A TROUBLED INTERNATIONAL MERGER
PIRELLI DUNLOP UNION (1970-1981)

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The Announcement

On March 2, 1970 Sir Reay Geddes and Mr. Leopoldo Pirelli, the respective leaders of tire manufacturers Dunlop and Pirelli, each sent shareholders a letter with a very similar content, informing recipients that negotiations for a merger between the two corporations were at an advanced stage. In fact, by December extraordinary assemblies at each of the companies had officially decided to approve the merger between the two groups. The Pirelli Dunlop Union from this legal act was born a multinational enterprise that ranked number 3 in the rubber industry (behind American giants, Goodyear and Firestone). If in the early 70s Goodyear had a turnover of almost 3 billion dollars and Firestone could vaunt one of 2.1 billion, Dunlop-Pirelli's combined turnover of slightly more than 2 billion preceded those of General Tyre (1 billion) and Michelin (900 million). The Anglo-Italian group employed 178,000 persons (76,000 were within Pirelli and the remaining 102,000 were with Dunlop).

Dunlop-Pirelli was a global company present in all five continents. In the letters sent to shareholders in March 1970, Pirelli and Geddes had written that in the late 60s their companies results were to be considered satisfactory but in a climate of harsh international competition they had to do much more in terms of rate of growth and geographical and product diversification. Given the characteristics of the two groups and their excellent relations in the past, the merger appeared to be the right tool in this direction.

The Two Groups

Among large Italian corporations, Pirelli was probably the most "British" in its style and approach since, from its very beginnings, the company relied more on its capacity to face the market than on State support and protection.

The company was founded in 1872 by Giovanni Battista Pirelli, a brilliant young graduate of Milan's Polytechnic. Given his excellent academic results, the university had given Pirelli a grant to use for traveling through Europe in order to find a new industry in which to start a business. After visiting several factories in Switzerland, Germany, and France he focused his attention on the production of rubber, setting up a plant in Milan with the financial support of some friends.

For several years, the principal Pirelli product was wire cables for telecommunications but by the beginning of the 20th century bicycle and automobile tires had become increasingly important for the company.

Pirelli pursued a policy of internationalization unusual for a large Italian company. In 1901 it opened a branch in the Spanish town of Villanova y Geltrù; 11 years later Pirelli General Cable Works Ltd. was created in Southampton, England. By 1917 Pirelli had landed in South America, setting up a factory in Buenos Aires for electric conductors; in Argentina the number of operations was increased to include plants for tires and various items made of rubber. In Brazil the company entered with the manufacture of cables starting in 1929,

By 1936 Pirelli was once again investing in Europe with the opening of a factory in Belgium. Following the 1926 Italian lira stabilization policy, Pirelli had decided to list itself on Wall Street. By the time it merged with Dunlop, Pirelli was present in all the most important European nations and in North America but it was especially strong in South America.

Notwithstanding this cosmopolitan attitude the governance was strictly based on the leadership of the Pirelli family. Giovanni Battista's successors were his sons, Alberto and Piero (following Italian tradition, in the firm the two were addressed as "Signor Alberto" and "Signor Piero"). Piero never had children so in 1965 Alberto's son, Leopoldo (also a graduate of Milan's Polytechnic) took over as president of the family creation.

In the late 60s the Pirelli group was structured around three entities. Pirelli e C. was the financial holding of the family which, in turn, owned 7.21% of the share capital of Pirelli SpA which controlled all the activities in Italy and in the European nations belonging to the European Common Market. Pirelli e C. also owned 18% of SIP (Societè Internationale Pirelli), the entity which owned all other international activities. In typical Italian fashion, there were cross-shareholdings (SIP owned 11.4% of Pirelli SpA and the latter controlled shares of companies which referred to SIP) and alliances which permitted the Pirelli family to be in control of the entire group even if they held a limited amount of capital.

In addition, the company's top management was strictly bound to the Pirelli family. Under Leopoldo Pirelli were three managing directors: Franco Brambilla, entrusted with the rubber sector, was Pirelli's brother in law; Emanuele Dubini, who supervised the financial and administrative functions of the group, was another relative while Luigi Rossari, in charge of the rubber applications for the electric industry, was a long-time veteran of the company.

Interestingly enough, the group was clearly diversified. Slightly less than half its turnover (45%) was in tires, 40% in cables, and the remaining 15% was in rubber-related items. Still, the company did not operate under a structure based on divisions.

While with tires Pirelli did not seem to reach the proper dimensions to be considered a world leader, things were different for the company in the cable sector. When combining this weakness together with turbulent industrial relations in the 60s, we arrive at the probable causes for a liability of 3 million dollars in the 1969 balance sheet.

Dunlop (which in the late 1960s was the top European producer of tires and rubber products as well as one of the top industrial groups in the UK), too, had its origins in an innovation. In 1888 veterinarian J. Boyd Dunlop invented the tire for bicycles; on November 18th of the following year the Dunlop Rubber Company was born.

From the outset, Dunlop's leadership demonstrated his perfect understanding that rubber was a sector of the Second Industrial Revolution and, therefore, a company that wanted to be successful had to aim from the start at big dimensions. So the company opted to buy up all the patents that could complete or complement Dunlop's invention, take control of a firm like the Birmingham Byrne Brothers, a leader in automobile tires which had started in the early 20th century to build up plants in France, Germany, and in British Commonwealth nations such as Australia, Canada, and South Africa. Successive years gave rise to a diversification process towards sports products and industrial tools together with sophisticated instrumentation. Dunlop owned extensive plantations of natural rubber in Malaysia but in the post WWII period it built an enormous plant for the production of synthetic rubber in the Midlands region of England where its most important factories were situated while headquarters remained in London.

Dunlop was dominated by the DuCross family from Dublin until the early 20s. After that, it became a managerial company with a diffused shareholder base. By the 1950s the major shareholders were institutional investors such as insurance companies and mutual funds. The structure had become multidivisional, reaching 14 divisions in 1970, and was led by a

management team oriented more toward financial objectives than to technical innovations, different in this respect from Pirelli where most of the management team was composed of engineers by training.
In 1969 Reay Geddes took over as chairman of Dunlop. He was the son of Eric Geddes, the manager who had rescued the company in the 20s. Reay Geddes served on various governmental commissions and, with typical British understatement, liked to portray himself as an amateur who lacked special know-how but who was capable of immediately recognizing the particular attitudes and attributes of individual. During the 1960s Dunlop launched itself into a program of geographical expansion, product diversification, and acquisitions, a policy unable to counterbalance the stagnation of its most important field, tires, which was seriously damaged by the policies of the Labour government with its imposition of heavy fiscal burdens on the automobile industry. As occurred with Pirelli, tires appeared to be the weak link in the group, with their low returns, low dividends, and lower shareholder values as well as difficulties in obtaining further financial resources to effectively deal with harsh international competition.

The reasons for the initiative

Weaknesses in the tire market which the two groups were facing around the same time was a serious issue for each. In fact, in the 50s and 60s, tire production accounted for more than half the demand for rubber products in the States, in Japan, and in Europe. To satisfy such intense demand, synthetic was prevailing over natural rubber given the volatility of the latter. If production of synthetic rubber amounted to 700 thousand tons in 1950, two decades later it had reached 5.5 million tons. In the same period, production of natural rubber increased only from 1.6 million tons to 2.8 million.
The kind of technology needed for the manufacture of synthetic rubber emphasized economies of scale and scope. In turn, this aspect pushed the issue of the company's size to the forefront. It became necessary to collect a large amount of financial resources to support a serious effort in research and the building of a pervasive marketing network. It was urgent to design strategies which were able to take into consideration continental or even global markets. No longer could a national market be considered sufficient for any player in the tire industry. In Italy, for example, Pirelli found itself competing with multinationals such as Michelin, Firestone, and Goodyear. At the same time, markets became increasingly challenging. The tire industry is divided into two distinct areas: first are the supplies destined to automotive manufacturers and the other market is

concerned with replacement tires sold through independent distributors. Following the radical growth of auto production in the first decade after WWII, the saturation in that sector was complemented by a boom in replacement tires. This new situation, however, meant that tire manufacturers had to deal with a much more fragmented demand and thus a shift was necessary, from production to marketing.

It was difficult for Pirelli to accept the new logic. Even in 1968 Franco Brambilla, managing director of the rubber segment, declared to an audience of managers that it was dangerous as well as illogical to consider marketing a pervasive philosophy for the company, almost seeing marketing as a technique for cheating consumers. Still, competition grew harsher and harsher, especially in the European markets that were growing at the fastest rate when compared to the US and Japan. Now competition was not based on price — given the limited number of actors involved — but, rather, on innovation and the capacity to be present in different geographical areas.

American multinationals à la Servan-Schreiber were rather aggressive in Europe but Pirelli found its toughest competitor to be the French firm, Michelin, a company founded in Clermont Ferrand in 1895 and still strictly controlled in the 1960s by the family whose name it bears; in other words, a true dynasty. Michelin put an exceptional effort into technological research. Taking advantage of a close collaboration with the automobile manufacturer, Citroen, in which it also held a controlling interest, Michelin was able to supply the market with a new type of tire where the structure was composed of steel strips and which offered better adherence to the road and greater durability over time. In order to exploit this innovation, Michelin opened 13 new plants in western Europe, the US and Canada in North America, as well as some Latin American countries. It was able to finance these developments by selling their shares of Citroen to the Italian auto manufacturer, Fiat, which immediately abandoned Pirelli as its supplier of tires in favor of Michelin. The other European rubber companies also had some catching up to do. A close alliance or something more between Dunlop and Pirelli seemed a natural consequence as their relationship was excellent. Dunlop had recently sold Pirelli its only plant in South America—Brasilera—at favorable conditions. In addition, the two companies produced tires for each other in some countries (Pirelli, for example, in Italy while Dunlop produced for both companies in France).

The advantages of the Pirelli-Dunlop Union

The advantages of the merger — at least theoretically — were evident at first sight. The two groups were complementary, both geographically as well as in terms of production lines. Seventy-five percent of Pirelli's turnover came from Europe with the remainder from Latin America (22%) and the remaining 3% from North America. The company had no presence in Asia, Africa, or Oceania. For its part, Dunlop located 63% of its sales in Europe, only 2% in Latin America, a good 14% in North America and in addition the company could vaunt a presence in markets in Africa, Oceania, and Asia — the latter of particular interest given its potential for development. Out of the 28 countries where the two companies operated, only in five did they overlap and only in two of these did both actually produce tires. Even stronger was the degree to which they were complementary in production. In the new group Pirelli would bring its important production of cables as well as sophistical mechanical productions such as shock absorbers, brakes, wheels, and aircraft landing equipment. For its part Dunlop would bring to the union its production of natural and synthetic rubbers as well as a large variety of rubber industrial items and consumer goods (being particularly well known for its sporting goods).

On these premises the "Union" could have brought about important economic results. First it could count on sufficient financial resources to foster research activities, especially in the field of tires. Second the Union held out promise for rationalizing production and distribution processes, especially by specializing the tire factories' productions to correspond to local standards of the various nations where they were present. In addition, very important were the savings that could be realized by integrating purchasing systems and for the stronger bargaining power they could exercise over suppliers of raw materials, semi-finished products, and components. Finally, the wider diversification in terms of goods and of geographical areas made possible a better risk distribution, an issue to which Leopoldo Pirelli was especially sensitive, given earlier experiences in his company when the good results of the cable sector had to compensate for the liabilities in tires and when the favorable situation in South America balanced out less positive results in other areas of the world.

Reactions to the announcement

As the operation had good economic as well as industrial logic, public opinion was generally positive in the UK as well as among those circles of the European Economic Community that emphasized the birth of a genuine European group able to successfully oppose the American invasion. In Italy, too, comments were favorable on the whole with the exception of some leftist newspapers which dwelled on the scarcity of information shared with national governments. The negative reactions in Italy were the result of tensions; there was a fear of losing employment, especially given Pirelli's tendency to produce wherever it was convenient while forgetting about the commitment to invest in Southern Italy. In the United Kingdom the unions felt threatened by the possibility of lower salaries since they were higher than what their colleagues in Italy received for similar work.

The architecture of the merger

At Pirelli's December 1970 assembly where the agreement with Dunlop was confirmed, Leopoldo Pirelli presented it not as a merger but as a "specular integration". To make it possible, it was necessary that the two groups had the same number of leading entities. In fact, the points of departure were different. Dunlop was based on one leading company at the same time both an industrial firm a well as a financial holding, while Pirelli had two companies at the top of the pyramid: Pirelli SpA was at the same time both an industrial company as well as the controlling holding of activities in Italy and in the European Common Market while Societè Internationale Pirelli controlled foreign activities in other parts of the world. In order to make an exchange on equal terms, Dunlop created Dunlop Holdings Ltd which controlled all the participations in the UK, Ireland and the countries of the European Common Market, a counterpart to Pirelli SpA which was transformed into a pure controlling holding company to which the Industrie Pirelli SpA, the coordinating industrial company, would respond.

All the industrial shares owned by Dunlop outside of the UK, Ireland, and European Common Market were controlled by Dunlop International Ltd. On the Pirelli side, the corresponding entity was Societè Internationale Pirelli. All this was done so that Pirelli could acquire 49% of Dunlop's assets in the UK, Ireland and Common Market as well as 40% of Dunlop's assets in the rest of the world; the same occurred for Dunlop as regarded its shares of Pirelli, with Italy taking the place of the UK and Ireland.

In order to guarantee an equal exchange, some activities had to be left out. On the Italian side this meant some small companies in the paper and electronic sectors in addition to the privileged shares of Pirelli Brasilera. On the British side, Dunlop's agreement with International Sports as well as the company it owned in Rhodesia were kept out of the exchange.

Making all these financial arrangements was not easy. Common criteria for assigning values to the assets were created, also in order to overcome the fact that Pirelli had not yet prepared a consolidated balance sheet. All this was done by the auditors; Unione Fiduciaria worked on behalf of Pirelli while Whinney Murray and C. did the same for Dunlop. The two were coordinated by the consulting firm of Price Waterhouse and Co. which gave all the necessary details to the two major banks involved: Mediobanca for the Italian side and Lazard Freres for the British.

The agreement was very detailed as regarded aspects such as future distribution of dividends, future joint ventures, and eventual increases of capital. The design envisioned the cross presence of the top managers of the two groups in all the controlling holdings but the general philosophy was that each group would maintain its own brands, its organizational structure with autonomous channels of authority and communication. Each of the partners would be the "boss in his own home".

But still a Union had to be formed and its future activities had to be coordinated. The best tool at the beginning seemed to be the formation of joint committees structured by products (tires, industrial products, consumer goods) and functions (planning, finance, purchasing, personnel) and on top of all this placing a Central Committee which would be the main engine of the whole machine. The Central Committee would be made up of eight individuals, with each of the two partners nominating four representatives. The committee would have the task of acting as an impartial guarantor of a merger built upon absolute equality. It would design the general strategy of the Union but would have no power for implementing the same as it was conceived as an advisor of the boards of the leading holdings.

Gavino Manca, a manager in charge of the planning studies for Pirelli group, took part in some of the meetings of the Central Committee and went on to describe them as hurried and bureaucratic. Meetings of the central committee took place once a month (less frequently for the other groups) and alternated between Milan and London. They would start late in the morning and finish by the late afternoon so as to allow those coming from outside the country to limit their travels to one day; the only interruption was a business lunch. Two secretaries (one from each of the companies) prepared accurately the agenda and kept the minutes of the meeting which always opened with a presentation on the macroeconomic scenario by Gavino Manca when the committee met in Milan and by his counterpart, Roy Marsh, when they met in London.

A real merger?

Eager to inform its readership in Italy of what was going on behind the scenes, the Italian periodical "Successo" wrote that the two companies had tried to also involved Germany's Continental Gummerwerke which briefly gave serious consideration to the offer but, at the last minute, withdrew most likely due to pressures of its most important shareholder, the chemical giant Bayer which wanted Continental to form an integrated German group in rubber with two other companies which it controlled: Metzeler and Phoenix Gummi. This refusal led commentators to talk of the Pirelli-Dunlop Union as a defensive merger aimed at maintaining the status quo in the face of competition from the Americans and from Michelin. Leopoldo Pirelli vigorously denied this hypothesis in a television interview which he gave, declaring that on the contrary Pirelli and Dunlop were so technologically advanced that their integration would end up bringing about a much higher return for the two companies.

But a merger of these proportions was not easy. It necessitated such a reengineering action of the entire ensemble so as to create a completely new entity which would certainly be different from the sum of the constituent parts. Such a feat of reengineering would create a unitary command and required the deep involvement of the entire management teams of both groups. Instead, the Union seemed above all to be a vertex operation realized primarily by the two leaders, Reay Geddes and Leopoldo Pirelli, each of whom seemed to admire the other.

But a personal agreement between the two presidents could not cancel the obsession for equality—the structure of the shareholding, the composition of the committees—which really wasn't a signal that the project was heading in the right direction. Even worse was an initial phase in 1970 when Pirelli and Dunlop could not distribute dividends as the first balance sheet showed liabilities.

Organizational and institutional issues

After a year of analysis on the their potential combinations, the complex company structure that was created during the summer of 1971 -- when the two groups signed the agreement -- mainly guaranteed that neither lost control of its structure, thereby keeping the share balance unchanged. This choice, which had a deliberately low impact on corporate bodies, encouraged a favorable reception of the alliance at all levels, but over time made it difficult to coordinate the two groups which were extremely different from an organizational point of view.

The first difference was the existence of just one holding company in Dunlop group (Dunlop Holdings Limited) and the presence of two parent companies in the case of Pirelli (SIP Sa in Basel and Pirelli SpA in Milan). This was linked with the first international expansion of Pirelli during the 20s. In those years, the strategy of the group mainly aimed to strengthen its position on foreign markets, raising capital abroad and investing it in Europe and overseas, especially in South America. With this purpose in 1920 the Compagnie Internationale Pirelli was established in Bruxelles then, in 1937, it was moved to Basel with the name Pirelli Holding Sa which, in turn, was renamed SIP Sa in 1954.

The group's head office remained in Milan, but, with the passing of time, SIP played a growing role in Pirelli strategies. The main functions of the Basel firm were in fact to link Pirelli with the international financial markets - especially the Swiss banks, representatives of which were seated in its board - and to manage commercial and productive foreign activities that for fiscal reasons made sense to be separated from the Italian ones.

Both companies were controlled by the Italian Pirelli & C., a limited partnership company also established in Milan, and there was a significant cross-holding of shares between them, but the financial strategy designed to avoid takeovers on the two holding companies could not solve the complex problems of coordination originated by the "two-head" structure described above; nor could the Union with Dunlop solve them. On the contrary the merger magnified these difficulties: as we have seen, the principle of equality, "an objective to be maintained and perfected in everything except trade investments unrelated to the Union"[1], led to a duplication of the "two-head" structure in Great Britain, separating local and overseas activities, while the growing dimensions increased the problems of international coordination.

Other gaps between the two groups in fact existed. As stated in an internal *Organisational Comparison* realized in the first months of 1971 "because of the profit responsibilities of divisional heads, both Dunlop and Pirelli [could] be classified as being divisionalised and decentralised types of organization", but not in the same degree. Despite the existence of different practices in various parts of the Italian companies, authority seemed "more centralised in Pirelli domestic (but not in Pirelli 'foreign') than in Dunlop". In Italy, according to the authors of the comparison, a distinction was made between the extent of authority delegated to divisions and subsidiary companies operating domestically or abroad: "the management of the former [was] more centralised, whereas those operating abroad [were] largely decentralised"; a difference that clearly testify of the diverging management styles that characterized the two Italian parent companies.

1 Asp (Pirelli's Historical Archive), Cplp (Leopoldo Pirelli's chairmanship), Segreteria 1 (hereinafter S1), b. Union Pirelli Dunlop 2, f. Documenti costitutivi della Union, *Code of practice*, 21 gennaio 1971, p. 2.

On the contrary, it was noticed in the comparative analysis, in Dunlop no such distinction existed due to the adoption of a more decentralized type of administration. It could be no coincidence - as the report pointed out - that in general corporate staffs were numerically larger in Pirelli than in Dunlop: it was clearly a reflection of the wider responsibilities given to the Italian managers.

There were also other less evident but equally significant differences relating to the management of single activities. For example, as far as the specific tire division was concerned, "in Dunlop responsibility for tire technical development world-wide [was] carried at corporate level by Tire Technical Division. In Pirelli these responsibilities [were] carried by the domestic tire division and [extended] to cover the requirements of the foreign based factories and certain of the other home-base product division". In each company corporate level advisory and specialist services provided support to the tire divisions but with specific emphasis: in Dunlop these operational support services were "predominantly technically oriented (Central R&D, Tire Technical, Tire Manufacturing Services and Materials Supply Division)" while in Pirelli they were "mainly administrative (Administration, Personnel, Purchasing)". In the end Pirelli's management model was more centralized than Dunlop.

Organizational consequence of diverging management styles, this difference was also the sign of the peculiar history of Pirelli: the creation of a second parent company for fiscal and business purposes did not diminished the role of Italian industrial divisions as far as productions and technical developments were concerned.

Considering this background, the Organizational *comparison* suggested that "priority [was] best given to a review of the staff and specialist services", keeping in mind that uniformity in the composition of the staff units could make communication more effective and could facilitate "the pursuit of common business strategies and the adoption of a common management style"[2].

In fact, after the establishment of the Union, only a few exchanges between board of directors and higher management took place; in general the various operating companies continued to change their directing lines internally, thereby charging only joint committees with group co-ordination.

Lastly there is another important difference between Pirelli and Dunlop that has to be mentioned given its influence in the subsequent developments of the Union; a difference inherent to the proprietary structure of the two groups. As we have seen, notwithstanding its dimensions, Pirelli

2 Asp, Cplp, S1, b. Union Pirelli Dunlop 2, f. Organisational Charts 1971-1976, *Dunlop Pirelli Organisational Comparison*, February 1971.

was basically a "family" firm: the descendants of the founder, with few other shareholders close to the family, controlled Pirelli & C.; this enterprise, in turn, by means of cross-holdings between the two parent companies, controlled the entire group. Dunlop, on the other hand, was a "public" company, a condition perceived as anomalous and dangerous by the Italian top managers who were worried about the lack of "control" over Dunlop to the extent that, before the establishment of the Union, they asked themselves if it could be possible to "arrange something in order to preserve at least a continuity in persons"[3].

Product management: an attempt to move towards integration

Notwithstanding the differences and the integration difficulties mentioned above, the creation of such a complex transnational structure changed the context in which the management of the two groups had to operate, and consequently, also how it conceived its own role. As a reflection of this, starting in the early 70s, Union management made new proposals of organizational changes, and the one leading to the most controversies was the idea of using the *product management* concept as the focus point around which to turn integration. Quite soon it was argued that a higher organizational efficiency and effectiveness could be reached by changing from *company management*, i.e. separate management of the group industrial activities, to *product direction*, the joint management of the single activity sectors, thereby making the Union become more similar to a multidivisional integrated group.

One of the first formulations of this reorganization proposal can be tracked in a study of the first months of 1972 by Stanley Crooks and Alessandro Signorini, respectively Deputy General manager of SIP and General Director of Pirelli SpA at the time. The document of the two Pirelli cable division managers pointed out the complex shareholding plot and the fact that the merging process had caused problems linked to it: shareholders' interests of each parent company depended, at least partially, on the decisions and management behavior of the other two parent companies. This was not a hindrance to making the already existing activities more profitable but it could become an obstacle when it was necessary to take decisions regarding expansion in new sector or disinvestment in activities which were no longer profitable.

The Union was therefore faced with the alternative of remaining organized on a geographical basis and then coordinating the activities of the various productive sectors on group level or, in turn, reorganizing itself on a productive basis. This second choice seemed the most suitable as far

3 Asp, Cplp, S1, b. Union Pirelli Dunlop 1, f. Posizione Pirelli Dunlop (1969/1970), sf. Posizione cronologica incontri, summary of the meeting on Dunlop and Conti, Milan, 16 April 1969.

as highly specialized technological activities and marketing, such as the tire, cable and special mechanics sectors were concerned.

That way the management of every manufacturing sector would be fully responsible for the economic results of the sector it had to manage and would have all the resources under its direct control. Once it had delegated responsibilities related to operating activities, top management of the Union would only take decisions about strategic investments and disinvestments, supply to the alliance the basic financial and research services, while making sure at the same time that the performance levels of the various sectors were in compliance with the preset standards.

However, these restructuring plans had to cope with two hindrances difficult to overcome: on the one hand, opposition against any change of the proprietary structure of the two groups, and on the other hand an economic situation negatively affecting profitability of some elements of the alliance itself.

As regards the first aspect reported, an anonymous document by the Italian top management presented as a comment on the Crooks and Signorini proposal, explained the core of the problem. Though Crooks and Signorini seemed to have very different opinions, that note laid emphasis on the fact that the incomplete merging of Pirelli and Dunlop was not due to the lack of suitable European laws[4], but to the management structure of the two groups. So, as already pointed out before, Pirelli & C. - the limited partnership company through which the Pirelli family and the shareholders closer to it controlled the Pirelli group - owned only the 7.1% of the share capital of Pirelli SpA (the Italian parent company) and 18% of SIP (the holding company of Basel); in this situation "SIP [represented] the control pillar of Pirelli SpA (11.4%)", while it was controlled by Pirelli & C. (18%) and directly by the family and close friends (20%). On the contrary, Dunlop did not rely on control groups, so in the event of a complete merging all the Italian cross-holdings would have been canceled and the Pirelli & C. shares would account for only 7.8 % of the share capital of the newborn company created by the merging of Dunlop Holdings Limited, Pirelli SpA and SIP Sa.

So this was the true reason hindering a greater integration of the two groups. In particular, as far as the proposal of creating a *product management* was concerned, it had also to be taken into account - stressed the authors of the document - that the "sharing of responsibilities between the product manager and the national holding companies directors [could] cause both fiscal and

4 This was the explanation given both by the Board accepting, as for the Italian side, to join the Union, and during the various press conferences when the plan was presented to the journalists.

functional problems"; the nature of these "functional difficulties" was explained through an example of an hypothetical controversy which could arise and which was described in brackets after the following statement: "the Tire Manager is not interested in Val Basento but Mr. Pirelli has to promote it for political reasons"[5], clearly alluding to the pressures that an Italian large corporation could not avoid.

Pirelli's troubles

As already mentioned above, the other *product management* obstacle was the progressive negative development of the economic and social situation, especially as regards Italy. The first symptoms were already to be seen before signing agreements with Dunlop. The last meeting of Pirelli's Board of Directors in 1968 could not take into account the radical changes affecting the factories, in particular the plant of Bicocca in Milan and that of Settimo Torinese in the outskirts of Turin. In summer 1968, the workers of these two plants bitterly quarreled about regulations and payment of piecework leading, in the quarter immediately after to a loss of over 900,000 working hours because of strikes.

Things didn't get better during the following years: labor costs increased over the three-year period from 1969 to 1971 with an absolute value equal to the Pirelli turnover; then, in the early 70s, the problems caused by the energy crisis and the subsequent decline in the automotive market, together with the more and more pervading spread of preference for radial tires[6], soon led to an overproduction crisis, being more severe in Italy, both because of the increasing social tensions and because of the reported lower productivity levels.

All these elements literally arrested the development of the Pirelli group. Increasing costs together with sales growth erosion, i.e. the figures of sales remain almost unchanged between 1970 and 1971, led to progressive outcome worsening and an increase in debt levels And these were the main hindrances to the already mentioned *product direction* implementation.

In June 1971, a few months after formally underwriting the *agreement* between Pirelli and Dunlop, when Industrie Pirelli SpA - the new operative European branch of the Pirelli group, created

5 Asp, Cplp, S1, b. Union Pirelli Dunlop 4, f. Incontri LP/RG 1972, *Osservazioni su studio organizzativo Union*, this document is anonymous and without the date, but it must have been written in 1972, a few days after the Crooks-Signorini note. Val Basento was one of the areas involved in the extraordinary intervention to help the Mezzogiorno (the southern part of Italy) starting from the early Sixties. In this region, in 1962, one of the first "Industrial Development Districts" was promoted with the help of the Cassa per il Mezzogiorno (Southern Italy Development Fund).

6 Radial tires increase average tire life from 40,000 to 100,000 kilometres, thereby making replacement less frequent.

within the Union - presented its six-month outcomes, the English counterpart pointed out that consolidation of up to 49% losses of the operating Italian company reported in the Dunlop Holdings Limited balance sheet, would reduce total profits to be assigned to its shareholders, despite "the better trend of Dunlop Limited, Dunlop International and SIP subsidiary companies". This decrease would even be higher than the one that Dunlop could have expected to reach throughout the year had it not stipulated the unification agreements with Pirelli.

Following severe criticism of British public opinion towards the developments of the alliance, Dunlop management asked to change its shareholding in Industrie Pirelli SpA, in order for the Union to being able to start without being "lame with one foot". Consequently an agreement was reached assigning to the shares which Dunlop held in the Italian operating company a preference up to their nominal value, in case of a merger breakup. At the same time, maybe "more for formal than for substantial reasons"[7], the same rules were applied to the Dunlop Limited shares owned by the Pirelli group.

Due to the huge losses of Industrie Pirelli SpA during the following year – at the end of 1972 they amounted to over 80 million dollars, i.e. over a third of the whole share capital (200 million dollars) – both ordinary and preference shareholders had to intervene financially in order to reduce company debts.

Dunlop decided to "freeze" its holdings in the Italian group. From that moment on, Pirelli SpA had to bear on its own financial responsibility for Industrie Pirelli SpA because Dunlop would no longer increase its initial investment in that company (amounting to 41.5 million pounds), at least not until "sustained profitability" could be guaranteed once more.

This financial agreement, which somehow was akin to bringing a default action against the Union itself, obviously affected the organizational level, too. The *product manager* issue continued to be discussed during subsequent years and, between 1974 and 1975, McKinsey was hired in order to implement this feature on the basis of the new agreements, i.e. excluding the Industrie Pirelli SpA tire division from reorganization, but as Filiberto Pittini, at the time Managing Director of Industrie Pirelli SpA, pointed out in September 1974, the particular company situation, being "extremely serious", was the real hindrance on the way to *product management* implementation. Inside this new background "the interest of the shareholders in a unified management had been lost".

7 Asp, Cplp, S1, b. Pirelli Spa 2, f. Consigli Pirelli Spa 1971, sf. Consiglio del 26 ottobre 1971, Annex 10 to the President report.

More in general, Pittini asked himself if the Union target, as it was initially conceived up to that moment, had not been a mistake in consideration of the fact that "in recent times, political, social, corporate and economic pressures exerted by national governments and lobbies [had become] more and more important on a national level". These pressures were likely to act against the classic multidivisional model and McKinsey itself, having contributed to the creation of that model, was probably aware of it. The first drafts of the consulting company's report on re-engineering in the Union did not take this openly, but indirectly into account, "when proposing highly complex and sophisticated systems in order to make up for very different requirements through detailed bureaucracy"[8].

Dunlop's troubles and the end of the Union

The *product management* subject did not disappear from the Union's agenda with the failure of McKinsey proposal of creating a unified European Tire Direction. In fact, in the following years it still remained the main organizational issue discussed inside the alliance, without being implemented practically, also because of the lasting economic problems. After a first "General plan" aiming at rescuing Industrie Pirelli SpA, elaborated in 1973, in the mid 70s two other plans were designed to reorganize the Italian tire sector, which in 1980 made Industrie Pirelli SpA earn profits for the first time since it had been set up. However, during the last years of the decade, the effects of the international crisis involving the tire sector also affected the British counterpart of the Union, thereby creating further problems between Dunlop and Pirelli, that in 1976 and 1978, respectively, decided not to accept the mutual funds requests in order to recapitalize the operating companies.

The first evidence of the crisis which affected Dunlop since the second half of the 70s could be found in Dunlop's Annual report of 1978. Campbell Fraser, the new chairman of the group, who had replaced Raey Geddes that year, began his speech on the activity stating than "during 1978 Dunlop [had shared] with other companies severe difficulties in the European tire market". It was generally accepted, continued Fraser, "that the companies making tires for (the) European market [had] more capacity than [was] needed"; the major reasons for this were the widespread factory construction in the late 70s, the halt in the growth of motoring mileage which followed the oil crisis and, as mentioned above, the growing use of the steel-radial tire. But in Great Britain there was another element that contributed to Dunlop's negative results: the contraction of the national

8 Asp, Cplp, S1, b. Union Pirelli Dunlop 16, f. Studi McKinsey su Product Management, sf. Product Direction, *Posizione Pirelli Dunlop*, confidential note by Filiberto Pittini of 12 September 1974.

motor industry, with imports that took a larger share of the market. This background and the related fall of tire prices led to a "drop from profit into loss at the operating level between 1977 and 1978, reflecting the serious deterioration in the United Kingdom results"[9].

Things got worse in the following years; delays in the modernization of plants and in the re-engineering of Dunlop group along with the recession in the vehicle industry caused an increase of operating loss from 5 million pounds in 1979 to 14 million pounds in 1980.

At the end of that year, Filiberto Pittini, then managing director of Pirelli SpA reading to the top management of SIP Sa a report written by Leopoldo Pirelli stating that the Union had to face two problems. First of all the negative trend of Dunlop Ltd, the main operating British company, and second the progressive deterioration of the mutual relationships to such a point that he could affirm that the 'essence' of the Union foundation failed and the initial "constructive co-operation" with which problems were approached had been replaced by an attitude, defined by Pirelli's president himself, as "bargaining"[10].

Obviously some advantages had been achieved by the Union, e.g. in the purchase sector where the bigger size allowed for extremely favorable supply contract stipulations, but the general negative feeling and the growing economic difficulties could not be cancelled, and as nothing new came about during the following months, in April 1981 the alliance was declared jointly dissolved by Leopoldo Pirelli and Campbell Fraser. Shortly before the Union dissolution, the hypothesis of creating the previously mentioned Europe Tire Direction controlled by one of the partners was evaluated again as well as the opportunity of extending the partnership to other European manufacturers but, in the end, after years of misunderstandings, the negative Dunlop trend prevailed.

The reasons for the divorce and its consequences

As we have seen, the troubled economic trends of the 70s played a main role in the failure of the alliance between Pirelli and Dunlop, progressively deteriorating the relationship between top management of the two groups and their mutual confidence.

But there were also deeper elements which led to the Union dissolution: the difficulties implied in the attempt to combine two groups characterized by significant differences in their models of corporate governance. Pirelli was in fact a family business while Dunlop, as seen above, was a

9 Dunlop, *Annual Report 1978*, p. 3.

10 Asp, Cplp, S2 (Segreteria 2), b. Dunlop 1, f. LP su Union, Leopoldo Pirelli's speech at the Mission directors' meeting of SIP, Basel, 11 September 1980.

public company. Pirelli, as well as many other Italian groups, was controlled by means of a pyramidal structure, cross-holdings of shares and agreement between shareholders, a delicate balance which could be compromised by little changes in the share capital distribution or in its total amount. A delicate balance to preserve which Italian top management refused to implement deeper changes in the Union structure that, in the difficult 70s, might have led the group to achieve better performances. In this regard we can find some similarities between the Union history and a subsequent unfortunate international merger attempt: the one between Fiat and Ford in 1985. Notwithstanding the potential synergies of the joint-venture between the two automotive producers this project failed because the two head offices were incapable of achieving an agreement on the crucial issue of corporate control.

Still, the Union's evolution was also influenced by Dunlop's structure: as it was a public company, top management was more susceptible to criticism from shareholders and this sensibility for sure played a role when - with scarce far-sightedness - they decide to "freeze" Dunlop's holding in the Italian group. A short-term perspective compromised the alliance few months after its constitution.

In conclusion, the main reason of the Union failure seems to be found in the attempt to merge two different organizations, both with their peculiarities, without a clear hegemony of one company on the other.

However, aside from the reasons of the Pirelli Dunlop divorce, the Union dissolution had deep consequences on the subsequent developments of both groups. Dunlop, now on its own, was not able to overcome its negative results, progressively deteriorating its financial structure: the debt/equity ratio that in 1979 amounted to 64% rose to 130% in 1983; in 1984, after several dismissals, a consortium of banks headed by Barclays and National Westminster- the major creditors of Dunlop - organized the financial rescue of the group that, in 1985, after a seven-week takeover battle was bought up by British Tire and Rubber (BTR) Industries.

On the contrary, as far as Pirelli was concerned, especially due to its structure, the Union dissolution made the group return to its situation of 10 years before. The joint share exchanges of 1971 could easily be reversed, and this is what happened in spring 1981. Nonetheless, the Union experience didn't get completely lost: studies and analysis of the organizational structure to define homogeneous criteria and procedures, the harmonization of the cost calculation system, the standardization of the estimate and planning methods, the design of Pirelli-Dunlop long-term strategic and operating sector plans, the co-ordination of a structure having international branches, were all new know-how which Pirelli progressively acquired, as shown for instance by the formalization of planning processes with the creation of a suitable corporate function.

It was probably this new knowledge that showed that a new structural development was now needed for the Group, which had been left alone. The Union dissolution presented almost the same problems that, at the end of the 60s, pushed top management at Pirelli to try to find an international alliance and to change the group structure in order to solve problems arising both from the size and from the type of organization, especially from the two separate decision-making centers represented by the two parent companies. It was fairly clear that – as the previous experience within the Union and the simultaneous development of other international groups suggested – it was necessary to manage activities of the two *parent companies* by "a single supervision centre, by just one Board and by one and the same management". When the decision to dissolve the alliance with Dunlop was taken, the hypothesis of merging Pirelli SpA with SIP was taken into consideration, so as to solve the long-lasting problem of the "two-heads". However, the implementation of such a merger was very unlikely to happen "both for monetary reasons, but also because Pirelli SpA, that was the main company on which the group strategies had been based till that moment, would have become too weak from a political point of view"[11]. Therefore an intermediate solution was chosen, i.e. setting up the Pirelli Société Générale (Psg), a holding with its head office in Basel, jointly controlled by Pirelli SpA and SIP and directly managing the operating companies.

The reorganization, however, didn't save the situation, because the "two-head" problem was not solved, but simply moved backward, changing the corporate configuration, so that after four years another reorganization was needed in order to simplify the whole structure. In May 1988, the planned new company structure was presented to the group's assemblies: the limited partnership company, Pirelli & C., would control 35-40% of SIP Sa, which should become the financial core of the Pirelli group; Pirelli SpA would be directed by the latter, with shareholding amounting to 45-50%. At the same time, Psg would leave the stage, transferring to Pirelli SpA all its competencies - including management of the newly born Pirelli Tire Holding of Amsterdam, that could then combine all the group's activities in the tire sector .

However, in the early 80s, Pirelli was late to meet the market needs, not only because of its financial and organizational structure; in fact, after leaving Dunlop, its scarce competitiveness was

11 Asp, Cplp, S2, b. Pirelli Spa 22, f. Studi per ipotesi creazione Pirelli Holding (P.H.), *Problema case madri,* highly "confidential" note by Emanuele Dubini of 13 April 1981.

mainly caused by its size, especially the size of the tire sector. On the one hand, the group was totally absent in the leading USA market, which the company lost when the Union was dissolved, and on the other hand, as described by a report presented to the Board of directors in December 1986, its tire sector was "too big to limit itself to market niches, too small to compete satisfactorily with the first 4 Big Producers" (in the early 80s: Goodyear, Michelin, Firestone and Bridgestone).

Within a market becoming more and more concentrated[12], it was necessary to create an international alliance or to increase the group size. Therefore, at first in the spring of 1988, the company tried to buy out Firestone and Armstrong, a much smaller American company; then - between 1990 and 1991 - it tried to stipulate an agreement with Continental. However, just one of these three attempts was successful, i.e. Armstrong acquisition, while the other two plans, that were more important because they involved bigger enterprises, failed. In the first case, Bridgestone submitted a counteroffer which was disproportionate according to Pirelli, which abandoned the deal, and in the second case, after many months of negotiation, the supervisory board of the German company rejected the proposal of unifying all activities of both groups into the tire sector under the corporate name of Continental, together with the purchase of the majority share of the latter by Pirelli.

These failures, especially the latter one, not only hindered the Pirelli group to develop in size, but also deeply negatively affected it from a financial point of view. Negotiations with Continental impacted on the 1991 financial statement, that was already quite negative, for about 200 million euros. The economic results of that year inevitably paved the way to a new trend of the group, i.e. trying to implement the second alternative which had already been taken into consideration during the mid 80: to reduce company size in order to focus only on the more profitable segment of its traditional manufacturing businesses, mainly cables and high performance tires.

12 In the period between 1970 and 1986, in Europe, due to the different agreements, merging or acquisitions of the major manufacturing companies, the originally fifteen operators of the tire sector, were reduced to only seven: Avon, Continental, Firestone, Goodyear, Pirelli, Sumitomo and Michelin.

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