
Event Report

Two Behemoths in a Troubled Industry

APRIL 6, 2009

*On April 6, 2009, the Center on Japanese Economy and Business organized the symposium “Two Behemoths in a Troubled Industry: Toyota and GM.” The panel featured Steven Sturm, group vice president of Americas Strategic Research and Planning and Corporate Communications at Toyota Motor North America, and William Holstein, author of *Why GM Matters: Inside the Race to Transform an American Icon* and Professor Hugh Patrick, director of the Center on Japanese Economy and Business as commentator. David Weinstein, Carl Sumner Shoup Professor of the Japanese Economy at Columbia University, served as moderator of the symposium which was co-sponsored by Columbia Business School’s Asian Business Association, General Management Association, and Japan Business Association. The panelists discussed the strategic positioning of Toyota and GM in the face of the current economic crisis, how they got there, and where they are going.*

As William Holstein affirmed, the competition between Toyota and General Motors (“GM”) represents one of history’s greatest industrial rivalries. “These two companies represent more than just companies, they represent the soul of their respective countries...” It began in 1957, when Toyota attempted to penetrate the U.S. market with its first car. Subsequently, it was literally laughed out of the market, with its automobiles mocked as “Toyota pets.” By contrast, GM was riding high, capturing over 50% share of the US market by the early 1960s. The fear for GM, as Hugh Patrick points out, was not the threat of competition but rather the threat of break-up via antitrust regulations.

Interestingly, GM found dominance while abiding by a dated manufacturing model and an inefficient organizational structure. GM’s manufacturing was little changed from Henry Ford’s assembly line of the 1920’s. Furthermore, GM’s segments operated autonomously, as initially organized by Alfred P. Sloan in the 1920s. For example, Chevrolet’s engineering, design, and

manufacturing processes were separate from the other brands, thereby minimizing synergies among segments. Nonetheless, Toyota entered the U.S market to face a formidable incumbent.

The turning point for Toyota was its development of lean manufacturing. Unlike GM, the Japanese auto company applied the insights of American manufacturing quality experts W. Edwards Deming and Joseph M. Juran by developing a system in which different teams of people performed specific stages of assembly. This process was clearly superior to the traditional method in which the vehicle was simply passed down the assembly line. In the Japanese model, teams took psychological ownership of their respective stages of the manufacturing process.

Eventually, the Toyota brand gained traction in the U.S., particularly among the baby boomers who rejected American-made cars amidst the backdrop of the 1970s oil shocks in favor of the smaller more efficient imports. In the 1980s, GM began to wake up to the Toyota threat. As a result, GM and Toyota formed a mutually beneficial joint venture, the New United Motor Manufacturing, Inc. (“NUMMI”) plant, based in Fremont, California. GM sought to learn the dynamics of lean manufacturing, while Toyota sought to learn about the American market. GM representatives based at NUMMI recognized the merits of Toyota’s lean manufacturing model and pushed Detroit to do the same. Detroit, however, steadfastly rejected such pleas.

Following the establishment of the NUMMI plant, Toyota continued to gain significant momentum in the marketplace while, as one Toyota representative commented, “GM was a giant sick in bed.” Professor Patrick stated that in its early days, GM secured a market dominance allowing it to set premium prices. Ford and Chrysler benefited from this heightened consumer willingness to pay. As such, the United Auto Workers (“UAW”) union was able to negotiate expensive contracts with the Big Three auto companies when there wasn’t much foreign competition. As Toyota’s subsequent entry eroded GM’s share, the legacy labor contracts eroded GM’s bottom line. A critical weakness for GM developed: the inherently hostile relationship between labor and management. By contrast, the Japanese learned to engage with labor and treat the ideas of labor as the most important aspect of the organization.

Toyota surprised GM by introducing the market’s first hybrid, the Toyota Prius, sporting 50 mile per gallon fuel economy. This was a particularly stunning blow to GM because the American auto maker had grown overly confident of its own intellectual and technological leadership. Steven Sturm noted that Toyota is now the world leader of hybrid technology, having 1.7 million hybrid vehicles sold globally and 1 million in the U.S. alone, which account for 75% of the hybrids on U.S. roads. As a result, 9 tons of harmful carbon dioxide has been kept out of

the atmosphere, not including emissions reductions garnered from production efficiency initiatives at Toyota's plants. Toyota has ramped up its R&D to the tune of \$1 million per hour to develop promising technologies for higher fuel economy and lower emissions. By 2020, Toyota expects to have a hybrid option of every car it sells.

Despite such successes, the present climate has taken its toll on all players. Even Toyota, a hallmark of the industry, has forecast its first annual loss since 1950. Mr. Sturm notes that industry sales are at their lowest since the early 1990s. Customers are holding off big purchases until the uncertainty recedes. GM is the industry's largest casualty, having experienced decreased market share and staggering losses. As the American giant bled cash, credit conditions worsened.

Mr. Holstein stated that amidst such circumstances, it is easy to overlook GM's more recent revitalization initiatives. First, GM has absorbed the Toyota lean manufacturing method full scale, albeit ten to 15 years after NUMMI was established. The company has demonstrated technological innovation through the introduction of the Chevrolet Volt's lithium ion battery, a technology which, in many ways, has leapfrogged over the nickel metal hydride battery of the Toyota Prius. GM has also driven down the cost structure, transforming its relationship with the UAW by implementing a two-tier wage system in which new entrants make \$14.85 per hour, in contrast to the \$28.00 per hour that veteran workers receive.

After 25 years of market losses to Toyota, Mr. Holstein argues that given some of the aforementioned initiatives, GM would have been well on its way to buck this trend if it were not for the current economic crisis. As such, the decision to fire GM CEO Rick Wagoner, who has led many of GM's revitalization efforts, was surprising to Mr. Holstein. As Professor Patrick pointed out, the rejection of the GM recovery plan presented to Congress, the ousting of CEO Rick Wagoner, the imminent replacement of most GM's board and the ultimatum for stakeholders to agree to a suitable arrangement by the end of May or file for Chapter 11 bankruptcy have all sent shockwaves throughout the car industry. Both Toyota and GM, whose presence in the U.S. is virtually equivalent, have been hard hit by the decline in the U.S. market, which sold 16 million vehicles in 2007 and will likely sell just nine to ten million vehicles this year.

The major difference between the two auto companies is that Toyota entered the economic crisis from a position of strength while GM was already quite weak. Professor Patrick asserted that this difference in positions can be attributed to cultural differences. Toyota was anxiety-driven and exuded cautiousness even when the company experienced significant growth. This is

not to say the Toyota was perfect. A few years ago, Toyota announced a “15-15” strategy to gain 15% of global market share by 2015. In the process of this aggressive expansion, quality – which had been a historical strength for Toyota – slipped markedly.

GM’s historical success, however, forged arrogance and complacency even in the wake of recent failures. GM and the rest of the ‘Big Three’ underestimated the threat of Toyota in the early years, attributing the Japanese company’s early success to unsustainable measures like government subsidies. The ‘Big Three’ welcomed Toyota’s U.S. entry, believing that it had succeeded in Japan simply because of aspects of cultural norms like worker loyalty and shared sacrifice; the ‘Big Three’ doubted the Japanese company’s ability to manage American workers and compete in the U.S.

In looking to the future, Mr. Sturm claimed that the most important factor in restoring health to the auto industry is to spur consumer confidence. The government stimulus package is a step in the right direction to getting buyers back in show rooms. Auto manufacturers must also be able to rely on a healthy supply chain to resume normal production when consumer demand picks up. Toyota has reduced production at all of its U.S. assembly plants. Expense management initiatives include executive pay cuts, bonus eliminations, and work week reductions.

The future for GM is more uncertain. Professor Patrick pledged that a downsized GM can and will be competitive in the future. The dilemma has been that the transformation process has been too slow and the restructuring has not been deep enough. Both panelists also agreed that liquidation would be unacceptable on both political and economic grounds. At stake for GM is a vast infrastructure of jobs, from auto manufacturing to management, design, and engineering positions. In addition, liquidation would detrimentally impact GM’s extensive complex supplier networks. Moreover, GM is the largest private sector purchaser of information technology in the U.S., as well as a vital client of distribution and dealer industries.

Thus, the question remains for GM: what type of restructuring process will be acceptable? As Chapter 11 appears increasingly likely, key questions remain. How should GM’s leadership change? How much more can worker legacy costs be cut through decreased pension and healthcare benefits? To what extent can bondholders stomach further losses? In Mr. Holstein’s view, addressing such questions hinges on what one believes drove GM’s demise. On one hand, management could be to blame for its unwillingness to adapt to changing market conditions. In this scenario, a hard-nose stance against the company and a policy of leadership dismemberment, as the Obama Administration has advocated, appears appropriate. On the other hand,

management could receive credit for turning around GM, only to be ambushed by dismal economic conditions. In this scenario, continuing to inject liquidity into the company until it reaches recovery would be appropriate.

Professor Patrick pointed out that the downsizing of GM creates great opportunities for Toyota but also uncovers significant political risks. Toyota currently captures approximately 20% of the U.S. market. If this share should rise in the wake of GM's downsizing, there would be tremendous pressure on Toyota, who already builds approximately 50% of its capacity in the U.S, to increase its U.S. production activity. The burden could be on Toyota to buy more parts from U.S. suppliers and create more American jobs, all at the expense of production in Japan. Thus, there is a strange irony in the realization that Toyota, as in the case of GM, could be a victim of its own success.

ADRIAN ALMAZAN MBA '10
Columbia Business School