

# General motors and risk essay sample



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In the fast moving business world, companies and firms are increasingly confronted with risk, risks that are complex and global. Emergence of new technology has made it possible for organizations and consumers to be exposed to the whole world on a scale that has not been seen before and at faster rates, hence exposing organizations to various risks; risks that may or may not be able to be anticipated or speculated or at times an organization might not be able to create solutions fast enough for these threats. Each organization is unique and operates in many areas of the world and will have risks that are both similar and different and each company may choose to mitigate the risks that may arise from vast operations differently.

Organizations may choose to use one or more techniques to offset their risks, such as buying forward contracts, options, using tax incentives, etc.

General Motors (GM) is a multinational organization, where they operate in countless countries over the world with assets, liabilities and sales; which is also vulnerable to risks associated with operating globally. Even though GM has filed for a Chapter 11 bankruptcy few years ago, it is today an active organization in the world. General Motors operates in 70 countries and have presence in over 200 countries (“ GM Careers”, 2012).

Evidentially the spread of General Motor’s operations makes it susceptible to numerous risks within the global market, where General Motors will have to anticipate and produce solutions to risks. Solutions are created through various arbitrage techniques and with intense market research that takes into account current and historical data; and as a result they are utilized to mitigate the risks. The risks are stated in the yearly report of General Motors as well as third party analysts, and some of risks are the following; exchange

rate risk, commodity risk, inflation risk, labor risk, market risks, supply risks, and there are several more that can be noted. As any global organization GM is aware of the existence of these risks and the organization takes precautions according to the level of risk and the necessity of solutions for these threats. In order to understand the approach that GM employs to mitigate risk, this paper will focus on few of these risks; they are exchange rate risk, interest rate risk, counter party risk, commodity risk, legal risk, environmental risk and the risk that is associated with economic cycles. While some of the risks can have the same solutions, most will have to be neutralized by different methods.

Exchange rate risk plays a key factor in the way organizations conduct their business. Since currencies, at least most currencies are at a float rate, there can be speculation and loss or gain in earnings when transferring the earnings from foreign currency to domestic currency. This is a risk that every global organization must deal with and discover a way to defuse the effects of the exchange rate changes. Exchange rate risk can cause exposures, such as transaction exposure, economic exposure and translation exposure; and if they aren't managed properly the result can be a net loss for the organization. Transaction exposure is when the organization has already entered into financial obligation and the fluctuations in the rates presents a risk. Economic exposure is when the earnings of an organization are affected. Translation exposure is when assets and liabilities are affected due to exchange rate changes. General Motors is a company that sells automotive vehicles all around the world and has assets, such as

manufacturing plants in strategic locations all over the globe; therefore GM is susceptible to all three of these exposures.

As a result GM must manage their exchange rate risk and reduce the level of the threat. General Motors accomplishes this task by entering into variety of foreign currency exchange forward contracts and options, which lock in prices or aid GM, manage the level of risk; which is under the responsibility of Risk Management Committee. (General Motors Co, Form 10K, 2011, p. 84). According to the annual report by GM "... foreign currency exposures related to buying, selling, and financing in currencies other than the functional currencies of the operations. Derivative instruments, such as foreign currency forwards, swaps and options are used primarily to hedge exposures with respect to forecasted revenues, costs and commitments denominated in foreign currencies" (General Motors Co, Form 10K, 2011, p. 84). General Motors is somewhat horizontally integrated; which is indicated because GM also offers automotive financing through GM Financial. GM Financial is service provided to GM consumers which gives them to ability to finance their vehicles directly with GM. Nonetheless, GM Financial is exposed to interest rate risk, just as any other financing company would be. Interest rates can change with changes in fiscal policy and availability of capital in the market.

The risk that arises from the exposure, if not moderated, can cause failure of GM Financial and severely decrease the net earnings of General Motors. GM uses interest rate swaps and purchases fixed interest rates receivables; and for securitization purposes GM will transfer its fixed rate finance receivable to trusts and in turn sell fixed or floating rate securities. Then GM uses

derivatives and other hedging strategies, such as swaps and interest rate caps to manage interest rate spread in floating rates in order to diminish exposure of interest rate risk (General Motors Co, Form 10K, 2011, p. 86). Counterparties Credit Risk can also affect organization's net profits and can cause extensive damage to their operations, when these counterparties are unable to meet their responsibilities as per the agreement made by the organization and the counterparty. General Motors has such risk with counterparties, and has entered into an agreement with respective counter parties to offset part of the exposures that derive from risk (General Motors Co, Form 10K, 2011, p. 158).

One of General Motors major risk exposure is in the commodities. GM purchases raw materials, supplies, parts, energy, and freight in order to manufacture vehicles and be able to ship them to their respective destinations. Speculations or fluctuations in commodities can cause high volatility in the earnings of GM and can cause net losses in the earnings and hurt investments within GM. During the year fuel or steel prices can vary greatly depending on global demand and condition, and a global company must be able to compensate this risk. Conferring to GM's annual report, GM actively invests in commodity options and derivatives market, the report states "...use commodity options to offset our commodity price exposures." (General Motors Co, Form 10K, 2011, p. 86). As a result General Motors can operate under the assumption that the commodities they purchase will have no or very little fluctuation in the prices and will be able to maintain and plan their budgets according to hedging prepared in commodity derivatives. Most of the risks that have been mentioned above have been mitigated with

investments in derivative markets, such as interest swaps, commodity options, foreign exchange rate option or futures contracts.

Nevertheless there are different types of risk that cannot be solved in the derivatives markets, such as legal risks, or environmental risk that can influence the earnings of a global organization. Each country has different laws and regulations that companies must abide by and these can differ for each industry and company, hence giving a rise to legal risk. There are several examples in the annual report for General Motors. One of them states that EPA issued a proposal to implement new requirements for 2017 through 2025 model vehicles to be produced, that will have reduced emissions and improved fuel economy. In order to accomplish this task a company must spend great amount in research and development if they haven't done so already. A large organization should be able to anticipate these types of problems and put solutions into place, which may require financing and capital. Nonetheless the report shows that GM will be able to meet new proposed requirements a year early in 2016, which helps them reduce legal risk and GM avoid paying any penalties or fines (General Motors Co, Form 10K, 2011, p. 12).

However this might not be the case in 200 other countries that GM has presence in. For example Korea has introduced stricter proposal for emissions of CO gases, and the expectation of these changes must be met between 2012 and 2015. General Motors according to their report are looking into credits, incentives and penalties depending on if they can meet the requirements and the deadlines (General Motors Co, Form 10K, 2011, p. 13). Legal risk as shown here can be costly for a global organization and

global companies must be aware of laws of the respective countries they operate in. Companies, especially companies that manufacture globally face environmental risks. Use of chemicals and raw materials produces waste, which must be disposed of carefully. This has become a hot topic around globe for both consumers and governments, and there have been regulations put into place to control the amount of waste. The risk that arises from this issue is that the organizations must have necessary equipment and compliance that meets the laws and regulations of the respective countries. General Motors outlines the environmental requirements by continents and further explains what is necessary to meet the conditions.

For example “...government imposes stringent emission control requirements on vehicles sold in the U. S. and additional requirements are imposed by various state governments. These requirements include pre-production testing of vehicles, testing of vehicles after assembly, the imposition of emission defect and performance warranties and the obligation to recall and repair vehicles that do not comply with emissions requirements. We must obtain certification that the vehicles will meet emission requirements from the United States Environmental Protection Agency (EPA) before we can sell vehicles in the U. S. and Canada and from the California Air Resources Board (CARB) before we can sell vehicles in California and other states that have adopted the California emissions requirements...”

(General Motors Co, Form 10K, 2011, p. 9). As seen within excerpt the risk of not complying with the necessary regulations is that there will be a freeze in sales until the requirements are met and necessary paper work is presented to the correct departments within the government; if GM does now get rid of

their inventory GM could lose millions of dollars that tied up in their inventories, and this is just in the US market.

There are similar environmental requirements in Europe, Asia and South America, where General Motors operate and they recognize the importance in environmental risk, and do take actions to overcome these obstacles. Organization also must consider both domestic and global economic cycles and plan according to the position of cycle that the economy is in. A global organization will diversify globally and use sources around the world to find its lowest level. GM is able to sell and buy companies and manufacturing plants around the world to avoid the downturn of economic cycles. For instance GM has acquired more of GM Korea interests in order to gain control of the company and increase their capital surplus by \$41 million (General Motors Co, Form 10K, 2011, p. 110). General Motors also bought AmeriCredit to provide subprime vehicle financing in US and Canada to ensure sales, and mitigate the risk of domestic economic cycle. General Motors has sold their India operations (General Motors Co, Form 10K, 2011, p. 112) and has been trying to partner with a European company to use common factories in Europe to cut down cost during this Global economic cycle.

A global organization must be aware of all the risks that are involved with operating in multiple countries and be able to shift focus and operating procedures within a short period time in order survive as a company. As validated in this paper, General Motors has been efficient in moderating various risks that are involved with its global operations through the use of different methods. These methods are as a result of studies and investments worldwide; whether they are investments in options, futures markets, or <https://assignbuster.com/general-motors-and-risk-essay-sample/>



direct investments in research and development. General Motors has been able to turn around from a chapter 11 bankruptcy to announce positive earnings and has been able to invest in assets in overseas, by taking into consideration the risk and mitigating them. In conclusion, survival of Multi-National Corporation relies on the meticulous study and research of risk involved in operations and taking steps to moderate these risks, in various parts of the world. Thus the organization can guarantee longevity of itself through investments in derivatives to diminish the exchange rate risk, or invest in research and development to aid in legal and environmental risk, and other solutions to given risks that are involved. A global world demands nothing less of a company in order to have and keep competitive advantage.

#### Works Cited

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