Europe Unlimited:
Winning at Home & Away
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The Re-Making of Fiat:
Remodelling the Last Chance Saloon

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Ladies and gentlemen,

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good afternoon and thank you for inviting me here today. I am flattered to be presenting at the most prestigious forum on the automotive industry calendar.

I have been asked to share with you some of my experiences in managing what are loosely referred to as turnaround situations, predicaments that involve or require a break with an unpleasant or unsuccessful past. And I would like to do so by describing what we have done over the last couple of years at and with Fiat, Italy’s largest industrial group.

I suppose that in describing my experiences with a company that is still largely Europe-centric, that we could derive some insight on how Europe can find new inspiration to drive growth and prosper.

The theme of this Congress is “Europe unlimited – winning at home and away”. There is a refreshingly up-beat tone in this title that is in stark contrast to the Anglo-American view that Europe is a restructuring story: has been, is and will always be. The consensus is that the task ahead of us is so daunting, so fraught with difficulties, that the outcome is highly uncertain.

If I can accomplish anything of value today, is to provide support for the optimism embedded in the theme of this Congress. An unrealistic pessimistic view of Europe is unwarranted and unjustified. And it clearly runs against the automotive industry’s strong will and determination to accept the many challenges facing it – both in legislation and competition - and to move the game on. As it has been doing for over 100 years.

Having said this, the history of our industry, and more specifically Fiat’s recent history, is not great.
About a year ago, the Lex column of the Financial Times expressed a view of the automotive industry, which in typical English style, left nothing to the imagination.

Choosing between carmakers is often like trying to pick the least flea-ridden dog.

The industry’s track record is in fact less than brilliant. It has been a consistent destroyer of value and with the exception of our Far-East competitors and one European producer, this lacklustre performance has broad brushed the whole European and North American industry. Fiat, as we shall see in a few moments, has fared the worst amongst its competitors. And the capital markets have punished it, together will the other value destroyers.

This chart shows that over a 30-year period, the European and North American competitors have lost more than half of their value, in a steady, almost predictable terminal decline. And Fiat was a large contributor to the European curve, consistently failing to make a Euro from its auto activities, in the recent past, since 1997.

The death-knell for Fiat had been ringing for a while. These front covers of Business Week and Fortune magazines go back to 2002 and 2003, even before making the last three capital injections totalling €6 billion. And the press, the financial community, the Italian government, the supporting banks, the labour unions all had their say, all had a solution, each different, to the industrial problems plaguing the Group.
Wrong model cars, wrong colours, wrong dealers, wrong investments, wrong advertising, wrong logos, wrong brands, wrong controlling shareholder, maybe even the wrong leaders...nothing we had done, were doing or were planning to do was right. The sub-title of this presentation, the Remodelling of the Last Chance Saloon, is but one of the characterizations that were stuck on Fiat by the Economist during the years of crises: junked, overtaken, under siege, the end of the road, a basket case, running on empty, the party’s over, to mention a few.

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I could show you many charts about the Group’s performance over the last 10 years, but they would all point in the same directions. The most telling is this one, which pitches Fiat against its competitors in terms of operating performance over the period 1994 to 2005. It simply says since 1997 the Group has consistently underperformed the industry, an industry which in and by itself has been a value destroyer. Not a great calling card and not a great recruiting platform, even in the best of circumstances.

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When I came in as CEO of the Group in June 2004, our hosts today, Automotive News Europe, ran this cartoon to welcome my arrival at Fiat’s revolving door! Five CEOs’ and three Chairmen in two years.

And so when Luca Ciferri asked me a few months ago to address this esteemed gathering of executives, I started thinking back at my initial days in Fiat some 25 months ago. And I remember feeling like Al Gore, the Vice President of the United States under President Clinton, who at one time in his political career was slotted as the 23rd speaker at a political dinner. He opened up by saying.

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I feel like Zsa Zsa Gabor’s fifth husband. I know what I’m supposed to do but I don’t know if I can make it interesting.

And to those budding, ambitious executives in the audience who are working their way up the corporate ladder to become CEO’s, I recommend you heed the advice of Warren Buffett:

When a management with a reputation for brilliance tackles a business with a reputation for bad economics, it is the reputation of the business that remains intact.

But as Mark Twain once remarked:

The report of my death is grossly exaggerated.

And so it goes for Fiat.

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We closed last year with a first net profit in 5 years of €1.4 billion. We collected about 2 billion dollars from General Motors to unwind the 5 year plus relationship, struck some 7 auto related agreements to share development costs and expand geographic reach of the car business, posted the first quarterly profit, albeit a small one, in the car business after a string of 17 quarterly losses. And at the same time, slashed debt levels by two-thirds to €3.2 billion, with gearing levels now at historical lows.

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The improvements have continued in the first quarter of this year. Car revenues were up some 23%, on the back of significant market share growth in Italy and the rest of Europe. The car business again made profits, €186 million more than last year. We brought debt levels down again, notwithstanding a historical working capital build in the early part of the year. In fact the car business stopped burning cash and contributed to the debt reduction.
As a result of all this, we have raised earnings guidance for the year.

And all of this could not have come at a more opportune time. The prospect of taking over the Chairmanship of Europe’s auto industry association ACEA this January as the head of a loss-making member did not seem to me to be great credentials for the position.

All of this sounds like a miracle. But it is not. And it is explainable.

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McKinsey recently completed a study on the development of American corporations over the period 1962 to 1998. They formed a pool comprising the top 80% of US companies measured by market capitalization. They allowed companies to enter and exit the pool to ensure that it always contained the top 80% of US companies. The results are somewhat shocking.

◊ Of the original 249 that formed the pool in 1962, only 160 or 64% were able to maintain their membership in the pool over the nearly 30 years being studied.

◊ In order to maintain the 80% condition, McKinsey had to track 1,008 companies, more than four times the original sample size.

◊ 759 new companies came into the pool, and only 536 survived during the period, implying an exit rate of approximately 30%.

◊ 20% of the 1998 pool was not there 5 years prior.
Similar results can be seen with the original list the Forbes 100 released in 1917, and the S&P 500 which was originally drafted in 1957.

Adam Smith’s invisible hand has been hard at work. But without the serenity and natural, paced rhythm which one would have expected.

The question is why?

An answer can be found in Joseph Schumpeter’s view of capitalism. By recognizing the vital importance of the entrepreneur in business, he saw the entrepreneur’s role as stimulating investment and innovation and thereby causing “creative destruction.”

…the…process of industrial mutation…incessantly revolutionizes the economic structure from within, incessantly destroying the old one, incessantly creating a new one. This process of Creative Destruction is the essential fact about capitalism. It is what capitalism consists in and what every capitalist concern has to got to live in.

The role of markets in Schumpeter’s world, in today’s world, is simply to allow for the efficient entry and exit of competitors and products. And that is how they function, without an ethical goal, without hesitation and without a conscience.

Capital markets are but an amalgam of providers of capital that keep on channelling the funds for the formation of new competitors whose sole objective is to displace the old ones. A similar level of activity has also been seen in Europe, but it has been slower, masked by the fragmentation of the European
capital markets. The European version of creative destruction has delivered a marginalization of players, rather than their extinction. But the process is picking up speed, as the last walls of defence to the maintenance of national champions come down.

Evidence of the workings of Schumpeter’s gales of creative destruction is everywhere. The Fiat story is one such case.

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In the October 28, 1968 Edition of Life Magazine, our company was described as a formidable auto maker.

“Fiat, almost alone among major European auto manufacturers, is racing along with profits and sales at all-time highs. Fiat achieves production efficiency by making 35% of its auto parts interchangeable, brings out a full line of models, and can respond quickly to new market opportunities by producing a new model in a mere 18 months.”

This is not the Fiat I found, and certainly not the Fiat of the 90’s.

Having set world firsts in the automotive sector, not just in Europe, it somehow lost its ability to compete, and lulled itself into a certain path to extinction. And yet this story, wasteful as it may seem at first glance, is also a story about the efficiency of creative destruction. About the market’s ability to fund new competitors and new technologies. And about the ability of the system to absorb the loss associated with the destruction of the old, and then to move on.

History has shown us that these events are possible, even necessary.
Take the great railway boom of the 1840’s in Britain where large amounts of money were raised in order to finance proposed lines. Most of these companies went bankrupt, but the process yielded great benefits to the economy long after these companies had disappeared. These bubbles, wasteful at creation, still produce long-term economic gains.

And the same goes for the recent bout of consolidation in the auto industry. The lesson we have all learned from those efforts is that acquired brands, however strong and attractive they look, take nurturing, care and years to restore. And that they need products worth the badge. Scale, the industrial driver of consolidation, is not all, not even a big part of the answer.

These events are examples of an economic dialectic that will always work the issues out. Maybe not elegantly, not efficiently, but out.

An article which appeared the Financial Times a few years ago has chronicled the development of the telecoms bubble and its subsequent demise.

Four trillion dollars were spent on setting up an infrastructure that was at the time of installation at best 1 to 2% utilized. In fact, between 1998 and 2001, the industry quintupled the amount of fibre in the ground. In the interim, technological advancements in fibre optics have allowed substantial improvements in yields, thus increasing transmission capacity of each strand of optical fibre 100-fold. Today more than 90% of installed fibre optic capacity is dark.

But that is only half the story.
The article sounds like a Charles Dickens novel, and is worth repeating here.

Down by the decaying dockyard, in an anonymous industrial park east of London, the telecommunication industry is suffering its final indignity.

Every morning, lorries arrive with refrigerator-sized cabinets of electronics. The plastic bubble-wrap designed to protect them from the Essex drizzle cannot obscure the names on the cabinet: Nortel, Ericsson, Lucent and Cisco, the stars of one of the most remarkable bull markets in history.

Not that the protection is necessary these days.

Shields Environmental, which this year expects to receive 6,000 tons of unwanted gear, tries to strip and sell as many of the parts as it can from the telecoms equipment. But a large telecoms operator has gone bust on average every six days for the past six months and the second-hand market is saturated.

Hence many of the cabinets will be taken apart by hand for disposal.

Each, once worth millions of dollars, will yield a smattering of precious metals and other scrap. Some toxic components and a lot of plastic, which is sent to nearby incinerators for burning.

The most important impact of this economic dialectic is on the choice and functioning of the leadership of the corporation.

It provides a structural framework within which the notion of competition can be effectively framed and understood by the
organization. People at all levels of an organization such as Fiat do not need to understand about capital markets, but they do need to understand that their collective objective is to survive and prosper in a market which is being continuously whipped by the gales of creative destruction.

The sharing of that objective is the fabric that holds organizations together and that motivates people in replicating, and if possible, setting the speed of the market.

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For those of you who were fortunate enough as children to read Through the Looking Glass by Lewis Carroll, you might remember the exchanges between Alice and the Red Queen.

“Well in our country, said Alice, still panting a little, you’d generally get to somewhere else - if you ran very fast for a long time as we’ve been doing.” “A slow sort of country! said the Queen. Now here you see it takes all the running you can do to keep in the same place. If you want to get somewhere else, you must run at least twice as fast as that!”

This image of the Red Queen was proposed by the evolutionary biologist van Valen to explain that evolutionary change by one species could lead to extinction of others. Under this view, species have to “run” or evolve in order to survive, i.e. to stay in the same place.

The parallel with business evolution is striking, and captures the gales of creative destruction heralded by Schumpeter.

We do not have to look very far to look for those responsible for this race.
We are the ones that pushed for tearing down trade barriers, for giving birth to unifying currencies such as the Euro, for creating the European Community with a free flow of factors of production, for wanting to expand internationally, for wanting to be the first in Asia, for wanting to grow, and reap the benefits of a global, seamless economy.

We are the ones, collectively, who have opted for a level playing field in order access to things we never had.

We are the ones that placed ourselves on the track for the Red Queen race.

The static models of the past, which heralded sustainable competitive advantage as the basis on which one could ensure the long-term survival of businesses, are of little use when faced with the turbulence and speed of today’s global, competitive market place. That type of advantage is competed away quickly.

Superior performance or even just survival comes to those who have the courage and the stamina to constantly change their position to stay one step ahead. The ultimate objective in order to ensure survival, is match the speed of the market.

This economic order requires a redefinition of leadership.

Each year institutions train thousands of businessmen and women in the science of management. What has somehow been lost in most of this training is that leadership isn’t just about measures or processes.

Leadership, when all is said and done, is a noble calling – it is about enriching people’s lives.

Leadership is a privilege.
It is a sacred trust.

Organizations created over the past two hundred years have been the product of two far-reaching assumptions.

The first: is that without extensive rules, policies and procedures, people will act irresponsibly.

The second is that the best way to organise an enterprise is to create simple jobs linked together by complex processes.

The first destroys trust. The second robs those involved of any feelings of personal worth.

To lead organisations under these assumptions is not leadership.

Leadership of both people and of change has become the cornerstone of the revival of the new Fiat Group.

We went through an initial period of assessment of the senior leadership and determined relatively quickly whether we had the right skills and values at the table to bring about the necessary cultural transformation of the Group. Many did not make the cut.

And then we went on to dismantle the traditional hierarchical structures that were the heart of Fiat’s management philosophy. Lean and flat structures are the now the norm within the company.

The Auto side itself is run by a group of some 27 leaders, some well below 40 years of age, who interact continuously in order to achieve some straightforward, quantified goals. Product, its quality, our relationship with the customer and the positioning and development of our brands have become the focus of our
activities. They support and give meaning to our commitment to technology and engineering development. Speed, simplicity and self-confidence are key. Decision authority has been widely delegated, and traditional control has been replaced by accountability for outputs and results.

The customer, a long forgotten element in Fiat’s business model, is now at its forefront. We committed that we would have the best customer service organization in the industry by the end of 2006, and extensive work is underway to develop the required infrastructure and carry out the necessary training to meet the deadline.

And notwithstanding this looser organizational design, the processes themselves have rigour and discipline. And the outputs are quantifiable and measurable.

Our business life at Fiat today is viewed and understood purely in a competitive context. Operating margin objectives, capital usage, cash generation are objectives which are developed and set only in the context of our ambitions to get our businesses to deliver best-in-class performance.

And given the high risk profile associated with the investment cycle in this business, we are looking for way to de-risk and share the burden of these investments with partners. We have been able to strike seven agreements from the time of the unwinding of the GM relationship, and work continues unabated to find other ways to minimize capital commitment risk.

This model, which has found its first application in the car business, is being aggressively migrated to the other sectors of our Group. CNH, our global agricultural and construction equipment business, is now undergoing an intense process of transformation. A similar flat organization has been put in place, and the four brands of the
business have assumed full responsibility for their global commercial activities, product portfolio and development.

These comments are not intended to impress.

There is no doubt that we have been able to move Fiat away from the threat of extinction but the real work has only just begun.

I feel more comfortable today than I have ever felt in my 24 months as CEO of Fiat that I am surrounded by an exceptional team of leaders, a lot of whom came from the bowels of the organization and have been given the space to grow and prove themselves. This collection of leaders will ensure that we remain vigilant and effective competitors.

The relevance of Fiat’s accomplishments in the context of this Congress are that the transformation is being carried out in Europe, based in a country with a strong institutionalized labour movement and with what most Anglo-Saxon commentators would refer to as inflexible working arrangements.

This, I suggest, is a myth. If I had a choice between trying to tackle GM’s relationship with the UAW or deal with employment levels in Europe, I prefer the latter. There is no doubt that productivity and flexibility remain the key elements of the relationship with our labour force. But I am convinced, not just on the basis of my experiences at Fiat but also elsewhere in Europe’s industrial landscape, that the dialogue can be had. And that the issues can be resolved successfully.

Nonetheless, it is neither just nor justified that business leaders sugar-coat this new economic reality for their constituencies, especially for their co-workers. A refusal to intervene in response to competitive pressures does more to harm to that constituency in the long term than an immediate intervention, painful as it may
appear to be. A refusal to act, regardless of personal outcomes, is not leadership.

Having said this, Europe can and must distinguish itself in the creation and management of liberal markets by recognizing and effectively dealing with the consequences of their operation on their constituencies. It must do so fairly and equitably, without falling prey to overly protective mechanisms which are in use in some European member states. But the obligation does exist, and cannot be ignored.

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In the midst of all this, CEOs must also deal with the fixation of most financial analysts, and to some extent, of liberal economic thinkers and commentators, that headcount reductions are good news. The inability of continental European CEOs to announce, American style, that thousands of people will lose their jobs is seen as a negative. I remember talking to Carlos Ghosn shortly after the announcement of his growth strategy in February this year. He had a distinct feeling that the markets were looking for blood to be shed on the shop floor. I had and continue to have similar experiences in explaining why I do not foresee plant closures. It makes no difference that labour represents 6-7% of total product cost, and that therefore the real reason for the large operating losses of Fiat Auto must be found elsewhere.

Yet, in the same breath, no one questions Toyota’s growth story and no one demands restructuring measures. Toyota will during this year probably become the largest carmaker in the world. It will surpass General Motors, having sold nearly 9 million cars through a meticulously planned growth strategy which is nearly all organically driven. Why this model cannot work for one or more European car manufacturer is unclear to me, but it is symptomatic of an emerging sense of defeatism, especially in the largest
economies of the Continent – Germany, France and Italy which must be stopped at its roots.

Our industry is facing many and difficult challenges in Europe: Euro 5 and Euro 6 for; CO2 reductions, Pedestrian Protection, Car Taxation, Whole Vehicle Type Approval, the White Paper on Transport Policy and issues related to Design Protection, international trade and China.

But I truly believe that the European automotive industry has the ability, the resources and determination to grow further, to compete with other manufacturing regions in the world, and to continue its key role in our societies as a generator of wealth, a driver of innovation and a provider of solutions for a more sustainable mobility.

The conclusions I draw from these experiences is that change is not only possible in Europe, but that is actually being actioned, frequently and rigorously. Fiat is but one example, and perhaps not the best, of the reshaping of European industry. It is being carried by a group of international executives who have embraced the notion of competition on a global scale and are willing to pressure other parties involved in our economic system to bring about change but in a socially responsible manner.

What I have learned from all of my experiences as a Chief Executive in the last 10 years, just as Lou Gerstner at IBM did some 15 years ago, is that culture is not just part of the game, it is the game. Organizations, when all is said and done, are but a collection of the collective will and aspirations of its people.

The era of the Great Man, of the know-it-all, fix-it-all Lone Ranger is gone. Leaders, great leaders, are people who have a phenomenal ability to craft sets of what Warren Bennis calls creative collaboration.
Great organizations are the result of the exercise of leadership by men and women who understand the notion of serving, of community, of fundamental respect for the humanity of others, and who inspire. Europe has them. I have met them, I have worked with them. And they do exist and thrive in the automotive industry.

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The challenge for all of us is to earn the confidence and support of providers of capital. What you see on the screen is a collection of comments by financial analysts that suggest that the biggest value creation opportunity for Fiat is to somehow dump or segregate the auto business from the more reliable capital goods side of our company. This analysis has undoubtedly a significant Fiat colouring, but the biggest reason for these propositions is that the car industry as a whole has historically been unable to earn its cost of capital. It is seen as a value destroyer. This must be fixed, and it is up to this new type of leadership to get it done.

Europe should not and cannot despair; we just need to keep on focusing on leadership as the instrument of change, and give these leaders the space and the support they need to deliver.

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And just remember, assume that whatever you have just discovered, the competition already knows.

Thank you.

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