

# [What went wrong with aig essay](https://assignbuster.com/what-went-wrong-with-aig-essay/)

What went wrong at AIG? Despite US$110 billion in annual sales and assets in excess of US$1 trillion, on the 16th of September 2008, AIG accepted the Federal Reserve’s US$85 billion rescue package in order to prevent itself from facing a Chapter 11 filing.

In exchange, AIG had given a 79. 9% stake in the company to the government and also the right to suspend dividends previously issued to common stock and preferred equity. In all, US$184 billion in shareholder value was wiped out in less than a year! This was the largest government bailout of a private company in US history. From a strategic management (i.

e. strategic analyses) perspective, what mistakes have been made by AIG in the recent past? Most of the traditional businesses that AIG is involved in, like insurance, are actually doing quite well. However, this fallout can be traced to seeds planted years ago, under former CEO Mr. Maurice Greenberg.

During his tenure, AIG became a global behemoth, expanding into many complex lines of business and insuring risk that few companies would touch. As a result, AIG began to go into business that they did not fully understand. As part of its strategy to diversify its investments, AIG began to invest in various types of securities, including credit derivatives and mortgage backed securities. Because of AIG’s excellent credit rating, it became a major player in these markets, insuring others’ debt obligations against losses. In 2007, AIG recorded a $5. 5 billion writedown on its investments.

Furthermore, AIG’s operating divisions held a total of $84. 8 billion worth of investments in mortgage backed securities, about 10% of AIG’s total invested assets. As a result, they had a rather significant exposure to sub-prime related losses from their subsidiaries and mortgage related investments. A key factor was the difference between the credit default swap business as compared to their normal insurance business. For example, in home insurance, AIG would insure a large amount of houses. Thus, if one house burns down, the premiums being paid by the other houses would cover the claims that AIG would have to pay out.

Furthermore, the fact that one house burned down does not increase the chances of other houses burning down as well. This is the complete opposite of the derivatives that AIG was dealing in. In short, AIG did not really understand the business that they were going into. Also, AIG has had a history of regulatory investigations and enquiries that adversely affected investor confidence over the past few years. In 2006, AIG had settled an accounting scandal for $1.

6 billion. Also, in June, the SEC and Justice Dept were examining how the company valued certain complex derivative transactions. All these past transgressions didn’t help AIG, rocking investor confidence and eroding their market capitalization, enterprise and brand value. This caused PriceWaterhouseCoopers, its auditor, to force AIG to change its method of valuing its derivatives and products.

This caused a sharp decline in the valuation of those derivatives. Soon, its credit rating was downgraded, triggering terms in their derivatives contracts that required AIG to come up with an additional $14. 5 billion in capital. Given that AIG had already raised $20 billion in capital through debt and stock and another $4 billion through private equity offerings. As a result, AIG had to accept the Federal Reserve’s bail out. Going forward, how should they improve their strategic management process or methods? AIG’s vision was to be the world’s first-choice provider of insurance and financial services.

Some of their core values include being accountable, managing risk, working honestly and seizing opportunities. From the above analysis, it is clear that even though AIG managed to achieve its vision to a certain extent, they abandoned their values along the way. AIG should improve their strategic management process by including a feedback loop, constantly evaluating performance, monitoring the situation and making necessary adjustments. This is because times and conditions change.

Events will unfold which might make better ways to do things more evident. Firms will often have to react to changing market conditions, crises and evolving customer needs and preferences. AIG failed to react to changes in the market, didn’t mitigate its risk and blindly went into businesses it never should have. If this was properly done, AIG might have been able to plug that hole in their balance sheet more effectively and transparently, boosting investor confidence in reducing the chances of AIG going into a liquidity crisis. They might even have avoided the crisis entirely.

Corrective adjustments can entail the alteration of the firm’s long term direction, the modification of performance objectives and improving strategy execution. Crafting and implementing a strategy are core management functions. A good strategy should allow a firm to become strong enough to overcome obstacles and overpower its rivals. More importantly, the strategy that is implemented should fit with organizational capabilities and culture.