did little but sweep floors and paint them with yellow lines. Then they started building three to five motorcycles a day. And at the end of each day they would disassemble each bike, piece by piece, to evaluate the workmanship. Mr. Alty hated it, and he kept getting grief from his older brother for working for a Japanese company. "I thought I had made a mistake by going to work there," he recalled recently. "It was like, 'What the heck am I doing here?' "

But Mr. Alty stuck with it, and Honda stuck with him. Honda's real goal was to build cars in America, but the motorcycle plant allowed it to test the mettle of American workers for a modest investment. The workers passed the test. Honda started building Accords in Ohio in November 1982. Ironically, some U.S. Honda dealers actually protested that they wanted to sell only Accords made in Japan. But the quality of the Ohio-made cars was soon confirmed.

Nissan, Toyota and other Japanese car companies soon started building factories in America, followed by German and Korean auto makers. There are now 16 foreign-owned assembly plants in the U.S., and many more that build engines, transmissions and other components. The UAW hasn't organized many of them, the main exceptions being plants that began as partnerships between a U.S. and Japanese auto maker, where the union was "grandfathered" in. As Detroit's oligopoly was broken, so was the UAW's labor monopoly in the auto industry. The big winner was the car-buying public.

Meanwhile, in the same year that Honda started building cars in Ohio, General Motors asked the UAW for wage concessions to help ease the company's financial straits. But on the same day that UAW members voted approval, GM Chairman Roger B. Smith unveiled a new formula that made it easier for him and other executives to earn bonuses. It was a historic blunder.

In 1987, when I was this newspaper's Detroit bureau chief, Mr. Smith asked me to tour several GM factories to view first-hand how the company's relationship with its workers had improved. At the GM engine plant in Tonawanda, N.Y., near Buffalo, I got glowing reports about the dawn of a new spirit of cooperation. Then I asked to visit the men's room, and was stunned to see that there were two: one for hourly workers, and a separate one for management. I used the hourly men's loo.

Meanwhile, Mr. Smith was trying to transform GM with a high-tech spending splurge. At GM's factory in Hamtramck, Mich., the automated guided vehicles that were supposed to replaced old-fashioned fork lifts sat as still as stones, because the programming algorithms were too complicated. The spray-painting robots turned their nozzles on each other instead of the cars.

While GM was going astray, Ford and Chrysler were in repentance mode in the 1980s. Chrysler staged a historic comeback from near-death under its charismatic CEO, Lee

Iacocca. In 1984 the company launched a new product called the mini-van, which supplanted family station wagons almost overnight. With the Taurus, Ford re-established Detroit's lead over the import brands in styling, evoking the days when Americans rushed down to a dealer to see the latest automotive designs, and the company forged better relations with the UAW. All three companies suffered in the Gulf War recession, especially GM, which posted a then-record $4.5 billion loss in 1991. The company's board ousted CEO Robert Stempel. But by the mid-1990s all three companies were posting record profits thanks to the boom in SUVs, which the Japanese didn't make at the time. The profit surge prompted Germany's Daimler-Benz to buy Chrysler, which owns the iconic Jeep brand, for some $36 billion in 1998.

As the new millennium began, Detroit envisioned a prosperous second century. In June 2000, GM's confident new CEO, Rick Wagoner, invited journalists to a resort in Italy's Alpine lakes to describe a corporate future of "fewer cars, more trucks," as the Detroit Free Press wrote. Ford's CEO Jacques Nasser upgraded the décor on the corporate jets and removed the company's blue-oval logo from the outside of corporate headquarters while the Ford Taurus -- once the best-selling car in America -- was falling further behind the Toyota Camry and the Honda Accord. It was going-astray time again. These days, Detroit's styling advantage has largely disappeared, and excitement over new designs is reserved for iPhones.

The debilitating management-union relationship largely remains, however. In 1998, after GM moved some equipment at factories in Flint against the UAW's wishes, workers went on strike for 54 days, costing GM $3 billion. While such headline-making confrontations have become rare, small-scale impasses occur regularly.

Not terribly long ago, says a Ford manager who must remain unnamed, Ford dispatched a team of welding experts to a factory to explore efficiency moves. The plant's union leaders, fearing layoffs might result, refused to meet with the team, and the effort came to naught. UAW leaders aren't bad people; far from it. But when everything is a negotiation, many things don't get done. (Just ask any parent.)

Several years ago Ford even considered dropping cars altogether because they weren't profitable, and focusing entirely on trucks. Then in 2005, Hurricane Katrina and growing oil demand from China and India sent gasoline prices soaring and SUV sales plunging. GM lost $10.6 billion that year. Ford topped that by losing $12.7 billion in 2006. Last summer Daimler gave up on Chrysler, selling it to private-equity powerhouse Cerberus for about one-fourth of what it had paid to buy Chrysler. Last fall the UAW approved significant wage and benefit concessions, but they won't kick in until 2010. That might be too late. GM lost $15.5 billion in this year's second quarter, Ford lost $8.7 billion, and further losses are coming. (Closely held Chrysler, of course, doesn't report financial results.)

What now? Cerberus is trying to sell Chrysler. The most logical buyer would be Nissan, India's Tata or some other profitable foreign car company seeking to expand in the U.S. But desperation doesn't breed logic, which is why General Motors might become the buyer. It's difficult to see how this deal would make any sense for GM, which already has too many brands (eight) and must cut billions from its cost base. Adding more brands (Chrysler has three) and more costs would be charging headlong in the wrong direction, and distract GM's management from putting its own house in order.

GM is bleeding cash so quickly that it likely will run out next summer without a sizeable transfusion. Selling assets, selling stock or adding debt will be enormously difficult for the company. But unless one of those things happens it's either a government bailout or bankruptcy for General Motors.

Ford's cash position is somewhat better than GM's, and the company seems to have more options. Its Volvo subsidiary and its 33% stake in Mazda are valuable assets that could be sold. But Mr. Kerkorian's apparent about-face on Ford is unsettling. It's possible that the blue-blooded Ford family is just as happy to see the Las Vegas billionaire cash in his chips, but his move could shut off a potential source of additional investment that Ford might need in its quest to survive.

But to thrive, instead of just survive, Detroit will have to use the brains of its workers instead of just their bodies, and the UAW will have to allow it. Two weeks ago some automation equipment broke down at the Honda factory in Marysville, Ohio, but employees rushed to the scene and devised a temporary solution. There were no negotiations with shop stewards, no parsing of job descriptions. Instead of losing an entire shift of production, Honda lost just 150 cars. The person overseeing Marysville's assembly operations is Brad Alty, still with Honda after nearly 30 years. These days, instead of a Gremlin, he's driving a Honda Pilot -- made at a Honda factory in Alabama.

Paul Ingrassia is the former Detroit bureau chief for The Wall Street Journal. He is writing a book about America's car culture.

Write to Paul Ingrassia at ingrassiap@gmail.com