

Disaster Deferred: The U.S. “Big 3” and the Labor Cost Squeeze

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- **Case study of the challenge of dealing *today* with business decisions made many years in the *past***

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- **Sean McAlinden, University of Michigan**
- **Goldman Sachs**
- **Prudential Securities**

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- **The Big 3 squeeze**
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BACKGROUND

In North America the Big 3 (GM, Ford, Chrysler) are unionized (UAW, CAW*), via a “pattern” system where 1 contract covers all 3 . . . more or less

In North America, the “transplants” (Toyota, Honda, Nissan, Subaru/Isuzu, etc.) are mostly not unionized, with the exception of those with close Big 3 ties:

- NUMMI in California (GM/Toyota JV)
- Mazda in Michigan (Ford control)
- Mercedes in Alabama (part of Daimler Chrysler)

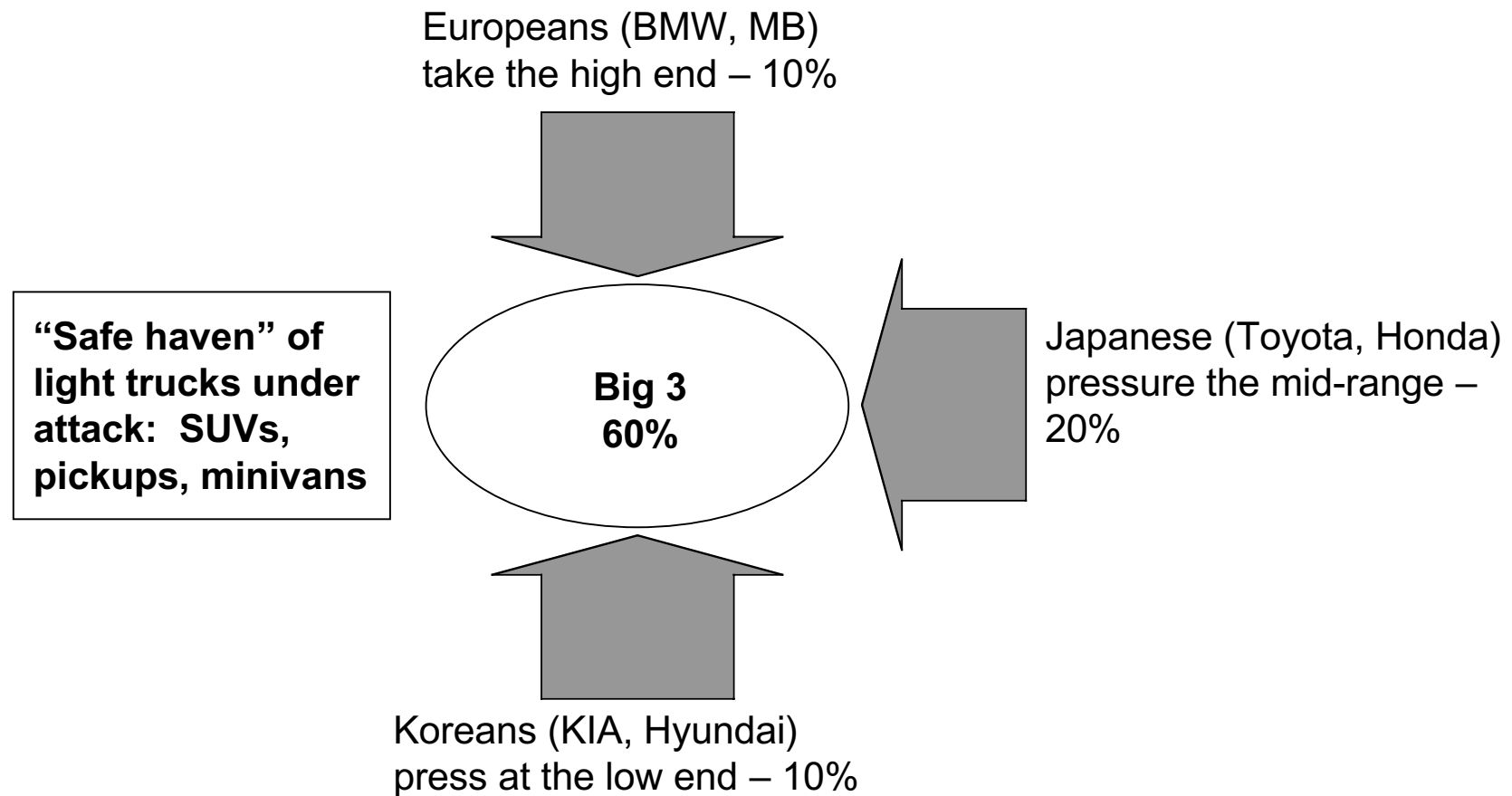
Mexico is a special separate case, not discussed today

The focus today is the USA, where the UAW contract expires in September 2003, and negotiations begin this summer

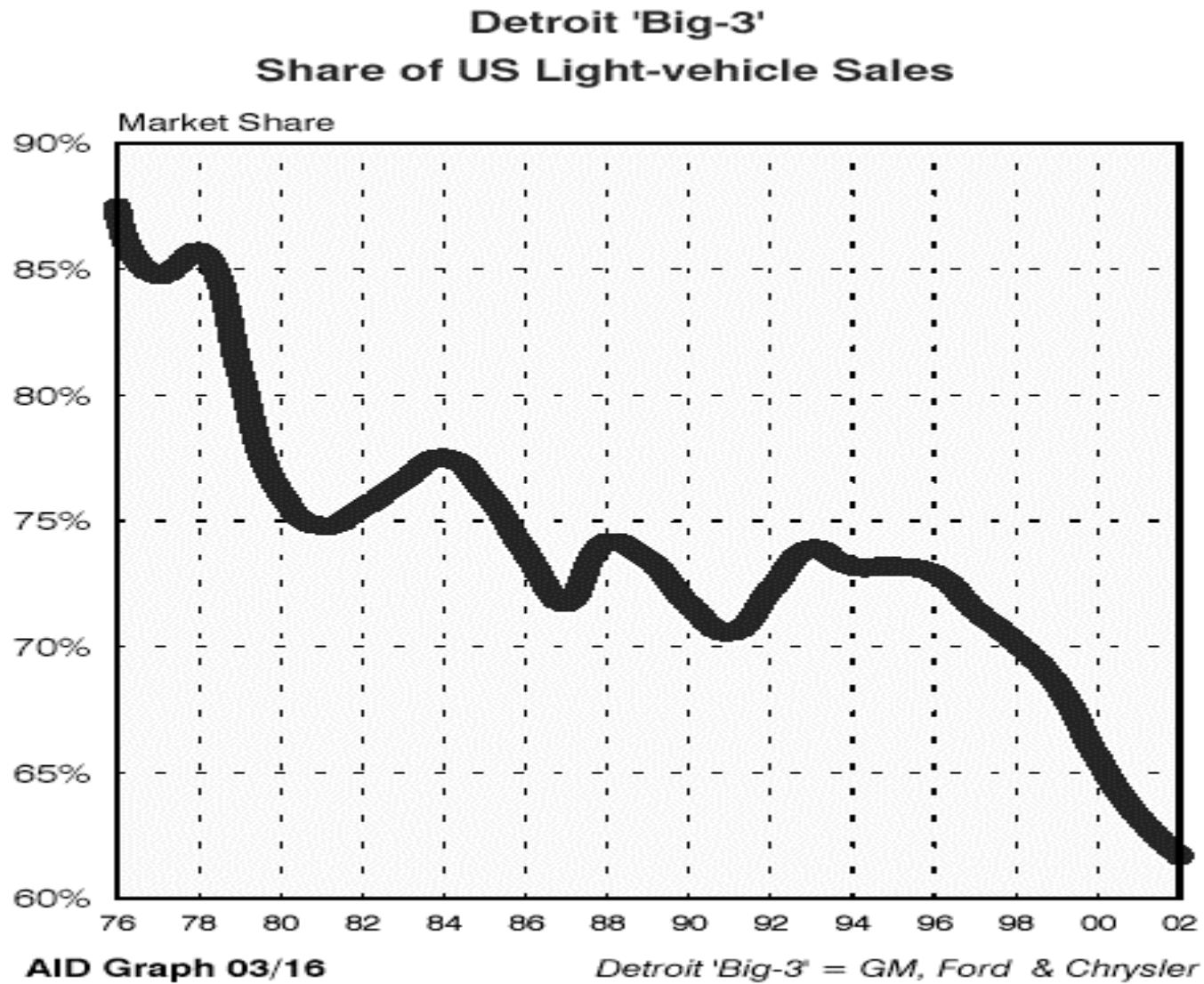
The Big 3 are in a 3-way competitive squeeze in the USA

Competitors and market share, USA

Percent



Accordingly, the Big 3's market share has dropped dramatically



The same is true at Ford

Labor benefits provided by the Big 3

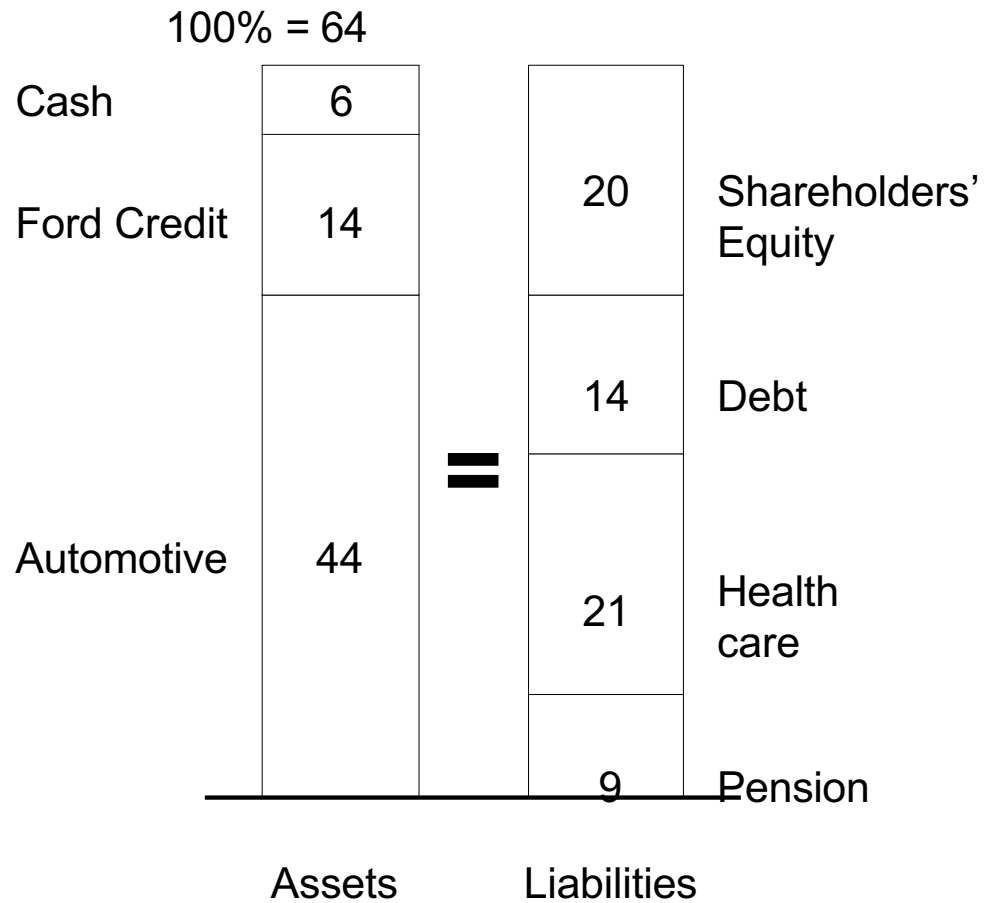
Pensions: Payments to retired workers

Healthcare: Medical costs paid to current workers, their dependents, and to retirees



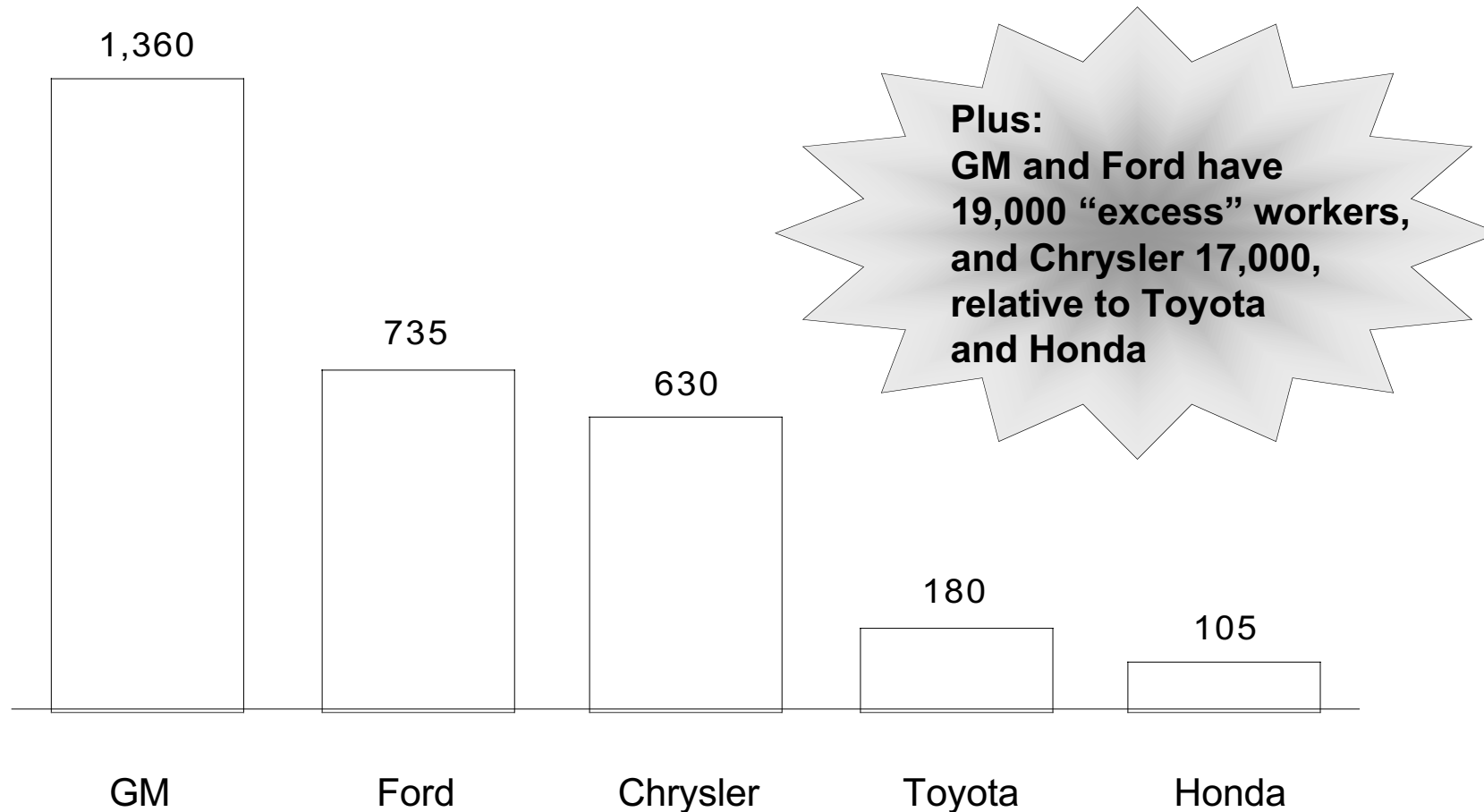
Ownership claims on Ford

\$ Billions



The benefits burdens translate into very large per-car cost disadvantages, relative to the competition

Estimated 2003 pension and healthcare costs per North American Vehicle
\$/car



The future outlook for the Big 3 does not get much brighter until ~2010

Future labor cost situation of Big 3 vs. Toyota and Honda: positives and negatives

- + Big 3 retirees “expire” (GM has 2.5 retirees for every active worker)
- + Big 3 retirement rates are high (~5%)
- + Transplant workers age
- Transplants keep building new plants, which hire younger workers, and lower the average age



**Forecasters see Big 3 improvement
by 2007 or later**

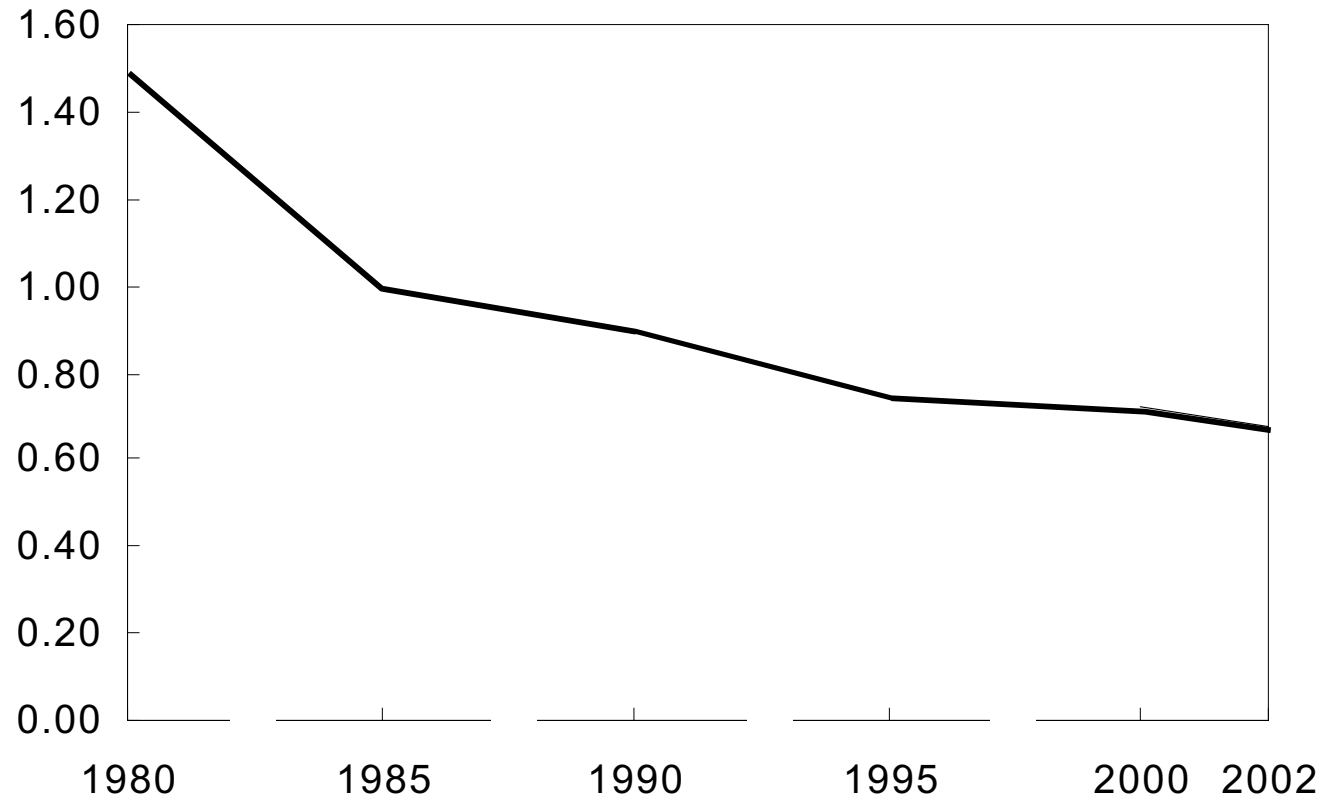
**Meanwhile, they will cut car price to
drive volume up, and spread fixed
costs across more units**

THE STORY: PERSPECTIVE OF THE UAW

From the union's point of view, the Big 3 work force has already sacrificed a great deal

UAW active workers*

Millions



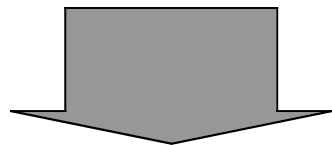
* Includes industries other than automotive; at the Big 3 only in 2002 UAW count was GM 132,000; Ford (including Visteon) 100,000; Chrysler 64,000; Delphi 31,000

Source: UAW

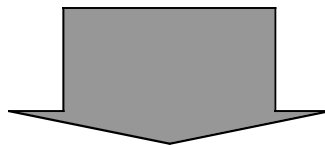
The UAW has to find a way to balance a variety of worker desires at the different Big 3 firms

UAW work force statistics, Big 3 only – 2002

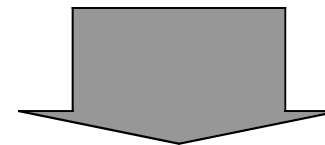
OEM	Average age	Average seniority	Active workers	Retirees	Retirees: actives	UAW main goal
GM	48.5	23.5	132,000	370,000	~2.8:1	Protect <i>benefits</i>
Ford	43.5	15.9	100,000	115,000	~1.2:1	Protect <i>jobs</i>
Chrysler	44.0	17.0	64,000	70,000	~1:1	



Workers at GM more in “end game” mind-set



Ford and Chrysler relatively more overstaffed



GM imbalance due to disproportionate share loss, 1970-2000

SIDEBAR: The basic terms of transplant and UAW contracts are similar in many ways, with the transplants emphasizing more managerial flexibility

Employment terms, NUMMI (UAW) vs. Nissan (not unionized)*

Term	NUMMI (CA)	Nissan (KY)	Comments
Base pay – \$/hr.	\$24	\$21	Cost of living is lower in Kentucky
Overtime bonus	50%	50%	Overtime voluntary at NUMMI, mandatory at Nissan
Phase-in (years)	3	3	Time for new hire to reach full base pay
Bonus	“Up to \$2,400”	“Up to \$4,800”	Both are set by management
Breaks	Lunch + 2	Lunch + 2	Similar
Vacation after:			
• 1 year	10 days	10 days	No carryover of unused vacation at Nissan
• 10 years	17 days	20 days	NUMMI hits 20 days at 14 years
Holidays	16	14	Similar
• Union employee	19	0	Several of the UAW officers are full time
• Personal leave – days	5	6	NUMMI personal leave is deducted from vacation
Pension after 20 years – \$/yr.	\$10,000	\$10,000	Approximate numbers, based on formulas
Grievance process	In contract	None	Nissan reviews employee complaints
Layoff rules	Constrained	None	(But Nissan has never had a layoff)
Union dues	~\$600/yr.	None	–

* NUMMI = New United Motors Manufacturing, GM/Toyota JV
 NUMMI Company, United Motors Manufacturing, California

THE CONFRONTATION IN 2003

The negotiations leading up to a renewal of the UAW contract that expires in September will represent the collision of 2 absolutely determined forces

Big 3 goals and tactics

Desperate for cost relief:

- Market share still falling
- Incentives climbing
- Ford “near bankruptcy”

GM needs benefits reductions

Ford and Chrysler need headcount reductions

None of the 3 want a strike, which would benefit the Japanese



A Guess:

- Minimal benefits reductions
- Further head count decline (offset by supplier unionization)
- No strike

UAW goals and tactics

The UAW has **never** granted a permanent benefits reduction

Members are angry that they have “paid for” Volvo, Jaguar, Fiat, GM China . . .

UAW President Gettelfinger wants the US government to use a national healthcare plan to solve this problem

Gettelfinger sees China as the great threat: a “race to the bottom”


Target is Chrysler (most likely) due to rich German “parent, ” recovery

GM workers may be more aggressive than Ford or Chrysler brethren

CODA: The real locus of transplant advantage is at the major suppliers

Hours of labor and cost per hour of labor, Big 3 vs. transplants

"Layer" or production	Big 3 Hours X \$/hr. = Total			Transplants Hours X \$/hr. = Total			Gap \$/car	Source of gap – Percent		Percent of total gap
								Production	Cost	
Car assembly	45	52	2,340	32	36	1,150	1,190	48	52	46
Tier 1 supply	105	35	3,675	68	30	2,040	1,635	67	33	63
Lower tiers	120	22	2,640	130	22	2,860	-220	100	0	-9
	—	—	—	—	—	—	—	—	—	—
	270		8,655	230		6,050	2,605	55	45	100
							In favor of transplants			

 The transplant advantage is **especially** at the Tier 1 suppliers!

* Total hours, not just assembly (i.e., includes foundry, engine plants, etc.)

Conclusions

1. This is actually a three-way or four-way struggle, not just a two-way struggle between the unions and the OEMs: government plays a role (in terms of not providing a “level playing field” to all OEMs via national health care), and younger workers very often find they have different interests than older workers.
2. This is a good example of how small, incremental, reversible decisions made years ago, can compound over the decades to become large, irreversible issues today.
3. The real locus of competitive advantage, however (when it comes to making cars) may have already shifted away from the OEMs to their supply chains, even though the news media may still prefer to focus on the big final assembly plants

* Footnote

Source: Source