“***How to change in a changing world***”

Article for *Civiltà del Lavoro*

P F Guarguaglini, Chairman and CEO of Finmeccanica SpA

As recently as five years ago, one of the most popular recurring themes in the Italian newspapers and elsewhere concerned when and how – not whether – Finmeccanica would throw off the burden of its activities in the civil sector, mainly transport and energy, to concentrate on its core business of aerospace and defence.

It appeared then that investors would never reward such a poorly-focused conglomerate, as Finmeccanica was then. Time has proved that this was not necessarily true.

It is certainly the case that in the past few years Finmeccanica has developed and strengthened its presence in aerospace and defence, to the point where today 80% of the group's revenues come from these sectors. However, the companies operating in the civil sector are not only still part of the group, but are also dynamic and profitable. And Finmeccanica’s share price has increased by over 30%, proof that the markets too have rewarded this strategy.

What can we learn from all this? Finmeccanica’s success is undoubtedly due, to a large extent, to the excellence of the products and systems that its companies offer. But there is another more general point that is worth making.

The world is becoming increasingly interconnected and, consequently, ever more complex. Sectors that were once distinct and virtually unconnected, now have a reciprocal, and sometimes quite significant, influence on each other. This is largely due to technological progress, which puts many increasingly cross-sector options at the disposal of all – the ICT sector is a case in point – such that individual products become increasingly less important, while systems and integrated solutions become more attractive.

Other external conditions, apart from technological progress, also help to connect once disparate sectors. For example, the new and urgent security requirements that have emerged with the eruption of international terrorism, are firmly redefining the approach to all major infrastructure, in terms of both hardware and software, encompassing the production and distribution of energy; air, road and rail transport; communications networks; logistics systems; and territorial and border control. It is no longer possible to design critical infrastructure without thinking about the security dimension.

This new scenario favours those companies that can put themselves forward as all-round operators along the whole value chain, and offer end-to-end solutions, forming real partnerships with clients, rather than simply producing the individual systems components that they require. Thus, it is the companies with a range of skills, able to bring together traditionally separate sectors, that flourish.

A similar level of interconnection to that described for industry, now also applies to the economy in general[1].

First, the question of whether the global economic boom seen over the past five years can continue is inextricably linked to the performance of the US economy, as shown by the impact of the US housing market crisis – which initially seemed to be a national phenomenon – on the financial markets, and more generally, on the economy as a whole.

Second, the global economy now operates in a multi-polar context and its fate depends increasingly on areas and countries that are not part of the traditional group of developed economies. In 2007, significant contributions to global economic growth came not only from China (11.5%) and India (9.2%), but also from central and eastern European countries (5.8%), Latin America (5.1%), the Middle East (5.1%) and even Africa (5.8%), all of which recorded higher growth rates than the US and western Europe (2.5%).

This increasing internationalisation stems from a combination of several factors: the growing inter-relationships in business, the economic and financial world and communications; greater mobility of people, goods and information; and the proliferation of multilateral institutions.

The industrial model in respect of global projection has changed a great deal in recent times. While in the 1970s and 1980s, relative advantage derived mainly from the availability of cheap labour, today the competitive advantage can chiefly be found in the opening of new markets and in access to technology – now increasingly widespread- and skills, which are also found in the emerging countries. India's leading position in computer science is a case in point.

In light of these considerations, it would be difficult not to recognise that our industrial landscape is not equipped, at least in its current state, to adequately respond to the challenge posed by these new paradigms.

The signs of a worrying decline in Italian competitiveness are plain to see[2]: in 2006 GDP growth was 2.0%, lower than the EU average (2.9%), as was the rate of labour productivity growth, which showed a modest 0.4% for Italy (1.3% in Europe). Italy's fiscal deficit also worsened compared to 2005, from 4.1% to 4.7% of GDP (2.0% in Europe).

The situation is even worse for investment in research. In absolute terms, Italy invested barely USD 18 billion in 2006, compared to figures of USD 40 billion

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1 "Le sfide dell'economia globale: tra opportunita' di crescita e rischi geo-economici" (The challenges of the global economy: growth opportunities and geo-economic risks), P. Guerrieri, Global Outlook 2007 – Final Report, Quaderni IAI
2 "Il sistema Paese e la gestione strategica in Italia", (The "country system" and strategic management in Italy), Ambrosetti, 2007

in France, USD 60 billion in Germany, over USD 100 billion in China and Japan, and over USD 300 billion in the US.

The fragmentation of the industrial fabric is one factor hindering Italy's success in competing at international level. Less than 10% of companies operate in high-tech sectors. This is because nearly 80% of the manufacturing sector's value added comes from SMEs, which, however, contribute less than 20% to R&D expenditure, versus 80% by major industry. This explains why the structure of Italian industry is highly skewed towards low-tech sectors.

This frustrates a great deal of the effort put into innovation: while Italian SMEs have higher innovation indices than the European average, these mainly relate to marketing, organisation and product communication, rather than technological innovation. But it is this last that creates a real competitive advantage.

In an attempt to restore competitiveness to our economic and industrial system so that it is well-placed to confront the new scenarios that we have rapidly sketched out, in my opinion, we need to concentrate on two elements in particular: our technology base and international projection.

With regard to the first aspect, if it is true, as I mentioned earlier, that SMEs are unable to invest sufficiently in R&D activities without hurting their operating profit, it is equally true that, by taking part in significant projects in conjunction with major industry, they have the opportunity to be part of the innovation process and to benefit from the transfer of technology, which improves competitiveness.

This model is not too far removed from the one that Finmeccanica adopts with the large, US prime contractors. Instead of putting ourselves forward purely as suppliers, we now aim to draw up partnership agreements with them: we jointly research the business plan, analyse the risks to be shared, assess the investment required and, on that basis, fully share in the successful outcome of the programme. This approach can clearly be replicated at national level[3].

An effective way of confronting the second aspect, on the other hand, is to shift from the international expansion of companies to the more fully-developed concept of "regional internationalisation". In other words, we should try to replicate successful examples of integration and expansion abroad of regional business clusters and local industrial systems including some manufacturing delocalisation of the lower value-added stages of production. This could help generate momentum and competitiveness even in the more traditional, typically Italian sectors.

For this to be successful it is vital that the institutional powers that can encourage the internationalisation process are also strengthened, and a clear overseas economic policy defined. In this regard, we should always

3 "Piccole o grandi, ma imprese" (Companies large and small), P F Guarguaglini, Il Secolo XIX, 31 March 2007

remember that Italy is an integral part of the European Union, and so any attempt to safeguard its national interests must take place in Brussels, with the aim of becoming part of the smaller group of countries that will play an active role in redefining the manufacturing landscape and the European economic area.

But that's not all. We also need to manage complex relationships with key players in the global economy, and especially with the new entrants appearing on the scene. In this case, too, Italy cannot reasonably be expected to confront the various situations alone; it is in the country's interests to play an active role in formulating joint European policies.

Russia and China are two obvious examples that spring to mind. As regards energy, the definition of a joint supply and diversification strategy including, among other things, a consistent policy towards Russia, would certainly be desirable. For China, meanwhile, trade policies and reciprocal measures are required that will encourage its transition from a mere exporter country to a large market offering opportunities to Italian companies – whether large, medium-sized or small.

In short, if Italy is to regain the ground lost in recent years, all parties involved – industry, institutions, entrepreneurs and financial operators – must pull together and play their part in achieving a common objective. To this end, it is vital that we improve our strategic co-ordination in planning and monitoring foreign economic policy instruments and actions to avoid the risk of excessive fragmentation and best exploit the wealth of opportunities available[4].

[4] "La necessità della rete: l'internazionalizzazione come strategia per competere nell'economia globale" (The essential network: internationalisation as a strategy for global competitiveness), P. Guerrieri Finmeccanica Occasional Paper, in print.