<u>WHEN IS AN ENTITY TOO LARGE TO BE ALLOWED TO FAIL ?</u>

A subject that many an economist of the world, today, is trying to fathom is when is a corporate entity too large to be allowed to fail.

Over the past few years, one has witnessed the 2 Detroit manufacturing giants, having been bailed out with billions of US dollars, all of which, one could rightly say was US taxpayers' money.

The 2 Detroit manufacturing giants were General Motors Company and Chrysler LLC. They were saved from the knacker's yard by the US Government because it was deemed that they were too large to fail – too many manufacturing jobs were at stake, more than 200,000, in fact, from General Motors Company, alone.

Following a corporate reorganisation, General Motors Company emerged from Chapter 11 of the Bankruptcy Code of the United States of America and successfully simultaneously pitched a $US23-billion **I**nitial **P**ublic **O**ffering (**IPO**) on The New York Stock Exchange and The Toronto Stock Exchange on November 18, 2010.

As a result of this successful IPO, which was, at that time, the largest the world had ever witnessed, the US Treasury, which, by then, owned 61 percent of the Issued and Fully Paid-Up Share Capital of this motor-vehicle producer, was reduced to 33 percent.

Disposal of these shares grossed The Treasury with $US13.60 billion in cash.

General Motors Company lived up to its financial commitment to the US Government, repaying its debts; and, the jobs of about 209,000 workers were saved.

At the time that it filed Chapter 11, General Motors Company was in debt to the tune of about $US173 billion.

Was it deemed too large to fail?

The US Government thought so and US President George W. Bush, among others, was gravely concerned about the backlash if General Motors Company went into Liquidation.

President George W. Bush determined that the US Government could not permit this giant, motor-vehicle manufacturer to fail. He announced an emergency financial rescue plan for General Motors Company, Chrysler LLC and Ford Motor Company, making available, immediately, $US13.40 billion for the Detroit trio.

Ford Motor Company, however, did not take any of the US Government's money, stating that it did not need it.

General Motors Company quickly gobbled up its slice of the cash *'pie'*.

History will, probably, record that the actions of the US Government saved the day.

But what would have happened if the US Government had not come to the rescue of General Motors Company and Chrysler LLC?

Would there have been a General Motors Company and a Chrysler LLC today?

Further, if General Motors Company had been unsuccessful in its IPO plan, being unable to obtain $US23 billion in interest-free money from the investing public of the US and Canada, would the US Government have had to pour good money after bad until the US money *'well'* ran dry?

If, after multiple attempts to rescue General Motors Company with US Government loans, amounting to the hundreds of billions of US dollars, and still the corporation could not be saved, how could the US Government have explained such a situation to the US taxpayer?

Who would pay the piper?

Politically speaking, it would have been a horrendous landmine on which the Administration of President George W. Bush had tripped over.

And so: At what point should a corporate entity be permitted to fail?

<u>Likely Solutions to the Conundrum</u>

There comes a time when a company becomes too big for its britches and, at that point, it starts to fail.

That is what happened at General Motors Company.

Corporate failures of material proportions could, and almost certainly will, happen in the future … unless, statutorily, brakes can be applied to a corporate entity when it is determined that it is running into trouble, one way or another.

In business, the concept of a momma-and-papa shop style of management can only be effective to a certain extent and, then, if momma and papa are not au fait with the concept of institutionalisation, whereby management responsibility is shared by committee(s), control of the business will, ultimately, decline until, eventually, the business will cease to be viable.

The same is true of a family run business, based on the hub-and-spoke management principle whereby management is controlled and centralised at a corporate hub – which is the single controlling shareholder(s) or a single family, owning all, or the lion's share, of the equity of the corporation – and every member of the senior management of the corporation reports to that hub for instructions.

Such management styles are not workable in large corporate entities because, simply put, there is just too much work for any one person or any one family to tackle on a day-to-day basis.

Delegation of responsibility becomes mandatory when a corporate entity reaches a certain size.

<u>Anti-Monopoly Legislation</u>

The introduction of anti-monopolistic practices to the world was, in the 19th Century, deemed to be an important breakthrough in stamping out big businesses and multi-million-dollar trusts, manipulating governments.

In the 21st Century, it appears that new legislation will have to be passed into law in order to prevent a situation, such as that which took place in the case of General Motors Company.

No government wants a repeat performance of such a situation.

If a bank, such as HSBC Holdings plc, the second-largest such institution in the world, today, is seen to be too big and, effectively, a prospective, potential danger to an economy and/or to the political machinery of a government, then, action will have to be taken to break up such an institution for the benefit of the bank, itself, its many shareholders, and for the benefit of all of its 307,000 employees and its 100 million-plus customers as is the case in respect of this bank.

One can only speculate as to the catastrophe that would follow in the wake of a financial failure of a banking institution of the size of HSBC Holdings plc if it were permitted to declare bankruptcy – unable to pay its debts as they fell due.

For such a bank to failure, it would be cataclysmic, probably never witnessed in the history of the world; and, so statutory action must be taken to prevent such a situation ever coming into existence.

An institution of the size of HSBC Holdings plc has the ability, as the Americans like to say, to call the shots and, by so doing, it can be an intolerable bully, either by accident or design.

It has the financial muscle, second to none, to dictate terms to its customers, like it or lump it, and senior management cannot know, on a day-to-day basis, what determinations are being made by its underlings – because the corporation is just too large for such daily monitoring of the many and varied junior management decisions.

This is not to suggest that management of HSBC Holdings plc is acting in such a manner, but it, definitely, has that ability so to do should it seek to engage in such dictatorial practices.

To give one an indication of the size of this bank, it has not less than $US2.454 trillion in Total Assets and an Operating Income, annually, of not less than $US19.037 billion.

The Royal Bank of Scotland plc

While The Royal Bank of Scotland plc had to sell 83 percent of its Issued and Fully Paid-Up Share Capital to the British Government in order to save it from going belly up, this action, effectively nationalising the largest bank in the United Kingdom, was seen as the only way to save the bank from utter disaster.

That which was the root cause of the problem in this bank was senior management's ambitious attempts to become an international banking institution – clearly without the wherewithal to provide for an emergency of the worst-scenario basis.

The Government of the United Kingdom sacked the old management team at this bank in a shake-up, never seen in the history of this, or any other bank in the United Kingdom.

The Royal Bank of Scotland plc was not the only bank in the world to have major problems because HSBC Holdings plc has had to admit its failures, too.

HSBC Holdings plc expanded into the United States of America, spending about $US15.50 billion in order to acquire Household Finance Corporation, a US, credit card issuer and a lender to the subprime property market.

In November 2002, Household Finance Corporation, which was renamed HSBC Finance Corporation, was the second-largest, subprime lender in the US.

About 7 years later, in March of 2009, HSBC Holdings plc announced that it would close the entire branch network of HSBC Finance Corporation, leaving only the credit-card side of the business to continue operations.

Some 6,000 employees of this company found themselves out of work in one fell swoop with this one decision.

The acquisition of HSBC Finance Corporation had been a complete disaster area.

In October 2007, the Government of the United Kingdom told all banks in the country to increase their respective capitals.

HSBC Holdings plc transferred £750 million (about $US1.06 billion; $HK8.28 billion) to London, almost overnight.

In March 2009, HSBC Holdings plc announced a Rights Issue in order to raise $HK138 billion. The call for cash was successful and, for the first time in the history of this bank, its Chairman thanked shareholders for their interest-free money.

To this day, that $HK138 billion, obtained in that Rights Issue, is, presumably, still in the bank's treasury, gather dust.

One important question that one might like to ask, today, is: For what reason did this huge international bank pitch a Rights Issue in March of 2009, a Rights Issue which, it seems, was never utilised, or never fully utilised?

TARGET () was told, not very long ago, that most Hongkong customers of banks, by and large, no longer consider loyalty as being important in their dealings with their traditional lending institutions and *'go shopping'*, looking for the best deals in town before making a new financial commitment.

It was not, always, like this and one recalls the old-time banking philosophy of about 4 decades ago, common to senior management of most Hongkong-based banks.

In those days, management of banks was more interested in the name of a prospective borrower/customer than any other single factor in making a determination about agreeing to a loan, large or small.

Times have changed, to be sure, but it is, still, a fact that a good loan must be considered preferable to a secure loan.

Banks in Hongkong, by and large, employ sales personnel rather than trained banking staff at the grass-roots level and, inter alia, that is one of the reasons that customer loyalty has waned over the years.

<u>The Future</u>

Many economies of the world are suffering from unstable disequilibrium – Greece, Spain, Portugal and Ireland are just 4 nations' economies that, immediately, spring to mind.

Imbalances in trade and high levels of borrowings on a macroeconomic scale have proved to be unsustainable.

The US Government, today, is a prize example of the above statement.

Price inflation is a natural result of the above situation.

Austerity measures are being implemented in Greece, Portugal and Spain and tens of thousands of people are taking to the streets in Athens, Greece, and Madrid, Spain, protesting about job losses, salary and wage reductions, loss of perquisites, etc, etc, etc.

The **I**nternational **M**onetary **F**und (**IMF**) and the **E**uropean **U**nion (**EU**) are planning to save these economies of Ireland, Greece and Spain from absolute ruin because the alternative is unthinkable: Perhaps the falling from grace of the euro, internationally, or even the breakup of some of the 17 nations of the EU that have adopted the euro as their common medium of exchange; and/or, the contagion effect of those desperate nations, infecting other EU economies.

Banking policies or the lack of prudent banking practices are said to have been among the root causes of the current situation, especially in Ireland where the economy is known to be in tatters.

Perhaps, if better governmental controls had been in place with regard to certain key banks, especially in respect of the situation that existed in Ireland before the balloon went up, the current situation could have been alleviated if not completely averted.

Aside from the banking industry, on which the world could not operate and on which industry, the world over, relies on a day-to-day basis, the factors that constitute good banking practices, also, apply to many other industries.

A huge consideration when the US Government bailed out Detroit was the matter of the number of jobs that would be saved by immediate cash, being made available to the troubled duo of General Motors Company and Chrysler LLC.

At that time, General Motors Company was said to have been the largest, single employer in the US.

As history has recorded, General Motors Company had to trim operating costs, drastically, sell assets in order to raise money to meet creditors' demands, and become leaner and meaner in order to confront the growing competition by motor-vehicle producers of Asia.

It must have been, for many of the senior management of General Motors Company, heartbreaking to be forced to sell off some of the corporation's *'family jewels'*, but the facts were that the company had become too large and ungainly to be efficient, any more.

Also, it was very clear that the previous senior management of General Motors Company had not been able to see the wood for the trees.

HSBC Holdings plc and The Royal Bank of Scotland plc are but just 2 other examples of senior managements, being unable to make determinations with regard to multi-billion-dollar acquisitions, being totally unable to see the potential for things to go wrong, somewhere down the line.

In the very complex world of today, new concepts are required in order to prevent the gross errors of yesteryear and, undoubtedly, new legislation will follow.

No matter what kind of legislation is put into place, however, there will, always, be corporate failures and, as in the natural world, the answer must lie in the weak, being permitted to fail to see the sun, rising in the morning, leaving the strongest to survive.

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