The Evolution of the Strategy and Structure of a State-Owned Company: The Case of Agip Petroli S.p.A., 1960-1990

Luigi Orsenigo
Fondazione ASSI and Bocconi University of Milan

Giulio Sapelli
Pier Angelo Toninelli
Fondazione ASSI and State University of Milan

The history of Agip is interesting for several reasons[1]. First, as the history of an oil company, it is a pertinent case study in the process of adjustment and reorganization of a large, vertically integrated company. This study highlights the perennial tension between centralization and decentralization within organizations, sheds light on the nature of the patterns of response to external shocks, and illustrates the role of precedent and tradition in shaping behavior, strategies and structures. Second, since Agip is a state-owned company, the story sheds light on the difficult relationship between politics and economics as well as on the behavior of state-owned companies. The history of Agip illustrates the influence of the process of evolution on managerial competency, and on the impact of the structure of incentives and control mechanisms on management. Third, as the history of an Italian corporation, the case of Agip provides material for the analysis of a crucial issue in Italian business and industrial history, namely the weakness of the large, managerially fragmented company, and the persisting role of family capitalism.

The Birth of Agip Petroli: Antecedents

"Agip Petroli" (AP) was founded in December 1977 as the result of the separation of Agip (the oil division of ENI) into two operating companies: Agip S.p.A., responsible for exploration and supply activities, and AP,

[1]This paper is based partly on interviews with current and/or former managers of Agip. In what follows, for reasons of space, we shall not quote these sources as evidence about specific issues. We take the opportunity, however, to thank all of them for their kind cooperation. Empirical evidence and data are drawn from [1, 2, 10].

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responsible for refining and distribution activities. The birth of AP marked the culmination of a long process of organizational and strategic change at Agip and ENI. These developments had been initiated in the 1960s, and were motivated by the interaction of economic, organizational and political variables.[2]

Traditionally, the ENI group had been extremely centralized. As an oil company, ENI was intrinsically characterized by a high degree of vertical integration and centralization. As a state-owned company, ENI had the precise "mission" of guaranteeing the energy self-sufficiency of the country through its control of all stages in the production of oil. Finally, ENI had been dominated by the personality of its founder, Enrico Mattei; strategy and management were strongly centralized in Mattei's hands.

Following Mattei's death in 1962, the organizational structure of the oil activities did not undergo drastic change. With regard to Agip, the company maintained an integrated management approach toward exploration, supply and distribution. Refining, however, was controlled by ANIC, the chemical division of ENI. By comparison with other private producers and the majors on the Italian market, the ANIC was quite small. In the late 1960s Agip retained 12% of the oil-refining capacity of the country, whereas the majors held 37% and the independent national private producers held 51%. During this period, moreover, the role of exploration was gradually reduced as a consequence of a strategy aimed at obtaining supplies of crude through long-term contracts with the "majors" and with producing countries. Agip, in other words, was becoming less a producer than a "merchant" [4, 14].

During the 1960s, the operating companies gained progressively higher degrees of autonomy vis-a-vis the holding company. This was the outcome of several factors. First, the death of Mattei had weakened the strategic initiative of ENI. In this respect, Agip's situation was comparable to that of a number of companies that experienced decline upon entering the "second generation" of leadership. Yet, the case of ENI is considerably more complex, primarily because ENI is a state-owned company. Furthermore, during the 1960s, the relationship between ENI and the political world underwent profound changes. In the "Mattei Age," the relationship was dominated by the company,

[2]The Agenzia Generale Italiana Petroli (Agip) was created in 1926 by Mussolini and given the task of exploring and supplying hydrocarbons and distributing oil products in Italy. The expectation of the Fascist regime was that the new state-owned company would reduce the foreign energy dependence of the country. However, up to the post World War II period results were virtually negligible, since the company was nearly paralyzed by contrasting economic and political interests of both private and public nature. The actual development of the company began with the 1946 appointment of Enrico Mattei as extraordinary administrator by the C.N.L. Mattei gave a new impulse to exploration and supply of oil and gas in Italy and abroad. Later (1953) he was responsible for the creation of a state-owned integrated oil group, ENI (Ente Nazionale Idrocarburi). Once again, the aim was to provide for the energy independence of the country, counterbalancing the power of foreign companies, as well as to develop chemical activities controlled by the state. As a consequence, Agip became the outstanding operating company of the ENI group. See, for instance, [4, 11, 14].

which was able to impose on the political system its own vision and strategy, and even to create its own constituency in the political parties [16]. This ability depended heavily on the personality of Mattei, but also on the contextual development of a strong and aggressive "corporate culture," which was capable of proposing and implementing ambitious strategies. Indeed, despite the high degree of centralization of the company, especially evident in strategy formulation, a competent, proud and technically oriented management was being created within the company. However, the autonomy of ENI also depended on a general confluence of interests and vision between the political system and the public "managerial" system. In other words, in the 1950s, the relationship between ENI and the political system was cooperative rather than hierarchical. In short, ENI was an active part of the political system, capable of influencing and transforming it [14].

This relationship was reflected in the organizational and control structures within ENI. At the top strata of the political system, the Minister of State Participation in Industry had political responsibility for the strategies of the company. The reciprocal relationship between ENI and the political system, as well as the validity of political influence, were reinforced as these strategies were implemented. In the middle, the holding company (ENI) coordinated sectoral policies and provided financial assistance to the operating companies. The operating companies were then free to pursue their own strategies and run day-to-day management within the above constraints [5, 15].

The inherent fragility of this system was revealed in the 1960s when the preconditions for its viability gradually weakened. In general, the very growth of the system of "State Participation" raised the issue of the relationship between the State and its companies. This generated a complex and sophisticated debate regarding the extent and mechanisms of political control over the management of the companies [5, 12, 15]. Moreover, changes in the political environment, when a Center-Left government coalition was formed, had introduced new parties into the administration of state-owned companies [7, 11, 13].

Other developments were specific to the case of ENI. As mentioned, the autonomous initiative of ENI declined to some extent as a consequence of Mattei's death. Second, the general political climate became less favorable to ENI. The turning point and clearest manifestation of this change was the so-called "chemical war," which occurred when the expansion of ENI into chemicals and the acquisition of Montedison (the largest Italian private chemical corporation) led to a bitter economic and political conflict. On this occasion, ENI lost a large part of its political support. Third, the economic and financial condition of ENI had worsened as a result of overleveraging and a decline in self-financing. Consequently, the company was subjected to the constraining power of the political system. Political institutions gained the latitude to make decisions regarding the provision of direct financing (in its position as sole shareholder), through the mechanism of "endowment funds". Fourth, and possibly more important, this constraining power did not coincide with the ability to formulate strategies; but since public shareholding was actually fragmented into different political factions, pursuing different interests and objectives, it manifested itself only as a power of veto.

ENI thus saw its ability to formulate strategies reduced. The resultant loss of control was not due to excessive size as such, but to the fragmentation of interests among its public shareholder, and the absence of a management capable of running the company free of the control of the shareholder. Within this context, the autonomy of the operating companies resulted in structural transformation to a "weak" feudal system. The absence of a clear strategy increased their scope of action and allowed the operating companies to establish direct links with the political system, independently of the holding company. At the same time, they were exposed to myriad political pressures and became a battleground for the definition of spheres of influence spheres and political factions. In part, however, the increasing autonomy of the operating companies reflected an attempt on the part of management to resist political pressures and to reassert their independence. This resurgence found a formal manifestation in 1972, when the new president of ENI, Girotti, explicitly expanded the responsibilities of the operating companies. Girotti redefined and restricted holding company involvement to the approval of general programs. Direct intervention on the part of the holding company became acceptable only in case of unsuccessful management of the operating companies.

Strategic and Organizational Change after the First Oil Shock

Despite these changes, the structure of Agip remained virtually unchanged. However, separation and sometimes conflict between upstream activities in Milan and downstream activities in Rome became apparent. As a result of the emerging merchant orientation in Agip, Rome had gained an increasingly important role. It must be noted that downstream activities represented a smaller share of total activities in ENI as compared to other major companies, but thiswas only a consequence of the strong domestic orientation of the downstream operations.[3] Thus, the structure of Agip, while seemingly simple on the surface, was actually quite complex. It integrated different cultures and hid a *de facto* autonomy which generated conflicts between the various directions, especially when the organizational and strategic weakness of the holding company is taken into account.

The change in the structure of the markets and competition which followed the first oil shock introduced further problems. In general, the first oil shock brought the following consequences at the industry level. First, the loss of control of the sources of crude and of prices, reduced the ability to

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[3]On the domestic market, Agip was the largest distributor of refined products in the early 1970s. The market share of Agip reached 25% for gasoline and 18% of all other refined products. The expansion of the commercial activities had taken place also through the development of supporting structures to distributors (e.g. motels) and through the introduction of innovative lubricants Outside the home country, instead, the growth of downstream activities was limited and concentrated in few European and African countries: France, Germany, Switzerland, Austria and Hungary in Europe. At any rate, 3/4 of Agip's outlets were concentrated in Italy and even in the following years the growth of downstream operations took place mainly domestically.

manage the oil cycle in a fully integrated way. The degree of vertical integration within the industry decreased quite rapidly as different agents now controlled upstream and downstream activities. Second, as a consequence, supply gradually became a separate function from production and was increasingly based on the knowledge of market operations. The development of spot and forward markets also meant lower transaction costs. During the 1970s, this trend particularly affected companies like Agip which did not control large oil reserves and were comparatively more downstream orientated. Third, declining profits made it necessary to increase the efficiency and accountability in the various phases of the oil cycle through the creation of cost and profit centers within the companies. It must be stressed that in the 1970s declining profits again became a characteristic of the "crude-poor" companies. Although higher oil prices raised the possibility of increased profits, companies with a limited supply of crude were incapable of benefitting from the situation [6, 9].

For Agip, the oil shock implied that its traditional "mission," i.e. the guaranteeing of energy self-sufficiency coupled with the need to curb import of crude, returned as the central strategic concern of the company. As in most oil companies, the immediate consequence of this strategic imperative was an effort to reconstitute vertical integration through renewed exploration. This exploration initiative was to be implemented both domestically and abroad and would include an emphasis on off-shore exploration.

Both the refining capacity and market share in total domestic distribution increased substantially after 1973. In part, this growth was the result of a conscious strategy of expansion of downstream activities. To a large extent, however, this choice was dictated by the fact that some important producers and distributors were restructuring their downstream activities worldwide, and consequently exited the Italian market. In this context, Italy was no longer perceived to be an attractive location, partly because of the 1967-75 closure of the Suez Canal, and also because Italian legislation on the pricing of oil products was considered excessively tight. Agip considered the gaps thus opened in the Italian market as an opportunity for growth. Even more importantly, as a state-owned company, Agip saw a threat to the continued supply and distribution of oil products on the domestic market. Therefore, Agip chose to acquire Shell Italia, which became IP, Industria Italiana Petroli.

As a result of internal and external growth, by 1975, the oil sector in ENI had substantially changed.[4] Both upstream and downstream activities, particularly refining, had expanded considerably. This growth had instigated several thorny problems. The downstream expansion had occurred in a piecemeal manner. Consequently, an extensive restructuring was necessary in productive capacity, logistics, and in the management of the distribution network.

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[4]The domestic market share of Agip reached 40% for gasoline and 30% of all oil products. Agip's refining capacity which in the late Sixties amounted to 12% of the total capacity of the country, surpassed 40% in 1978, while abroad it was reduced.

Furthermore, the expansion of refining activities as well as the acquisition of Shell Italia, had introduced new technical and corporate cultures and capabilities. All these developments implied changing power relationships within Agip. Offices overseeing exploration remained relatively subordinate within the structure of the company, even following the marked increase in exploration. The exploration branches of Agip began to request higher levels of autonomy. Finally, it had become necessary to introduce greater accountability and transparency in internal transactions, particularly concerning the relationship between exploration and downstream activities. A lack of transparency in supply operations also needed to be addressed.

The process of reorganization of Agip began in 1975. It was a source of considerable conflict, which involved several different (and overlapping) cultures. First were the "make versus buy" cultures. The conflict was between one part of management that considered it a mistake to separate a "naturally integrated oil cycle" and another part that emphasized the potential benefits deriving from a more decentralized organization. Second were the "public" versus "private cultures. The first stressed Agip's traditional mission as guarantor of the oil supply; the latter was gradually growing within ENI, both internally and through the entry of the management from private companies that had been acquired by ENI. These managers had a financial rather than a technical orientation and advocated devoting more attention to efficiency and to the economic performance of the company. Third were the upstream versus downstream cultures, both of which asked for more power and/or autonomy within Agip. These cultures interacted in complex ways, generating a wide spectrum of opinions and prescriptives. Moreover, the conflict was also influenced by political considerations and the political affiliation of individual managers.

The reorganization project was eventually approved at the end of 1977. Agip was divided into two operating companies: Agip S.p.A, which was responsible for upstream operations and supply, and Agip Petroli, which controlled refining and distribution in both the home market and abroad. Agip Petroli was in a subordinate position *vis a vis* the upstream company.

The partition of Agip was the outcome of the growing autonomy of the operating companies, coupled with a response to the need for higher degrees of accountability within Agip. The particular solution chosen reflected the ascendancy of upstream operations, both in economic and political influence.

Evolution in the 1980s

Radical transformation of the national and international markets in the aftermath of the second oil shock quickly made the new organizational structure obsolete. Falling demand and prices resulted in overcapacity and declining profits. These factors strengthened the trend toward vertical disintegration, transformed supply into a market-oriented activity, and stimulated attempts to attain higher cost efficiency. Compared to the period following the first oil shock, the crucial strategic problem was no longer the sheer availability of oil. In the 1978-81 period supply became a pivotal aspect of Italy's energy policy to the point that it required "political" management, or at least "supervision" of ENI on Agip S.p.A.[5] Efficient acquisition, utilization and particularly, distribution of oil in the marketplace became the crucial issues [6, 9].

As chief determinant and source of profits, downstream operations acquired strategic importance. Correspondingly, supply activities became more closely linked to refining and distribution. The cumulative results included: rationalization of the organizational and productive structures to check falling prices; modernization of industrial activities through the adoption of technologies capable of increasing conversion capacity and making more efficient and flexible use of the crude; and rationalization of the distribution network.

Emphasis on downstream operations made for a new change in strategy and structure of oil activities in ENI. Rationalization, efficiency and profitability gradually substituted market share as the main strategic imperative. In 1981 Agip Petroli was promoted to the position of parent company, to be placed in the position of coordinating the refining and distribution activities, as well as streamlining the downstream cycle. A special committee was appointed in ENI to coordinate upstream and downstream activities, in particular the supply and definition of transfer prices. However, the working of this committee was never fully satisfactory and the coordination of supply between the two companies remained a constant source of disputes.

A long-term efficiency and rationalization plan was immediately initiated. Refining required major restructuring as well as substantial downsizing of some plants. An additional goal was the adoption of new technologies capable of introducing greater flexibility and overall efficiency into the production process.[6] Moreover, refining had long been managed by the chemical division of ENI. Refining therefore required effective integration into, and coordination with, distribution. This task amounted to the creation and merger of productive capabilities within a structure traditionally orientated toward marketing and distribution. Difficulties were compounded by the fact that existing refining capacity had resulted in the acquisition of heterogeneous plants, technical competency and corresponding managerial strategies. Similar problems were involved in the restructuring of the distribution network, which was characterized by an excessive number of small and inefficient outlets. Rationalization, however, implied coordination with other oil companies and was hampered by legislation which essentially protected small, independent outlets.

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[5]Evidence supporting this view can be found in a number of sources both internal and external to the ENI group. See, for instance, [3, 8].

[6]In the early 1980s refineries in Agip were working on average at 60% of their primary capacity while conversion capacity was below 10%. As far as distribution is concerned, the network of gasoline stations averaged only about 400 tons per unit/per year. This was quite a record for the Italian market but was much lower than the average of most other European countries.

In 1981 AP acquired the plants of Mach, a private refining and distribution company. This acquisition was highly controversial and strongly opposed by a large faction within Agip management. Opponents considered the move economically unsound, and viewed it as a result of political pressure aimed at rescuing the politically influential Mach group.

The rationalization program achieved some notable results. As a state-owned company, Agip faced special constraints when considering layoffs and plant closings. The government expected Agip to help avoid social conflict, as well as to prevent entry into the domestic market by the Middle-East companies.[7] In 1985 a new rationalization program was launched, which emphasized technological change intended to increase conversion capacity and achieve greater profitability. The program was quite successful, although rationalization of the distribution networks proceeded much more slowly than initial projections.[8] A major result of this strategy has been the decentralization of all activities except distribution. This was accomplished through the creation of a number of subordinate companies. Moreover, increased efficiency was reached through the informatization of logistics and of the distribution network. This downstream growth revived the issue of the organizational structure of oil activities. In 1991, Agip Petroli was assigned responsibility for managing supply.

Conclusion

The study of the history of Agip suggests several avenues for future research. First, it provides a rich case study of the nature of strategic and organizational corporate change. In Agip, such changes were rather (but not always) slow and were heavily influenced by precedent and prior evolutionary developments. Change and innovation also involved deep conflict. It must be also stressed that to some extent the process of adaptation was not fully conscious. The debate that led to various reorganizations did not always concern the issues that turned out to be the most relevant. Even now it is not entirely clear whether the options chosen were the best available. In particular, economic variables did not suggest *per se* precise strategic and organizational solutions; rather, they identified only a broad set of constraints which would have allowed a broad menu of choices. Thus, the processes of decentralization and of (partial) vertical disintegration that took place in Agip resulted not only from a conscious evaluation of the potential economic and organizational advantages, but were stimulated to a large extent by the weakening of the strategic and control capability of the coordinating function

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[7]Such entry would not only have threatened Agip' s market share, but more important, it would have also added instability in the market.

[8]In 1985 two of the less productive refineries and a few deposits had been already closed and elimination of less profitable gas stations was underway.

within the holding subsidiaries. Nevertheless, the resulting solutions were used and adapted to meet the problems that were left unresolved or emerged unexpectedly.

The case of Agip also illustrates some of the problems associated with state ownership. It demonstrates that political and social constraints influence corporate strategy, structure and performance. This is often accomplished through managerial diffusion at the micro level, of "politically-oriented" rules of behavior and selection mechanisms. In particular, it illustrates the fragmentation of interests and objectives of the shareholder which had weakened the strategic capabilities of the company, as well as the ability of the holding companies to control and direct the activities of the operational branches. From this perspective, the case of Agip testifies to the difficulties involved in the development of "managerial companies" in Italy, even in the case of a state-owned company. Soon after the death of the "founder," and as the confluence of interests within the political system broke down, the company was exposed to a process of loss of control and strategic paralysis. In private Italian companies the solution to the problem of "succession" has been the persistence of "family capitalism." In the state-owned companies, succession of leadership has often been accompanied by a decline in efficiency.

The case of Agip is distinctive because an independent and professional management has expanded and adapted to change, while frequently resisting political pressure and influence. In other words, a strong managerial culture has persisted over time and has heavily contributed to the shaping and evolution of strategies and structures.

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