Parmalat's Fall: Europe's Enron?

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In December 2003, Italian food and dairy giant, Parmalat, went bust. The dramatic fall of family-owned Parmalat was triggered when Bank of America claimed that a document showing 4 billion Euro in company's Cayman Islands bank account is forged. Just a couple of months ago, Parmalat's bosses had claimed a cash balance of 4.2 billion Euro but on December 19, 2003, they admitted a 4 billion Euro hole in company's finances. Given the complex way of financial wizardry employed by Parmalat's bosses coupled with off-balance sheet financial transactions (such as derivatives) and funds stashed away in offshore subsidiaries in Cayman Islands, there is no exact assessment of company's total debt. Estimates range from 8 billion Euro to 14 billion Euro as the authorities are still uncovering the true state of company's finances.

The Italian authorities have put Parmalat under "extraordinary administration" to work out whether the company could be revived again or its assets could be sold off to repay the creditors and suppliers. The authorities have arrested nine people including Parmalat's founder, Mr. Calisto Tanzi, and launched criminal investigations. Mr Tanzi has admitted siphoning off about 500 million Euro from Parmalat's owned companies to finance the company in which his daughter was director.

It needs to be emphasized that Parmalat was not an ordinary food and dairy corporation. Founded in 1961, Parmalat rose to prominence in the 1970s when the processing milk was in great demand in the absence of refrigerators. In early 1990s, Parmalat launched a massive acquisition drive to spread its businesses throughout Europe, Latin America and Africa. With sales touching 7 billion Euro in 2002, Parmalat was a giant transnational corporation with trading and manufacturing businesses in over 100 countries. The company also owned Parma AC, a popular football club, which won European Cup in 1993. Despite family-owned, Parmalat's rapid expansion was facilitated by huge borrowings from banks and financial institutions, complex international organizational structure and financial wizardry to minimize tax liability and cover losses over the years.

The collapse of Parmalat has not only shaken Italy's political establishment, investors and farmers but has also sent shock waves throughout Europe and US where investors' confidence has already been dented by several recent corporate scandals. Parmalat's collapse has been the Europe's biggest corporate scandal. The complexity of financial ac-

counting through which the company's bosses misappropriated funds sounds like Enron scandal in the US. Therefore it is also popularly referred to as "Europe's Enron." But unlike Enron, Parmalat was not running a fictitious trading business. The company was running a strong business in manufacturing and trading of food and dairy products and had a large market share in many countries.

Although the detailed investigations into the operations of Parmalat are still going on, the initial reports suggest that the collapse was triggered by murky financial dealings by its top management. The collapse was not an outcome of a typically cash-flow problem, as faced by many companies. Rather the top management deliberately used a variety of methods to misappropriate funds including use of complex financial instruments (particularly derivatives) and siphoning funds through its subsidiaries, Bonlat and Epicurum, located in Cayman Islands. The global structure of company came in handy for the top management to conceal certain losses.

It is unlikely that Parmalat's existing creditors and investors would pump in more money to revive the company. Unless the Italian government bails out the company, the prospects of closure appear imminent. The real price of Parmalat's closure would be faced by its 39,000 employees located in over 30 countries. Not only employees are on the verge of losing their jobs, their retirement savings are unlikely to be returned. Besides, livelihoods of over 5000 dairy farmers who used to supply milk and other products to company would be in jeopardy. Already Parmalat owes about 120 million Euro in unpaid bills to dairy farmers. Since several Italian banks had huge exposure to Parmalat, there is a fear of systemic banking crisis if the company is closed down.

However, the ramifications of Parmalat's collapse are not restricted to Italy alone. Big international banks and financial institutions located on both sides of Atlantic, which had blindly lend money to Parmalat, would also face music. Bank of America alone would suffer a loss of $274 million while Citigroup is expected to write off $242 million in bad loans to Parmalat (see Table 1).

The Parmalat collapse has to be seen in a larger context. Very few can deny that lax corporate regulations in Italy acted as a lubricant in the triggering of Parmalat's fall. Ever since businessman Mr. Silvio Berlusconi became the Prime Minister in 2001, corporate regulations have been further relaxed in Italy. The relaxed regulatory environment made it possible for Parmalat's bosses to mislead auditors, banks, financial institutions and rating agencies. However, this does not mean that bankers and auditors are innocent and

should go scot-free. It is shocking that company's auditor, Grant Thornton, kept on approving Parmalat's cooked accounts without asking uncomfortable questions. News reports suggest that auditors rather gave advice to top management of Parmalat on how to commit financial frauds through complex financial transactions and tax haven subsidiaries.

This episode also reveals the shoddy role of some well-known international banks such as Citigroup and UBS. The laxity of big banks and financial institutions to lend unsecured loans to Parmalat needs to be probed. While working closely with subsidiaries, investment banks overlooked the large picture. Banks and financial institutions were so busy in making money through their dealings with Parmalat without considering longer-term consequences. In the words of Luca Sala, formerly the head of Bank of America's Italian corporate finance division, "when you have a client like Parmalat, which is bringing in all that money and has industries around the world, you don't exactly ask them to show you their bank statements." In the same vein, credit ratings gave higher ratings to Parmalat without adequately examining its financial data. It seems that the lessons related to corporate governance have not been learnt from the corporate scandals, from Enron to Worldcom.

When the news of Parmalat's imminent bankruptcy spread, another European company,

Table 1: Banks' Exposure to Parmalat

Bank of America	$274 million
Citigroup	$242 million
Capitalia	614 million Euro
UBS	420 million Euro
Banca Intesa	360 million Euro
Banca Monte dei Paschi di Siena	183 million Euro
Unicredito	150 million Euro
Banca Nazionale del Lavoro	110 million Euro
Banca Popolare di Lodi	100 million Euro
Banca Popolari Unite	100 million Euro
ABN Amro	70 million Euro
Credem	50 million Euro
Banca Lombarda	35 million Euro
Banco Popolare di Verona e Novara	35 million Euro
Barclays	£45 million

Source: Reuters.

Adecco, suffered a major crisis amid rumors of accounting frauds. It remains to be seen whether Adecco turns out to be another Enron or Parmalat. There is very little doubt that the recent corporate scandals, from Enron to Worldcom to Parmalat, have severely dented the credibility of market-led capitalism. The message is loud and clear: a major corporate and financial reform agenda is the need of the hour for the endurance of present day market-led capitalism.

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