Too Big to Fail

By Michael E. Chadwick, CFP®

This is a common theme people seem to develop when companies are very successful and turn into giants of industry, they are simply too big to fail. The theme isn't always correct as has been proven hundreds of times with virtually every type of business that exists. In the automobile business there are countless numbers of firms that have failed in the past, names such as American Motors, DeLorean, Edsel, Columbia, Oldsmobile, Pierce-Arrow, etc. With the economic environment we have today many are wondering if any of today's big three auto companies (GM, Ford, and Chrysler) will make it out of this economic situation. It's a valid argument today that we need a trade in the game and that the big three are now GM, Toyota and Ford. The bottom line is no company is too big to fail; Toyota can make a series of bad decisions and be gone in just a few short years. I don't expect that to happen, but nobody expects firms to fail, especially when they've established a large size business. One thing is for sure, if you continue to do what you've always done and expect different results, that defines insanity. Many firms today are changing gears as quickly as they can. The companies are trying to ramp up production of efficient vehicles and decrease production of large, inefficient vehicles. This is a good sign and although there will be some pain in the process with layoffs, plant closings and price cutting, it'll ultimately help the consumer in delivering what is wanted. If your car manufacturer were to fail today, it wouldn't really impact the car you are driving, its ability to get you back and forth or its reliability. It may affect the dealer network, parts availability and resale value, but it won't stop you from getting around. People think poorly of US automakers but their issues aren't all their faults – government regulation and intervention and lopsided union deals contributed to most of the current woes of US automakers.

In the financial arena it's a whole different issue if your company goes under. The government just took over Fannie Mae & Freddie Mac by taking them into receivership, admitting failure of the two largest mortgage giants on planet earth. The government just provided AIG with a "bridge loan" of $85 billion at 11-12% interest and has the right to buy 79.99% of the company's stock – essentially a takeover but giving the company a chance to fix its woes. If you were an investor in any of those companies, you have unfortunately lost about 97% of your investment. AIG shareholders still have a chance at gaining value long term if they can pay off the government loan and buy back their shares. When investments go real bad, you may recoup some, but it doesn't look good. In finances, it's critical to know the financial health of the company you're investing in, as that health will ultimately determine your long-term financial happiness or unhappiness. There are many ways to get around investing in a Fannie or a Freddie, AIG, a WorldCom or an Enron. If you don't know how to read financial statements and determine the value of a company today and if it makes any sense in buying the company, don't buy individual stocks. To further complicate things, a company like AIG is financially health, even today but accounting mark to market rules caused a major part of their problems, even though their underlying businesses remain healthy. Wall Street has too much credit card debt today and has to deleverage itself. I see too many people fail because they buy a stock based on a hot new product or service, knowing nothing about the company. The best example of this is Sirius & XM Satellite radio, everyone had to have these stocks as they sounded sexy, neither have ever made a penny to date, even as a merged company. You also need to stay on top of each company to see how it's going as time unfolds. Things change and you must stay on top of this business. If you're not cut out to do this, you're not cut out for stock investing. Your best bet is to buy mutual funds or unit investment trusts. These products offer you the ability to buy businesses that have the potential for appreciation, with people at the helm to get out of them if something goes awry with the business. With today's extreme volatility also comes extreme opportunity, but only for those who can see clearly through the financial fog. Don't let emotion paralyze you financially: act intellectually and not emotionally. Who are you going to depend on for your financial future? It's much more important than if any company succeeds or fails! ☺

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