

David versus Goliath: Porsche and VW

Porsche was founded by Ferdinand Porsche in 1931, based in Stuttgart, Germany. Originally the firm did not make cars itself but sold consultancy to other manufacturers. This included a commission to contribute to the development of the original Volkswagen Beetle.

Porsche still sells consultancy – clients include Audi, Seat and Subaru – but the company is now best known for its sports cars, notably the Porsche 911. Employing only around 2,000 staff, turning out 100,000 cars a year, Porsche has retained most of its production in Germany, unlike many other car manufacturers who have outsourced production to low-cost countries. During the 1990s Porsche almost went bankrupt, but otherwise has been extremely profitable. Moreover, unlike other luxury carmakers such as Aston Martin, owned by Ford, and Maserati, owned by Fiat, Porsche remained independent.

So it might have continued. Except that in late 2005, Wendelin Wiedeking, then chief executive, decided that Porsche would build a stake in VW, a company 82 times bigger than itself. Porsche sold 100,000 cars a year, VW sold 6m. Over the next three years, Porsche purchased options to buy VW shares and made about as much from dealing in these financial contracts as from making cars. But that was only on paper. In 2008, moreover, it revealed that it had used a special type of option that did not have to be disclosed and that involved hedging against a rising VW share price.

VW's share price quadrupled when it was announced that Porsche had acquired a 75% stake in the company. Consequently, many hedge funds that had bet on VW's share price falling incurred heavy losses.

Porsche took two big risks. First, it borrowed around €10 billion in order to increase its stake in VW from just under 51% to 75%. Second, it relied upon the repeal of the so-called Volkswagen Law, a local law restricting individuals to 20% of the voting rights in VW, regardless of the size of their holdings, and giving the state of Lower Saxony a veto on major decisions. As the European Commission had long been opposed to this law, Porsche had good reason to believe that it would be repealed. If it were not, Porsche could not assume control of VW and its shareholding would be useless.

Both gambles failed. When the global financial crisis struck, Porsche's sales fell and the company ran short of cash to pay interest on debts. Simultaneously, the supply of credit dried up. Indeed, Porsche was allowed to roll over its existing loan only by pledging shares in VW as collateral, and promising to repay over €3m within six months. Worse still, the Volkswagen Law was not repealed. Consequently, Porsche was unable to use its 75% stake in VW to take control of VW's billions of euros, leaving Porsche perilously exposed. The result was a forced merger with VW.

Risk as choice

Above all it is important to be mindful of what risk means. Although the dictionary defines risk as "mischance", "hazard" and "possibility of bad consequences", the word actually derives from the early Italian *risicare*, meaning "to dare". This portrays risk as a choice rather than a fate. Lord Revelstoke could have reduced the risk involved in the Argentinian project by arranging underwriting. He chose not to. Porsche chose to take on a much, much bigger company and to

rely upon the government to repeal a law it had never said it would repeal. Toyota chose to ignore mounting criticism. In other words, calamity does not just strike. Firms bring it upon themselves through the choices they make.