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Fiat's Strategic Alliance with Tata (A)

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"I like the Tatas. I like the organization and the way they operate."[1]

Sergio Marchionne, CEO of Fiat Group

Introduction

On October 11, 2007, firm handshakes were exchanged between top executives of Italy's Fiat Group and India's Tata Motors to mark the signing of a joint venture (JV) to manufacture passenger cars, engines and transmissions for the Indian and overseas markets. Several executives from both sides had worked on securing the agreement since the initial idea to collaborate had emerged in early 2005. From the first memorandum of understanding (MoU), signed in September 2005, the relationship had expanded. In addition to the recently signed JV, the alliance encompassed an agreement jointly to manufacture pickup trucks in Fiat's Argentinean facility as well as a distribution arrangement between Fiat's commercial vehicle subsidiary, Iveco, and Tata's commercial division.

Observers lauded the tie-in, stating that Fiat had the potential for more sales in the burgeoning Indian market while Tata stood to gain technology and new export markets. Fiat and Tata executives had been given a clear directive that all contracts detailing different aspects of the companies' collaboration such as engineering support were to be wrapped up by the end of the year. Fiat executives thought about the immediate road ahead during which they aimed to conclude the final agreements in fewer than three months.

[1] "Fiat Offers Technical Tie Up With Tatas in CV Venture," Press Trust of India, May 3, 2007.

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As the ceremony was coming to a close, one observer quipped: "You know, in India, the average joint venture with a foreign firm lasts three and a half years." The bittersweet remark gave Fiat executives pause to ponder: How could the Fiat team guarantee long-term success?

Section 1: Background

Global Automotive Industry and Automobiles in India

Valued at $1.2 trillion in 2006, the global automobiles market encompassed retail sales of new cars, light commercial vehicles,[i] and motorcycles.[ii] Some 65.7 million automobiles and commercial vehicles (excluding motorcycles) were sold, representing an increase of 4% over 2005.[iii] **Exhibit 1** shows volume and revenue growth between 2002 and 2006.

There were 18 manufacturers that produced more than one million vehicles per year. The top five companies were responsible for almost half of the industry's output, and the top 10 represented more than 68%.[iv] In recent years, automotive manufacturers had been plagued by overcapacity.[2] The oversupply caused car makers to engage in price wars, thus destroying margins and reducing profits. In an attempt to lower costs, most major automotive makers had set up factories in emerging markets such as China, India, South America and Eastern Europe. (See **Exhibit 2**.) While lower production costs were one incentive, car makers also could gain access to growing and fertile marketplaces.[3] All manufacturers with production greater than one million vehicles were involved in one or more alliances with other producers. They formed alliances to reduce labor, energy and raw material costs.[4]

The automobile industry in India was valued at more than $23 billion (€18 billion) in 2006. Unit sales in the same year exceeded 1.5 million passenger cars. As of 2007, the top players in the domestic passenger car market were Maruti Udyog with a 48.8% market share, Tata with 20% and Hyundai with 19%.[5] The market for commercial vehicles was dominated by Tata Motors with 65%. See **Exhibit 3** for more information on the Indian automotive market.

India's automotive sector had attracted international attention for both its manufacturing capabilities and blooming market potential. Nearly all international automotive players had ownership stakes in a manufacturing facility in India. Over the previous five years, the number of new car sales had grown at a CAGR of 19.2% while the number of trucks had posted a CAGR of 24.3%.[6] Over the next decade, future growth was expected to exceed 10% year on year.

To add to the excitement of an explosive marketplace, Tata was in the process of developing the "1 lakh rupee" car, with a target date of 2008. ("Lakh" means 100,000: 100,000 rupees was $2,500 or €1,750.) Many predicted that the car would change the Indian automotive landscape dramatically, considering that it would cost half as much as the least expensive car then available.

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[2] Gabriel Kahn, Stephen Power, and Alessandra Galloni, "Separation Anxiety: Once a Dream Couple, GM, Fiat May Face Messy Breakup…," *The Wall Street Journal*, January 24, 2005, p. A1.

[3] Labor costs represent about 9% of the wholesale price of the average car in Europe. In Central Europe, the costs are lower, and labor's proportion of the wholesale price is trimmed by as much as 40%. Source: Gaëtan Toulemonde and Jochen Gehrke, "Global Automotive Review," Deutsche Bank, December 2006, p. 5.

[4] Datamonitor, *Automobiles Industry Profile: Global*, March 2007, reference code 0199-2011, p. 8.

[5] "New Cars in India," Datamonitor, October 2006.

[6] "New Cars in India," Datamonitor, October 2006, and "Trucks in India," Datamonitor, November 2006.

Background of Fiat Group

Established in 1899 by Giovanni Agnelli and a group of investors in Turin, Fiat Group was Italy's largest car maker and one of the country's dominant industrial groups. Fiat Group posted net revenues of €51.8 billion and net profits of €1.1 billion in 2006. The group comprised five business areas:

- Automobiles (49.3% of net revenues)
- Agricultural and construction equipment (20.3% of net revenues)
- Trucks and commercial vehicles (17.6% of net revenues)
- Components and production systems (23.9% of net revenues) and
- Other businesses (3.1% of net revenues)[7]

Refer to **Exhibit 4** for Fiat Group's financial statements and divisional performance.

Although Fiat had been credited as the first successful automobile maker to build a "global car," with the Palio model in the mid-1990s,[8] most commentators agreed that the past 10 years had been rough for Fiat, especially in its ailing auto division. Market share in Italy fell from 60% in the mid-1980s to 30% in 2006.[9] Within Europe, Fiat's share dropped from 13.8% in 1990 to 6.5% in 2005.[10] Between 2001 and 2004, the company overall lost nearly $12 billion (€10 billion).[11] Several factors were seen as contributing to Fiat's difficulties including its low-margin mix of smaller cars, lackluster launches of new products and the onslaught of more Japanese cars in Italy due to the abolition of quotas on foreign imports.[12]

In 2003, the company's management began taking steps to reduce costs and sell noncore divisions. The period was also marked by a series of changes in top management. The long-time chairman died and Ferrari's CEO, Luca Cordero di Montezemolo, was appointed as the new chairman, John Elkann (Gianni Agnelli's grandson) as vice-chairman and Sergio Marchionne as CEO. Marchionne set out to perform "radical surgery" by reducing Fiat's management, firing underperformers and refinancing the bank debt. He continued with the former management's plan to sell off noncore assets and breathe new life into the frail auto division through the introduction of new products.[13] The company recruited a number of high-profile auto executives, including top design talent from Rolls-Royce and BMW, to infuse a nimble culture of design and innovation into the company. Some 12,000 jobs were shed across the group, including a large proportion outside Italy. The company chose not to close its national plants to avoid a clash with Italy's powerful unions.[14] To spur on a change of mindset, Fiat's management set a target of growing the volume from 1.3 million units in 2006 to 1.9 million units by 2010.[15]

[7] Fiat Annual Report 2006, December 31, 2006, p. 26. Note that eliminations account for the other −14.2%.
[8] Nandini Lakshman, "Fiat Makes a New Friend in India," December 15, 2006.
[9] "Working With Fiat: Rising Star Ties Up With Old World Titan," *Economic Times*, September 7, 2006.
[10] Gail Edmondson, "Fiat's Comeback—Is It for Real?" *Business Week*, July 25, 2006, last accessed March 2008. http://www.businessweek.com/globalbiz/content/jul2006/gb20060726_749437.htm?chan=search, accessed August 8, 2007.
[11] Gail Edmondson, "Fiat's Turnaround Takes Root," November 10, 2006, http://www.businessweek.com/globalbiz/content/nov2006/gb20061110_334864.htm, accessed August 12, 2007.
[12] Gail Edmondson et al., "Fiat: Running on Empty," *Business Week*, May 13, 2002, http://www.businessweek.com/magazine/content/02_19/b3782014.htm?chan=search, accessed August 8, 2007.
[13] Gabriel Kahn, "Fiat CEO Says Major Surgery Drives Revival," *Wall Street Journal Europe*, November 4, 2005.
[14] James Mackintosh, "The Impetus Behind a Move into Higher Gear," interview with Fiat chief executive Sergio Marchionne, *Financial Times*, May 22, 2006.
[15] Luca Ciferri, "Marchionne: Fiat Will Push Its Rivals," *Auto News Europe*, December 11, 2006, p. 17.