"What's good for General Motors is bad for America: A case study on John Heskett's design-oriented theory of value in retrospect"

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Abstract

This research is an applied case-study in the recent history of the General Motors bailout in 2009 using John Heskett's economics as a starting point for analysis. Prof. Heskett (1937-2014) wrote in *International Design* in 1992 how GM's myopic design vision at the corporate strategy level leads to a stagnant car company with the inability to compete. Heskett both captures GM's competitive position at the time and foretells more decline. Shortly after Heskett's article in 1992 GM declared losses of $23 billion, the largest loss in US corporate history. And, despite having accumulated losses of $35 billion, GM was bailed-out and nationalized by the US government in 2009, again an unprecedented event. This article examines (and expands upon, using GM as a case-study) Heskett's critique of mainstream economics and uses Heskett's research into institutional economics and the national system to help define the asset regime which leads to the GM bailout. There are lessons learned for firm management theory and practice, the role of the firm and designers in value-creation, and for those interested in political economy from the point of view of historical context and institutionalism.

Keywords

General Motors, Institutional Economics, Design as Strategy, Asset Specificity, Rent Seeking, Creative Destruction

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Introduction

This research is an applied case-study in the recent history of the General Motors bailout in 2009 using John Heskett's economics as a starting point for analysis[1]. Prof. Heskett (1937-2014) wrote in *International Design* in 1992 how GM's myopic design vision at the corporate strategy level leads to a stagnant car company with the inability to compete. Heskett both captures GM's competitive position at the time and foretells more decline.

For example GM lost US market share from approximately 43% in 1982 to approx. 20% at the time of the nationalization and restructuring in 2009 (Goolsbee and Krueger 2015, 6). GM has accumulated losses of more than $35 billion from 1982 to the time of the restructuring in 2009 (see GM profit history in the Appendix to this article).[2] Later in 1992, shortly after Heskett's article, GM declared losses of more than $23 billion, the largest corporate loss in US history (Levin 1993).

We illustrate in this article how Heskett's concurrent and subsequent writings on economic theory, although some of the ideas used here are underdeveloped empirically in Heskett's own work, can help explain the GM bailout in retrospect. Heskett's economic theory is a critique of mainstream neo-classical economics; he finds mainstream models of the economy cannot explore adequately how the *creative destruction* of design-based entrepreneurship can create value in the economy (nor can mainstream financial theory posit how a company can remain operating for years at a time with cumulative unprofitability).

[1] This article draws on the economics of John Heskett as found in Heskett, Dilnot, ed. (2016) and (2017).

[2] In addition to accumulated operational losses since 1982 as of year-end 2015, GM has almost $83b in non-current liabilities (mostly for employee and employee retirement benefits), more than half of GM's total liabilities (www.stock-analysis-on.net).

> If designers are to cope with the demands of varying cycles of change, the concept of innovation must be understood on many different levels — from radical and incremental innovation. Radical innovations are the basis of Schumpeter's 'creative destruction' concept, which provides new industries and needs (first published as "Creative Destruction," *I.D. International Design*, September/October 1993, reprinted in Heskett 2016, 282-292).

The GM bailout in 2009 was a direct intervention against creative destruction with national policy (in fiscal and other interventions and monetary policy) prioritizing "stability" over creative-destruction, and with policy actions unprecedented until this time.

Heskett's work leaves unexplored some of the economic concepts he contrasts with mainstream models of the economy. Kristensen (2016, 279) writes,

> According to e.g. Karl Popper's "falsificationism," we may ask if he [Heskett] proposed falsifiable hypotheses and whether some important ones have indeed been falsified. If this is the case, then we may leave it here. We must admit that, although many of the writings are good approximations to an empirical reality, we find few real testable hypotheses; on the other hand many of Heskett's descriptions, assessments and predictions seem well corroborated. Heskett himself did not test hypotheses as such and his style of research was explorative rather than corroborative. That is perhaps a very good idea, because Heskett's interest was much more to stimulate the fire of contemporary designers and others interested in these issues rather than in digging up the ashes of the past.

We hope that this present research will fill in some of the missing empirics related to Heskett's two theses most applicable here in our case study on GM,

1) A user-focused design strategy at the highest levels of the firm is necessary for long-term value-creation, and
2) We must draw-on heterodox thought in economics to better understand a design-based economy.[3]

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[3] We should note that Heskett's critique of mainstream economics is meant to be constructive. "The critique of neo-classical economic models is not conducted merely negatively. What Heskett shows - and this becomes apparent in the key series of diagrams of economic models that illuminate the text - is that as one contrasts neo-classical theory, first with Austrian theory…and then with the insights gained from institutional theory and New Growth theory, that it is possible to see a successive deepening of understanding of economic relations." (Dilnot, "Introduction," in Heskett 2017-forthcoming).

GM (and the smaller Ford and Chrysler) simply lost competitive advantage to the more user-responsive designs from foreign competitors, a trend which started particularly in the late 1970s and early 1980s after the OPEC oil-shock (we explore this history in the next section of the article), and from which the US auto industry did not recover due to protectionist interventions created by an increase in asset-specificity at the national policy level.

From our reading of John Heskett we can learn lessons from institutional economics which can help explain the politically-oriented bailout of GM in 2009, which is perhaps not an unpredictable result of the historical trajectory of US political economy, and which can explain how an unprofitable 'national interest' company can remain in business for so many years. We specifically focus on the case of GM, preceding and through the financial crisis and the bailouts of 2009 and today's situation in historical context. We claim that Heskett's concurrent work in the history of economic thought can help explain the GM trajectory.

More than just a focus on entrepreneurship-economics Heskett discovers and incorporates two additionally applicable concepts absent from mainstream perfect competition models which we find useful for our purposes here to help explain currently existing state-capitalism in the United States as exemplified *in extremo* with the case of GM in 2009. The first of these is "asset-specificity" leading to market distortions and economic rents as borrowed from New Institutional Economics. The second is from Original Institutional Economics in the work of Thorsten Veblen, specifically the contradiction in "workmanship" versus "craftsmanship" which can help explain the movement from a focus on quality to quantity in industrial strategy and a rise in the "pecuniary habit" (or if you will, *financialization*) under modern capitalism.

Heskett also uses Veblen to criticize graduate management education's focus on financial results in corporate strategy to the detriment of quality-based design-oriented strategy, something we draw on as well in this article, specifically related to trade and monetary and fiscal interventions which lead to the GM (and many other) bailouts in the 2007-2010 period. We can place then the GM illiquidity, nationalization and restructuring ("bailout") within a larger context of industrial relations, as also described by Heskett. Here we draw on Heskett's use of the category the National System to place in context the political economy as evolved historically in the US and how this idea of economic nationalism can also help explain the bailout of GM.

John Heskett on the National System

We know that nation-states use industrial policy to encourage the development of domestic industries deemed of national interest and/or which can provide economic rents under the category of *national defense* or *energy* or *food security*, etc. The failure of world trade agreement under the WTO is due, in broad strokes, to "rich" or "developed" or "industrialized" nations subsidizing and protecting domestic agricultural production whereas "developing" or "poor" nation special-interests prevent competition against local manufacturing production, the means for which are usually under the control of local elites (although most nations protect both, it can be a matter of degrees when making category judgements).

National trade protection regimes depend uniquely on each country's circumstances and historical development.[4] National interest industries have included railroads, rights in ownership and access to shipping and ports, military-industrial research and manufacturing, airlines and automobiles, aluminum and steel production, export bans on 'strategic materials', and interventions into energy technology, food labeling, domestic content, intellectual property rights, and this is only a partial listing. These interventions are sufficient to claim that the perfect-competition model is insufficient to explain many of the major historical changes in technology and markets.

John Heskett's research includes the relationships between design and national industrial policy and as related to different forms of economic nationalism. For example in 1999's **"**National Design Policy and Economic Change"[5] he finds that historically there have been two types national design regimes, those that fused the state with industry, such as fascism (which were in reaction to diminished power of the state relative the power of the corporation), and those that were used to gain competitive trade advantage (mercantilism and neo-mercantilism). He finds that countries such as Taiwan, South Korea and Japan have been more successful in mercantilist interventions than has the U.K.

In his exposition of the National System in *Design and the Creation of Value* (2017-forthcoming) John Heskett brings in writings on German state-craft of the

[4] "Americans tend to view the automobile (auto) as the archetypal American product. Not only does auto production loom large economically, but the automobile itself bears a unique social relationship to the national self image" (Nelson 1994, 1).

[5] Originally published as "National Design Policy and Economic Change," (in German and English) in *MD-Magazine* (Germany), August 1999, reprinted in Heskett 2016, 229-236.

early Republic in the mid to late 19th century, specifically highlighting the work Friedrich List to find that perfect competition atomistic economic models miss the larger national context and finds that in the case of today's Germany and Japan national strategies have resulted in known *high quality* design and export-oriented economies based on this high quality design and manufacturing.

Despite these results Heskett does not call for an active government subsidy and/or protectionist program to encourage economic growth.[6]

> The evidence that design policy can promote economic competitiveness is therefore mixed. Success seems to depend on two factors: the existence of authoritarian characteristics in government, such as absolutist France, or the guided economy of Japan; and relative industrial stability, as in ceramics and tapestries in the eighteenth century, or automobiles and domestic electrical products in the late twentieth century, in which innovation tends to be incremental and gradual. How then can national governments handle the dramatic changes on multiple levels and technologies, of global markets, and business organization and that are currently causing major economic disruption and unemployment? The answer, I believe, is they cannot: government policy exercised through bureaucratic organizations is ill-equipped to understand and dynamically respond to change on any level. The world economy is at present so diverse and dynamic that attempts to control it through mercantilist-style policies will be not only be futile but extremely damaging (Heskett 2016, 231)

For Heskett it is important that governments send the signal that state policy prioritizes innovation and introduction of the new, and not protection of the old. "Establishing clear concepts of entrepreneurial approaches to design in small companies should be at the heart of any national design policy." (Heskett 2016, 232). The creative destruction of user-based design, rather than inertia-causing producer-based design, is especially important in the new economy or what today we might call the sharing or gig economy, made possible by the second internet revolution of mobile devises. "Similar developments are currently apparent with

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[6] In "A Design Policy for the UK: Three Suggestions" reprinted in Heskett 2016, 252-267 (originally unpublished and written as a contribution to **The Cox Review of Creativity in Business: Building the UK's Strengths** as commissioned the UK government in 2005), Heskett calls for changes in awarenesses and practices on behalf of businesses and designers, not for any specific government action. Heskett's is a "design entrepreneurial" form of industrial policy where entrepreneurs, especially small business where he finds growth, must be free to compete. The role for the state is to encourage education in design and policy which allows low barriers of entry for the introduction of change-making technologies introduced by designer-entrepreneurs. In this focus on entrepreneurship Heskett draws on Austrian economics (see specifically Chapter 4 in Heskett 2017-forthcoming).

companies being established on the Internet on the basis of new approaches to interactive design" (ibid.).

Governments should lead by example and not pick winners and losers. We find later that the US government does not prioritize creative destruction during the bailouts of 2009, nor in industrial policies leading up to 2009, especially in our case, for General Motors. (We also note today that vested interests, such as hotel and taxi-driver associations, labor unions and city, state and national governments are making it difficult for sharing apps such as Airbnb and Uber to compete with politically-entrenched asset regimes.[7])

> If governments wish to encourage such developments [designed-based value creation], they will need to understand what they can and cannot do well. They can continue on the basis of the status quo, attempting to control or influence overall trends, or they can encourage a diversity of new design initiatives. They can do this by building infrastructure and exploring possibilities of how to use design in their own activities, demonstrating in environments, communications and products not just an aesthetic veneer for bureaucratic inertia, but leadership through an encouragement of possibility (ibid.).
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> Above all, policies for promoting design and for design education are the most powerful tools available to governments, but these need to emphasize the new demands being made on business and design practice. *Businesses that do not adapt to change disappear*. (ibid., *emphasis added*).

John Heskett on Institutional Theory

In this section we discuss how Heskett's engagement with institutional theory can help explain why a bankrupt GM might not "disappear". Economic thought based on perfect-competition models cannot explain why a bankrupt company receives bailouts. However in the neo-classical synthesis, where it is perfect competition in the short-term, with Keynesian macroeconomic management in the long-term, we can find an argument for government intervention to increase aggregate demand

[7] See for example *Economist* 2016, which notes how the city of San Francisco is requiring that Airbnb renters register with the city, and is to fine Airbnb $1,000 per day for each renter not registered. Airbnb replies that it cannot require its renters to register with the city. City and other governments and their vested interests do not like the sharing / gig economy because it is difficult to locate, tax and unionize. We also note that the US Treasury declares Bitcoin an asset, so that the IRS can collect capital gains taxes on Bitcoin and to prevent currency competition against the US dollar ($US), the Federal Reserve Bank being a trusted purchaser of US government debt denominated in the US dollar.

during times of economic slow-down where the economy is not creating enough 'jobs' for acceptable levels of unemployment.[8]

Keynesian economic fiscal intervention is supposed to in theory transfer resources from those who are saving to those will spend in the short-term in order to set in place the 'multiplier' which reverberates spending increases through the economy. Demand management provides the *why* for intervention, but we need insights from institutional theory for the *how* and *who* of redistribution.

Heskett starts with the work of Ronald Coase to illustrate the 'transactions-based approach' of new institutional economics. Firms are faced not just with the allocation of scarce economic resources (land, labor, capital and entrepreneurial talent) but with management of its social and political environments as well. He then brings in the work of Oliver Williamson to describe how decisions on resource allocation (and the cost of managing these resources) are based on "asset specificity," assets are not perfectly substitutable and are specific to a given time and place based in the historically-derived institutional environment.

> In what has become known as New Institutional Theory (NIE), examining this pattern of complexity has given alternatives to Neo-classicism a new impetus. A seminal paper in this direction was by Ronald Coase in 1937, "The Nature of the Firm," in which he questioned the Neo-classical argument that the price mechanism is the determinant in how markets allocate resources. If this was so, he asked, what was the reason for the existence of firms? In examining the actual workings of firms he identified a layer of functions beyond those associated with production that he termed "transaction costs." These, he argued, were of equal importance to manufacturing costs in explaining the existence and workings of a firm. By transaction costs, he included all the costs that were an essential part of how a firm undertook its business, such as purchases of materials and supplies, banking, legal and insurance costs, information and promotion, design and delivery. Minimizing transaction costs was therefore suggested as the primary function for firms but Coase also envisaged how transaction innovations and efficiencies

[8] Heskett (2017-forthcoming, his most complete work on value theory) does not discuss Keynesian economics nor the neo-classical synthesis in his unified value theory. We introduce Keynesianism here (the macroeconomic mainstream) to illustrate why the bailouts of 2009 are the result of conventional economic wisdom and concomitant justifications for statist interventions, and also to conclude that this mainstream thought is not adequate to explain specific cases of resource redistribution during the downward portion of the business cycle. Heskett is correct in noting that institutional theory can help explain specific cases, while Keynesian theory is a general theory.

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> contributed more widely to an economic model involving product innovations and dynamic imperfect competition (Heskett 2017-forthcoming).

In a creative destruction policy environment resources are allocated more by the market (and consumer sovereignty) whereas under firm-based allocation decisions, resource allocation becomes more political. Heskett uses the work of Williamson and Douglass North to draw-in the limits to human rationality in making resource allocation decisions, entrepreneurs are not all-knowing as in the neo-classical models. In modern capitalism, some economic actors have more information than others, and can use this information for strategic purposes to curtail competition or to gain other economic rents.

> This is typical of modern economies, which are more impersonal, requiring complex contractual relationships for their functioning. Personalized relationships and codes of conduct might still be important but the *returns for opportunism and dishonesty* require some form of coercive third party, which is best achieved by creating a set of rules that make constraints effective (Heskett 2017-forthcoming, *emphasis added*).

It is this *opportunism* which concerns us in our research here on GM. In the case of the GM restructuring of 2009, it is the US government – who is supposed to be the impartially coercive third party – which is in fact party to the opportunism. Instead of creating value through user-centered design, we find that GM focuses attention on gaming the rule-makers to gain advantage. In return the rule-makers get political patronage and discretionary power.[9]

[9] Nelson (1994, 1) uses the notion of a "regime" to refer to what we would now call asset specificity. "The concept of a regime, which is discussed in detail in section IV, refers to the institutions, rules and norms that regulate relations among the members of the regime. We are interested here in the sectoral regime regulating relations among producers of automobiles – especially the firms, labor and the US government. In addition…independent producers of intermediate goods for the auto industry [especially the steel and parts industries] have occasionally been significant participants in the politics of auto trade policy."

From http://jalopnik.com/the-ten-worst-cars-gm-ever-built-1577414782 , permission requested

The caption for this photo from the internet reads:

The 1972 Chevette

Quite possibly the most-hyped car of all time turned out to be a classically GM nickel-and-dimed turd.

A brief history on the rise of "asset specificity" in the US auto industry

Until the oil-shocks of the 1970s US automakers dominated the US market and there was little call for rents. However starting in the mid-1970s the United Auto Workers trade union begin to agitate for protectionism in the form of anti-dumping policy; in 1976 the US Treasury Department announced that it would seek a "negotiated solution" with the foreign automakers.[10] In 1977 the Labor Department announces that workers in US auto plants affected by imports are eligible for federal adjustment assistance. These interventions despite the fact that in the 1970s the foreign share of the US auto market was less than 7% (see Chart 1).

[10] "The UAW was the first major player to actively pursue protection" (Nelson 1994, 3).

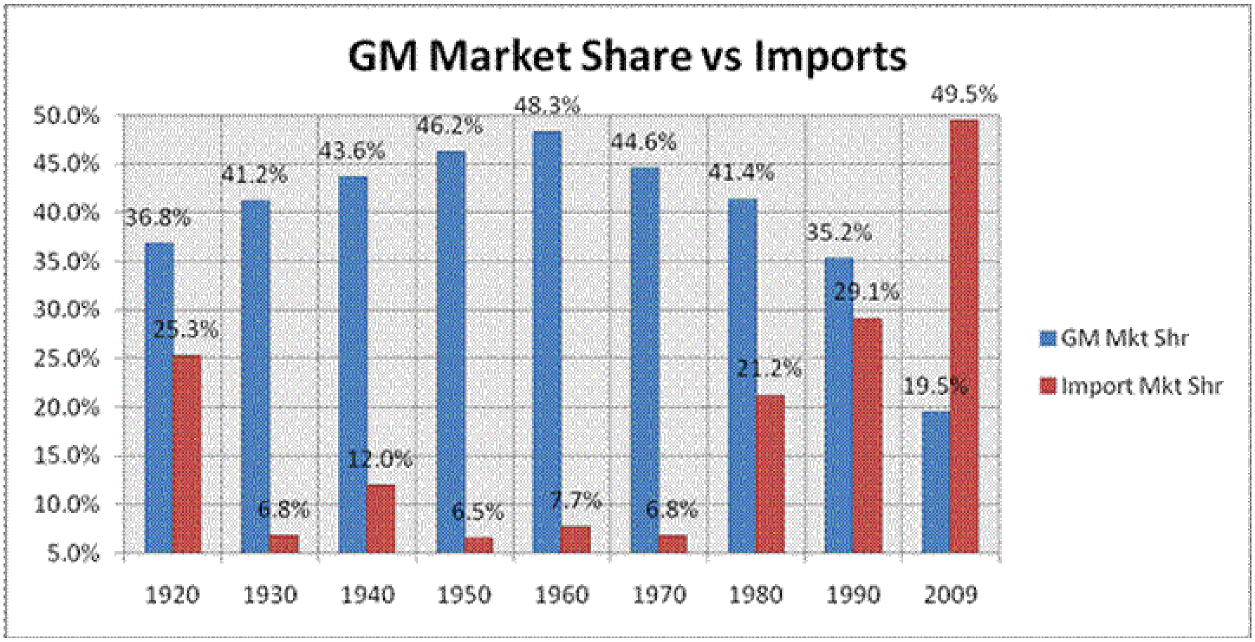

Chart 1: GM and Foreign Share of US Market (from gminsidenews.com)

This situation changed in the 1980s when the foreign share of the US auto market is now greater than 20%. US automakers could not catch-up to the more fuel-efficient, better designed and less expensive Japanese cars. In 1977 the UAW starts agitating for import restrictions unless foreign auto companies invest in the United States. In 1978 the US Trade Representative "pressured Toyota and Datsun to manufacture autos in the US" (Nelson, 1994, 4). In 1980 (an election year) Chrysler receives a $1.5b loan guarantee from the US government after "the UAW, the Michigan congressional delegation and Detroit Mayor Coleman Young were actively mobilizing popular and Congressional support for a bailout" (ibid.). Opposed to the Chrysler bailout was the strange (or perhaps not-so strange) combination of "the National Association of Manufacturers, Ralph Nader's Congress Watch and the National Taxpayers Union" (ibid.).

Douglas R. Nelson in his 1994 NBER study on the US auto industry finds a source of structural change in US political economy,

> By early-1980 many members of Congress had recognized the issue of auto industry distress had widespread appeal as a political issue. That a core industrial sector that had long been dominated by US firms was "threatened" by Japanese competition, crystalized public concern with the nation's economic performance and the role of "unfair" foreign competition in that performance. These public concerns made the auto issue a focus of a

much wider range of political activity than even an industry as economically significant as the auto industry would normally expect to generate (Nelson 1994, 5)

Ford and the UAW filed for protection against Japanese competitors in 1980 with the US International Trade Commission voicing that foreign imports were the cause of the low profits and declining market share in the US auto industry. Instead, the ITC rejected the filing stating that market stagnation was due to general economic recession and voted against trade protections (note that this economic recession argument was used as justification *for* the 2009 bailouts).[11]

From http://jalopnik.com/the-ten-worst-cars-gm-ever-built-1577414782

The caption for this photo from the internet reads:

The 1978 Corvette

Don't believe the tires, those were not good years. Only 180-90 horsepower from a 5.7l V8? You must be having a laugh.

The situation at the time is illustrated by an anecdote about William Niskanen (1933-2011). Niskanen became Ford's chief economist in 1975 and was outspoken against Ford's rent-seeking and Ford's movement towards a corporate policy against free-trade. Niskanen believed (like Heskett on GM later) that the

[11] President Carter is against protectionism as believes competition is healthy for US automakers (Nelson 1994, 5.)

company's problems were due to making cars that the consumer didn't want due to bad quality, performance and design.[12] Niskanen wrote a company memo arguing against protectionism stating, "A common commitment to refrain from special favors serves the same economic function as a common commitment to refrain from stealing" (Segal 2011).

Niskanen was shortly thereafter fired from Ford and went to work for President Reagan's Council of Economic Advisors. The Reagan Administration announces a three-year Voluntary Export Restraint (VER) program for Japanese autos in 1980 (later extended to four years, and not fully removed until 1994 [Benjamin 1999]) due to the perceived public bias against "Japan, Inc.", and to which Japan's MITI agrees in 1981 (Nelson 1994).[13]

> Trade policy in the Reagan administration is best described as a strategic defeat. The consistent goal of the president was free trade, both in the United States and abroad. In response to domestic political pressure, however, the administration imposed more new restraints on trade than any administration since Hoover. (Niskanen 1988, 137).

Nelson uses a survey approach of findings on the results of the VER policies to illustrate the significant changes in the US auto industry due to the consolidation of asset specificity (the entrenchment of special interest regimes) leading to the big GM losses in 1991 and 1992. Protectionism means that per-car costs for US automakers are 35% greater than Japanese cars, and that only textiles and steel have higher consumer costs (1994, 21). In addition during the period the shares to returns on labor and profits for US automakers do not change, showing the consolidation of the regime. "However, it would also appear to be clear that these profits primarily reflect increased rent extraction from US consumers" (ibid., 24). Nelson also notes that it appears Ford and possibly Chrysler have become more

[12] Nelson (1994, Table 3, Appendix) finds that for the period 1980 to 1991 Ford cars needed repair twice as often as did Japanese cars, whereas for GM the figure is almost three times as often.

[13] Niskanen later falls out with the Reagan administration due to its economic policies (in this case, its tax policies, which increases corporate income tax rates) and becomes chair of the libertarian Cato Institute. See Sorkin 2016 on how car parts companies, indirect recipients of the $80 billion GM and Chrysler bailout funds and who advocated for the bailouts, are now using "inversions" to reduce corporate income tax, "Ultimately, the only way inversions will stop is when the corporate tax code changes so it becomes more attractive for American companies to be American companies."

competitive over the 1980s compared to Japanese competitors, but the larger GM did not become more competitive.

From http://jalopnik.com/the-ten-worst-cars-gm-ever-built-1577414782

The caption for this photo from the internet reads:

1987 Pontiac Le Mans

Nothing could hide the fact that the latest Pontiac was no more than an old Opel built in South Korea only to get rebadged and sold in the US. Imagine how the tooling must have looked at that point!

Benjamin (1999) finds that the key impacts of the VER were for the period 1986-1990 (when there were less macroeconomic drags on the economy); Japanese-made cars are 14% more expensive in the USA than they would have been absent quotas and Big Three profits increase more than 8% per year (until the large GM losses of 1991). Also during this period is a rapid increase in imports as a share of US automobile sales, a rapid increase in foreign automakers locating to the USA (in regions where the UAW has less power), and, US auto parts makers, retail car dealers, and auto financing arms become part of the special interest regime.

John Heskett on Design and General Motors

John Heskett's 1992 article, "GM's current woes reveal the price of corporate arrogance and amnesia," is written at a time when US protectionist measures, and resulting negative effects on design quality due to reduced competition, come home to roost, with GM net losses and lay-offs after years of rent as steady and increasing profits.[14] For Heskett protectionism leads to arrogance through eliminating the perceived need to compete.

> But GM is not an isolated case. Rather it is symptomatic of a generation of companies once dominant but now struggling to adapt to competition and change. As the largest and most powerful of these firms, however, the problems of the automobile companies are more public and painful.
>
> Sympathy for the automobile companies would flow more easily if they acknowledged their present woes as essentially of their own making, but such honesty is an exception. It is simpler in difficult times to blame problems on someone else. Scapegoats are easy targets, something Americans should well understand, having often been the butt of other countries' discontents over the years. Yet it often seems Americans are collectively intent on proving the old adage about those who fail to learn from history being condemned to repeat its errors (Heskett 2016, 183).

Heskett also finds arrogance (or amnesia) in the way US automakers forget their own beginnings and blame others for their myopic vision of production-oriented rather than customer-oriented design strategy.

> An example is the resentful implication that the Japanese have "stolen" or "copied" designs and processes developed in the U.S. and somehow, through underhanded dealing, made a commercial success of them. This conviction can be hilariously funny until one realizes that many people take it extremely seriously. They don't know, and maybe don't want to know, that the foundations of American industrial power were laid by very similar means.
>
> Detroit's convenient amnesia, for example, omits mentioning that the automobile was not an American invention—it originated in Europe. And Americans did exactly what they accuse the Japanese of lately doing, namely, manufacturing a product invented somewhere else, in unprecedented quantities, to hitherto unknown standards of design and quality, at a price affordable by millions, and with great benefit to themselves. It is a perfectly legitimate thing to do, and good business if done well. We should get back to doing more of it (ibid.,184).

[14] GM loses almost $2b in 1990 and $4.4b in 1991, after at least a decade in profits, see Appendix for GM profit and loss since 1982.

Heskett compares the histories of GM and Ford. Henry Ford of course created mass manufacturing with the Model T in 1907 and dominated the US auto market for the next 20 years. However Ford became complacent with its production-oriented strategy, and Henry Ford is rumored to have said, "You can have any color you like, as long as it's black." Shortly thereafter GM under Alfred P. Sloan takes an opposite tack, that of prioritizing design as strategy, which orients production for the consumer through innovation and entrepreneurship (leading to monopolistic competition and GM's market dominance instead of Ford's). Sloan creates an Art and Color section at GM, renamed the Styling Section in the 1930s (now, GM Design) and by the 1950s GM employs more than 1400 designers.

> The GM model of design was adopted by other automobile companies and by firms in other industries. Indeed, if one considers current arguments about promoting design in companies—support from the CEO, positioning design at a senior level, focusing on products, allocating adequate staff, facilities and so on—General Motors under Sloan was a pioneer and a model.
>
> Apropos of introducing design into business school curricula, Sloan's autobiography is probably the only book with any reference to design read by several generations of business school students. As a result, his concept of design as styling still has enormous sway over American corporate consciousness (Heskett 2016, 185).

Heskett in 1992 is stock-taking as to what went wrong with GM, from corporate innovator in the use of design-oriented strategy through the 1960s to what less than a year later after Heskett is writing in 1992 becomes the largest corporate loss in US history. "So what went wrong? There are no simple answers. In part, Sloan's emphasis on external form as a marketing devise eventually lead to a gulf between form and function, between image and reality. The balance was lost" (ibid., 186).

Heskett describes how GM grew as a bureaucracy and began to focus on financial returns (Veblen's *pecuniary habit,* although not mentioned in the 1992 article, but later in Heskett's work in the history of economic theory, has replaced Veblen's *instinct of workmanship*[15]) and on protectionism rather than competition and creative destruction. (We note too that US automakers also have come to use

[15] For more on Heskett on Veblen see especially Heskett (2017-forthcoming). Under Veblen's taxonomy an *instinct* is something normatively positive for human progress whereas a *habit* is normatively negative.

macroeconomic downturns as an excuse for underperforming when requesting government assistance.)

> GM's huge size and unwieldy bureaucracy also took a toll. Sloan had always sought a diversity of design ideas, insisting each division should have its own distinctive character. But his successors played it safe, massaged the numbers, and soon one product was indistinguishable from the next. Since all the automobile companies followed GM's lead, by the 1970s a depressing similarity and lack of quality had opened the door for overseas competitors.
>
> And what of Sloan's concept of design as the cutting edge in recommending products to customers? It turns out that it wasn't design that was neglected, but the customers. Design became absorbed by a profound inertia stemming from success. It became parochial, refusing to acknowledge that other approaches might be valid. In 1989, the head of GM Design, Chuck Jordan, was quoted at the Tokyo Motor Show as saying, "The Japanese haven't gotten their act together, design-wise. There are some ugly, ugly cars here." Buyers across the world were deciding otherwise (Heskett 2016, 186).

We learn that Japanese auto makers are focusing on "life-style" design-oriented strategies, where quality is taken for granted and the consumers' values, both aesthetic and economic, are incorporated in firm's strategies.

> Above all, lifestyle expresses values, and requires a corresponding expression of values in the products offered to meet that market's needs. Although the engineering quality of American automobiles has clearly improved recently, measures of success based on statistical conformance may not be enough. In a lifestyle market, performance quality is something everyone takes for granted. Adding value by design will need to mean what it implies: a content of real value, expressed through both aesthetic and economic dimensions (ibid., 187).

By 2005 in a report commissioned by the UK Design Council Heskett is expanding on his concept of "design as strategy". Design should be taken at a holistic level by the firm and should permeate the firm's organizational structure, the firm's strategic planning process, and the firm's implementation or product roll-out and review processes. This integrated relationship between the firm and design is illustrated below.

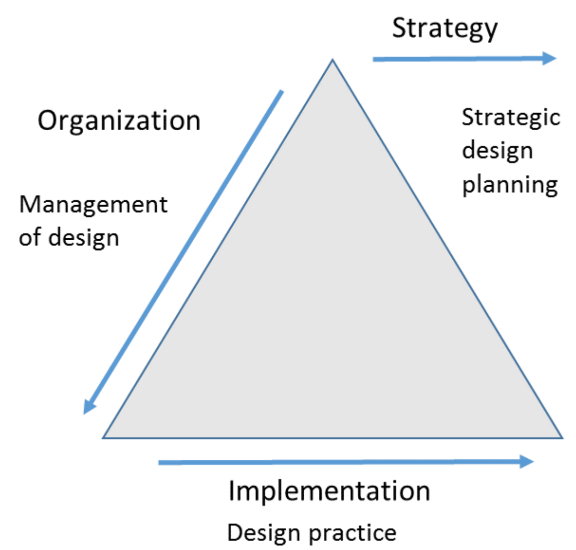

Illustration 1: Design as strategy, from Heskett (2016, 258), used by permission.

Design is different than styling (which becomes an unstainable “formula” at GM) and firms need to understand this and incorporate design as strategy, not just as implementation. This integrated concept as well needs to be understood at a national policy level and is to be included in both graduate business schools and design programs at theoretical and practical levels (though we note above when Heskett is writing in 1992 on the genesis of US and Japanese auto-making, that he is weary of an over-emphasis on intellectual property protection).

> There is currently much talk of design as strategy but scant clarity about what it really means or can mean. Considered in the most elemental terms, any business has three functions: it needs a strategy that explicitly or implicitly sets out what it intends to do and be; it requires a managerial structure to organize implementation; and implementation in tangible or intangible form (Heskett, 2016, 259).
>
> The emphasis of the introduction to the Design Council’s submission to the Cox Review seems to me to give exactly the right emphasis: “… our primary goal must be to make UK managers the best users of design in the world” - in other words, the management of design as an aspect of its integration into all aspects of corporate activity. Although this emphasis is rare in practice and ill-defined in theory, however, where it does function successfully, as at Samsung, the results of strategically positioning design can be spectacular (ibid., 260).

We find that GM faces continued decline without a change in corporate strategy, firms must lose their self-interest (what we call *returns for opportunism and dishonesty* when we delineate the growth of the asset specificity regime in US auto manufacturing above) and adapt a consumer-interested strategy. Consumer sovereignty is needed to create value.

> Meanwhile, the continuing pleas for protection from Detroit ignore this trend, insisting instead that American designs be judged in terms different to what manufacturers in the rest of the world can provide. Protectionism of this kind is self-interested, seeking to deny the American public its right to purchase the best design from wherever it comes (ibid., 187).

However Heskett notes that arrogance and amnesia are not irreversible.

> Decline is not inevitable. Ford reversed a trend in the early 1980s by encouraging its designers to focus on what they believed to be the best. But staunching the hemorrhage at GM and other companies that dominated the age of mass production will require a fundamental cultural shift. From the illusion that everything can be altered but nothing has to change, there needs to be an acceptance that times are profoundly different. This means facing the future instead of trying to recreate the glories of the past, coming to terms with this different world, rather than expecting it to dance to your tune.
>
> Understanding a user-oriented market requires another kind of business organization, with a radically different application of design, going far beyond the concept of styling. This shift represents an enormous challenge, requiring confidence and a clear vision of the future. In contrast, demands that Americans buy products they don't want and that Japanese buy products not even designed for their conditions, reinforce a sense of obsolete, producer-oriented arrogance (ibid.).

The GM bailout of 2009

We know from the bailout of GM in 2009 that the asset specificity regime which becomes entrenched in the US automobile industry in the 1970s and 1980s is stronger than any need for GM to compete with user-oriented design in a market with creative destruction characteristics. Heskett's "arrogance and amnesia" have replaced value-creation and consumer sovereignty. And the results of the 2009 intervention also show that the pecuniary habit has replaced the instinct of workmanship and politically-based asset allocation decisions at the firm level have replaced decisions towards creating value in the competitive market.

Despite losing more than $69 billion in 2007 and 2008, GM is 'saved' from bankruptcy and liquidation through a nationalization by the US government in

2009. This nationalization violates bond-holder rights by forcing bond holders to take equity shares less than the value of the bonds[16] and which wipes-out all existing shareholder claims while at the same time giving majority equity-ownership to the US government (61% of post-restructuring shares) while the next largest portion of equity goes to the UAW (17.5%) (Goolsbee and Krueger 2015, Krisher 2009, Heberling 2009). The nationalization / recapitalization divides GM into two parts, a "Shiny New GM" (Goolsbee and Krueger 2015) capitalized with GM's $82b in assets at the time of the June 2009 bankruptcy filing, and a second entity which carries GM's $173b in liabilities at the time of bankructy. The US government in total lends $51b to GM and $17.2b to GMAC Finance.[17]

Austan D. Goolsbee and Alan B. Krueger, economists who were advising the Obama administration during this period from positions within the US Treasury Department and the Council of Economic Advisors, write that it was estimated that from 1.1 million to 3.3 million jobs would be lost if GM and Chrysler are not bailed-out in 2009, "we feared a chain reaction" (2015, 12). Retrospectively writing in 2015 Goolsbee and Krueger find, "The increase in the number of jobs in motor vehicle and parts manufacturing accounted for nearly 60% of the total rise in manufacturing jobs in the recovery's first five years" (ibid., 20). For these economists the mainstream Keynesian diagnosis of the problem and the subsequent Keynesian interventions used to address the problem were both accurate and successful. However from the point of view of asset specificity we note that auto makers, auto parts makers, labor and auto finance are all special interests who

[16] Research into whether the GM nationalization is the first in which the US government explicitly violates private bond-holder rights has remained inconclusive. Jay Alix (2013) calls the GM case, "the most important bankruptcy in U.S. history." Michael Heberling (2009) writes,

> In a time when we are trying to restore faith in our financial system, the government chose to run roughshod over the investor class. This near-term political expedient will have long-term negative consequences. Other corporations [those not part of an asset specificity regime] will have a much harder time raising capital by selling bonds. If American investors get stiffed by the government, how will potential foreign investors view this shabby treatment? Could they be next?

[17] By the end of 2013 the US government has sold all its shares in GM and receives $39.7b of the $51b loaned and as well has liquidated its position in what was then GMAC Finance (Goolsbee and Krueger 2015).

gained from the intervention at the expense of the rule of law regarding corporate bond and equity investment in the United States.

For the specific case of GM, the US national system of Keynesian stability policies towards special interests wins-out. Creative destruction through civil bankruptcy gives way to macroeconomic stability and continued rents to regime stake-holders.[18] However the 2009 intervention shows that the regime is even stronger today than in the 1980s or 1990s, though with a shift in power *from* the management class in the auto companies (who earn consistent bonuses despite decreasing market share in the years leading to 2009) *to* the UAW and the US government. When GM did not live up to the reorganization plan required by the Bush administration on condition of the TARP loan, President Obama fired GM CEO Rick Wagoner in March 2009 and in July 2009 the administration replaced half of the GM board (Goolsbee and Krueger 2015, 13)

In November 2008, leading to the Bush administration's TARP-funded interest-free loan to GM, which opened the door for further US government bailout of GM, the chief executives of the Big Three testified before Congress stating that bridge-funding was needed because of buyers' and dealers' lack of access to credit due to the national financial crisis[19] (the Motor and Equipment Manufacturing Association submits a February 2009 request to the Treasury, also requesting government financing).

> When critics highlighted the US auto industry's decades-old problems of high cost, questionable quality, and the like as factors contributing to the industry's troubles during the financial crisis, the executives argued that they were no longer an issue. In reality the Big Three automakers' problems had built up over many years and were certainly not solely a result of the economic downturn (Goolsbee and Krueger, 2015, 5)

Goolsbee and Krueger (2015) contains a survey of the cost differentials between US manufacturers and the foreign transplants in the US around the time of the nationalization/bailout. We can use these findings to illustrate how solidified did the asset specificity regime for the US automaker market (and the other special

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[18] The Dodd-Frank Act of 2010 also gives immense power to the US government for determining which finance-oriented "nonbank" companies are "too big to fail" (and which firms are not finance-oriented?) with negative implications for creative destruction through civil bankruptcy on-going.

[19] In February 2009 the Motor and Equipment Manufacturing Association submits a request to the US Treasury for government bailout financing (Goolsbee and Krueger 2015).

interests up and down the supply chain) become from the mid-1970s through today. Big Three labor costs are 25% higher than the transplants and 45% higher when legacy costs are accounted for. In addition the UAW established that workers receive 95% of their salaries when on lay-off (making labor a fixed rather than variable cost).

> To summarize, the problems facing the automakers included long-term falling market share, compounded by a massive short-term drop in aggregate demand, with large fixed costs and even if the recession ended and aggregate demand returned to normal levels in the short-run, unless they could stop the persistent decline in market share, these automakers would soon be back in trouble (Goolsbee and Kruger 2015, 7).

The bailout and restructuring conditions on GM require the firm to make costs more in line with the foreign transplants (and prevents the company from opening foreign plants replacing US workers) and to shut down unprofitable dealers. Given the politics of the US auto asset specificity regime, the efficiency and efficacy of these mandates remains to be seen.[20] Although GM has been operating profitably since 2010 (no doubt more than $65 billion in "free" financing for four or five years has been helpful for GM's recovery), only time will tell whether or not arrogance and amnesia will again be in evidence with the next macroeconomic crisis. We do know that the goal of "stability" has been achieved in the near-term as GM's market share has been lately consistent near 18% of the US market share. It is not yet clear whether this result is due to quality or bailout.[21]

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[20] Kessler 2015 finds that the number of auto dealer franchises now number 18,000 down from 22,000 a decade ago, and those in business are customer service oriented and profitable, "Dealerships increasingly have the high-tech atmosphere of an Apple Store, and consumers arrive fully informed about a car's features and price. It's a marked departure from the high-pressure sales environment traditionally associated with dealerships." We expect to see asset specificity rents in this segment of the market, "Also, strong franchise laws – fiercely defended in state legislatures – still give dealers a virtual monopoly on selling new cars."

[21] "Since the restructuring, there are some signs that quality has improved and that price discounting has become less aggressive, though the jury is still out" (Goolsbee and Kruger 2015, 14)

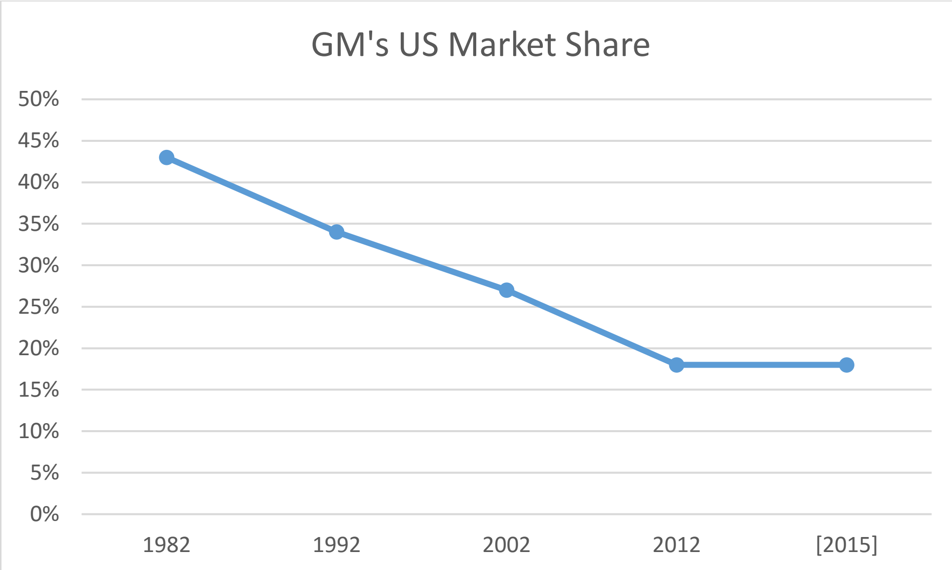

Chart 2: GM's US Market Share, adapted from Goolsbee and Krueger (2015) and *Wall Street Journal* (2016).

Conclusion

John Heskett is using the example of General Motors in the United States in 1992 to make his larger point that value creation needs to be both aesthetic and economic and that firms who integrate design with a consumer-oriented approach to include consumer feedback (he does not use the work "prosumer" but might have) will outperform those firms which are less consumer-oriented. He finds that GM is both arrogant and amnesic in its stubbornly producer-oriented approach, much as Henry Ford was after gaining the predominant market share in the early US auto industry.

In his subsequent writings Heskett turns to the history of economic thought to create a platform by which business people and designers can better understand and integrate the value-creation process, and where radical design as strategy puts in place the creative destruction necessary to have economic growth which is both qualitatively and quantitatively significant. Heskett finds that mainstream economics cannot adequately explain the entry of new products into the market and that mainstream management theory does not adequately address the role of design in the firm. To integrate these ideas Heskett turns to institutional economic theory to show that firm management and decision-making is contextual to time and place, something economist Oliver Williamson calls “asset specificity”. Heskett also draws from Austrian economics, in his emphasis on designer as entrepreneur, and from German writings on the National System to delineate national context.

Heskett mentions, but does not explore in any detail, the negative aspects of asset specificity. We do so in this article using Heskett’s 1992 article on GM as a starting point. Specifically we show that the political economy of the US automobile industry since the oil shocks of the 1970s has become one of entrenched special interests seeking rents. We see this in the continued existence of GM, which had accumulated net losses at the time of its US government take-over in 2009, a take-over and restructuring which prioritizes the US government and the United Auto Workers at the expensive of GM equity and bond-instrument investors in the name of macroeconomic stability and job creation, and at the expensive of creative destruction and civil bankruptcy. GM profits have returned and the GM market share in the US market vs. foreign competitors is stabilized however it remains to be seen what the massive US government restructuring of GM has done for the ability of the US national system to attract foreign investment in the long-term.

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Appendix: GM's Profit and Loss from 1982 through 2015

Year	Profit (Loss) ($ billions)	
1982	0.96	
1983	3.70	
1984	4.50	
1985	3.99	
1986	2.95	
1987	3.55	
1988	4.86	
1989	4.22	
1990	-1.99	
1991	-4.45	
1992	-23.50	
1993	2.47	
1994	4.90	
1995	6.90	
1996	4.70	
1997	6.70	
1998	2.96	
1999	5.70	
2000	4.50	
2001	0.60	
2002	1.50	
2003	3.80	
2004	3.60	
2005	-10.60	
2006	2.20	
2007	-38.70	Total through nationalization
2008	-30.90	and restructuring of 2009
2009	-4.30	-35.18
2010	4.70	
2011	7.59	
2012	4.86	
2013	3.77	
2014	2.80	Total through 2015
2015	9.69	-1.8

The yearly profit data for GM comes most predominantly through the *New York Times* archives, though other sources are used when GM results are not published in the *New York Times*. We start with the year 1982, 10 years before John Heskett's 1992 article on GM in *International Design*. The following is a list of internet sources from which the GM profit data is sourced (accessed July 8 to July 15, 2016).

http://www.nytimes.com/1982/02/02/us/gm-posts-profit-for-1981-as-slump-in-sales-persists.html

http://www.upi.com/Archives/1983/02/07/GM-posts-biggest-profit-in-three-years/5731413442000/

http://articles.latimes.com/2002/jan/17/business/fi-gm17

http://www.nytimes.com/1993/02/12/business/company-reports-gm-lost-23.5-billion-last-year.html

http://www.nytimes.com/1994/02/11/business/company-reports-gm-posts-2.47-billion-profit-for-93.html

http://articles.latimes.com/1989-02-14/business/fi-2351_1_earnings-record

http://www.nytimes.com/2008/02/12/business/worldbusiness/12iht-12gm.9975802.html

http://www.nbcnews.com/id/23124844/ns/business-autos/t/gm-reports-biggest-ever-automotive-loss/#.V35vuo-cHic

http://www.nytimes.com/2014/02/07/business/general-motors-reports-lift-in-quarterly-earnings.html

http://www.marketwatch.com/investing/stock/gm/financials

http://www.gurufocus.com/financials/GM&affid=45223

http://www.accountingweb.com/gm-revising-2000-to-2005-profit-figures

http://articles.latimes.com/2011/feb/25/business/la-fi-autos-gm-profit-20110211

http://www.nytimes.com/2011/02/25/business/25auto.html?_r=0

https://www.stock-analysis-on.net/NYSE/Company/General-Motors-Co/Financial-Statement/Liabilities-and-Stockholders-Equity