Fiat: Italian champion struggles to compete globally

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In the eyes of the world, Fiat is seen as a national champion of Italy, its legendary patriarchal founder, Gianni Agnelli, a more well-known leader than most of Italy's postwar prime ministers. While Fiat as a brand represents above all Fiat Auto, the motor manufacturers, in its 100-year history, the company grew into a vast conglomerate covering a multitude of businesses. At its height, the motor industry businesses include the Iveco truck manufacturer, the CNH farm and construction machinery company, Magnetti Marelli car component manufacturer, FiatAvio aero-engine company and Ferrari sports cars. More expansionist forays were into insurance, energy and publishing. It is Fiat Auto, however, that defines the company's image. Its mounting difficulties from the late 1990s onwards caused anguish, not just among those associated with Fiat, but within the Italian government and general public. The very thought that this Italian icon might collapse under a pile of debt, to be taken over by a foreign owner, was turning painfully into a probability. How did it get into this perilous position and how could it claw its way back? Key to finding answers to these questions is the cultural and political environment of Italy, coupled with the external pressures of the EU and the globalization facing the car industry worldwide.

Fallen Icon

Like most Italian businesses, Fiat has been dominated by a family. The Agnelli family controls about 34 per cent of the ordinary shares, through two holding companies, Ifi and Ifil. Maintaining family control has been a priority, making it difficult for Fiat to enter alliances and joint ventures, common among its competitors. Fiat Auto has enjoyed a dominant share in the Italian market, helped in large measure by successive governments, which have protected its position. This is not to say that the company had been entirely cushioned from external pressures. It went through a difficult period in the 1970s, when its factories and managers became targets of extreme left-wing, Red Brigade terrorists, who caused widespread disruption, including the assassination of Aldo Moro, president of the Christian Democrat party, in 1978. The company was forced to restructure following the oil shocks of the 1970s. However, it was helped by government policies which held back the introduction of anti-pollution requirements, such as catalytic converters, which competitors elsewhere were compelled to install, giving the company a price advantage in the 1980s and early 1990s. The government also barred the import of Japanese cars into Italy until the mid-1990s, keeping at bay, in particular, the threat posed by Japanese small cars to Fiat's market share. Fiat had been slow to invest in quality improvements and other innovations, leaving it in a weak position in terms of quality guarantees when the market was finally opened to competition. A further aid for Fiat was the succession of currency devaluations which helped it to remain price-competitive. With the adoption of the euro in 1999, Italy could no longer devalue its currency, and by then global competitors were making inroads into the Italian market. Fiat's debts were rapidly accumulating. A deal was done with General Motors (GM) in 2000, by which GM would buy 20 per cent of the shares in the Auto division. In addition, Fiat had an option to sell the other 80 per cent of Fiat Auto to GM between 2004 and 2009.

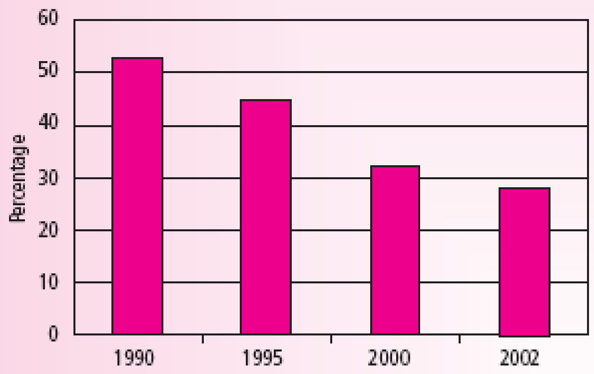

Figure 1 Fiat's market share in Italy

Source: Kapner, F., 'Trouble with Fiat', *Financial Times*, 4 March 2003.

Fiat's market share in Italy dropped from over half in 1990 to 28 per cent in 2002 (see Figure 1). With debts in the order of €6bn. and sales falling, Fiat was staring into the abyss, with operating losses of €1348m. in 2002 (see Figure 2). In the restructuring which followed, some 6000 jobs were lost and production was cut back at 18 plants. Some of the businesses were sold, including the insurance and aero-engines operations. In 2002, Fiat's car operations still employed 36,000 in Italy and a further 100,000 indirectly, and were estimated to account for about 1.5 per cent of the country's GDP. When Prime Minister Silvio Berlusconi was elected in 2001, he promised as much support as he could give to Fiat, while keeping within the EU's strict rules on state aid to industry. He described the crisis at Fiat as a 'national problem' (Betts, 2002).

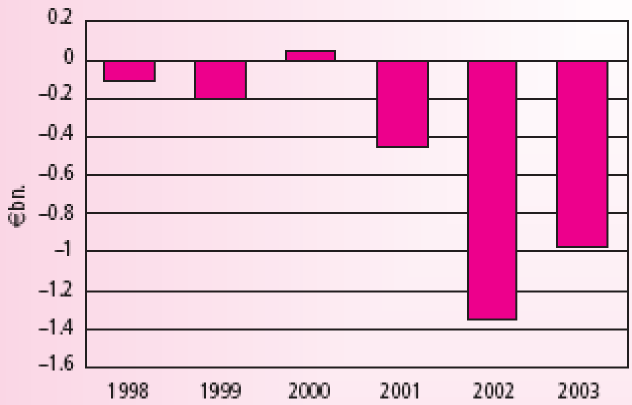

Figure 2 Fiat Auto's operating profit/losses

Source: Fiat S.p.A., Annual Report at 31 December 2003.

Mounting problems for the Italian government

Mr Berlusconi has been in office longer than any postwar Italian prime minister, navigating his centre-right coalition through a series of problems. He had promised a reinvigorated economy, tax cuts and structural reforms, but has had troubles keeping his four-party coalition together and met public resistance to unpalatable reforms. He introduced some reform of Italy's rigid labour laws, providing for greater flexibility in labour markets. Unemployment remains high, at 9 per cent, and rising inflation, persistently above the EU average, is a worry. Tax cuts are not universally applauded, causing disagreement within the coalition and objections from the EU Commission. The EU Commission has advised him to raise taxes, mindful that the national debt stands at 106 per cent of GDP, the highest in the EU. Italy has one of the highest rates of early retirement in Europe and about 14 per cent of GDP is spent on pensions. The government aims to reduce the pension bill by 0.7 per cent by requiring many workers to work until they are 60, rather than 57, to qualify for a full state pension (those who have paid 40 years of contributions into the system could still retire at 57 with the full pension). This would take effect from 2008 onwards. Many observers, particularly within the EU, see this measure as too weak, but the government faced stiff resistance, including surviving a vote of confidence, in getting even this modest reform passed into law in 2004.

Berlusconi himself has been the subject of much criticism – criticisms which go to the heart of Italy's democracy. These criticisms focus, first, on his alleged criminal activities, which are still going through the courts. Judicial proceedings are pending against him for alleged crimes involving multiple business interests. Secondly, criticism focuses on his media empire, which constitutes a conflict of interest with his public office. As Italy's richest man, Berlusconi owns a media empire which includes the country's three main television channels, its largest publishing house and largest advertising agency. He is also accused of exerting pressure on RAI, the state-owned network. He has acknowledged that there is a possible conflict of interest between his media businesses and his public role and has proposed legislation on conflict of interests. However, critics argue that this measure is too weak, and, importantly, would not require him to divest any companies, but simply refrain from exploiting his privileged position. Why Italians would vote for a man who had been the target of a number of serious criminal investigations, and whose media domination would be considered intolerable in many democracies, is a question which exercises many inside and outside Italy (Lane, 2004). Lane argues that the concentration of media power makes it difficult for Italian voters to form informed judgments. The country has a history of power politics overlaying political institutions and close ties between business and politics which breed corruption. The collapse of the dairy empire, Parmalat, another family business, which hinged on large-scale false accounting, is indicative of weak corporate governance, facilitated by opaque ties between political and business players.

Fiat's recovery prospects

Parmalat's collapse sent a shiver through Italian businesses. They are facing the realities of global competition at a time when favours from the government are drying up. Generational changes have taken place at Fiat, with the deaths of both Gianni and Umberto Agnelli (in 2003 and 2004 respectively). The new chairman is Luca Cordero di Montezemolo, the chairman of Ferrari. Product development has been pushed up the agenda, along with quality improvements. Two new models have been introduced, and the management is focused on improving the brand image. Development of the new models of course added to the borrowings. The operations in developing markets are improving and good profits are being generated in Brazil. But restructuring and debt reduction are priorities. Improvement in shareholder value in 2004 indicated that the restructuring was producing results (see table).

Total shareholder return: comparisons of leading automakers, 2003–4

Company	Percentage change in total shareholder return, 2003–4
Fiat	23.4
DaimlerChrysler	41.0
Ford	46.8
Renault	49.4
Toyota	58.4
General Motors	35.6
Volkswagen	3.2

Source: Armstrong, J. (2004), 'Automakers' 2nd quarter is sound', *Automotive News*, 78(6103), p. 40.

Nonetheless, the prospect of takeover by GM still loomed on the horizon. For its part, GM was regretting its agreement to take over Fiat, as its market share at home was on the slide, and the takeover of the loss-making Italian car maker would constitute a further headache. By 2005, both companies were looking for a way out of the deal, and the parties agreed that GM would pay Fiat a1.55bn. to terminate the takeover agreement and other aspects of the relationship. Some of their successful joint ventures would continue, but Fiat is now free to devise more deals with other car companies. The much-needed cash can be used by Fiat for restructuring and, as part of the deal, it retains the benefits of being part of GM's worldwide purchasing operations. What of the future role of the family? Following the deaths of its two elder members, new appointments to the board were soon made. They included grandsons of Gianni and Umberto Agnelli, both 28 – an indication that the family intends to keep its grip on the tiller.

Sources: Betts, P., 'Fiat's fate', Financial Times, 30 May 2002; Barber, T., 'Italy passes bill on pensions reform', Financial Times, 29 July 2004; Kapner, F. 'Champion that can't turn round', Financial Times, 22 July 2002; Kapner, F., 'Trouble with Fiat', Financial Times, 4 March 2003; Kapner, F., 'Leaning towards change: why Italy's companies must reform to prosper', Financial Times, 2 June 2004; Barber, T., 'Berlusconi's burden: Italy's economy languishes and reforms have stalled,' Financial Times, 25 May 2004; Armstrong, J., 'Automakers' 2nd quarter is sound', Automotive News, 78(6103); 'Whither Fiat after Umberto Agnelli?', The Economist, 5 June 2004; Fiat S.p.A., Annual Report at December 31, 2003; Lane, D. (2004) Berlusconi's Shadow: Crime, Justice and the Pursuit of Power (Harmonsworth: Penguin); Michaels, A. and Simon, B., 'GM pays Fiat a1.55bn to end legal disputes', Financial Times, 14 February 2005; Michaels, A. and Simon, B., 'Fiat and GM still face problems after deal', Financial Times, 14 February 2005.

Case questions

What factors caused Fiat's difficulties from the 1990s onwards?
In what ways have links with the Italian government helped or hindered Fiat?
Describe the tensions which exist in the Italian political environment.
What are the global pressures facing Fiat? How is it responding?

@ Fiat's website is at www.fiat.com