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Sava Transformation Chronicle (C)

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Abstract: This case study is part of a sequel of cases (from A to D) prepared to be used together in a course on Strategic Management (more in particular on topics related to Mergers and Acquisitions, Business Portfolio Management and Corporate Transformation). Due to the article length restrictions, parts B – D, as well as the case Teaching Note, will be published in a separate article. Please refer to the Teaching Note for more precise suggestions related to classroom use.

Kronika preobrazbe Save (C)

Povzetek: Ta študija primera je del primerov od A do D, ki so pripravljeni za uporabo pri predmetu o strateškem managementu. Natančneje o temah, povezanih z združitvami in prevzemi, upravljanjem poslovnih portfeljev ter korporativno preobrazbo. Zaradi omejitev dolžine članka bodo deli B - D skupaj z navodili za poučevanje objavljeni v ločenih člankih. Za natančnejše predloge glede uporabe v učilnici, se prosim sklicujte na navodila za poučevanje, ki so na koncu prispevka.

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Successful closure of the JV contract between Sava and Goodyear in 1997 brought new challenges to both companies. Two new business entities in joined ownership were formed, Sava Tires and Goodyear Engineered Products Europe, both located in Kranj on the same site with the remaining part of Sava. The contract spelled out detailed agreement on how to share the common infrastructure. It also included a put and call option, allowing Sava to sell the remaining shares in these two entities at predetermined conditions within four years. Both companies had scheduled to start their operations in 1998, although the actual production of tires and engineered products stopped only during production facilities refit.

Sava Tires

The tire production was the part of Sava, which Goodyear had valued significantly higher within the deal than the engineered products production. The valuation was based on the net present value of forecasted free cash flows, which, in turn, was the result of the estimate of favorable cost position of the tire production operations in Kranj, as well as the solid market presence and potential of Sava brand in Europe and in particular in the markets of former Yugoslavia. While Goodyear had to switch the whole production technology from the one based on Continental licenses and know-how to its own, it could count on excellent technical competence of the production employees, including the technology and production related services, which it took over through the JV.

Goodyear had over years developed significant amount of M&A related experience. Therefore, it had based its preparation for actual take-over on the insights from thorough due diligence process, which had lasted for more than 18 months. One of the early decisions was that ex-pat management team sent to Slovenia should be small, consisting only of two experienced executives. The Financial Director had to cover both JV's with the main task of bringing the accounting, treasury, I/T and management reporting in line with all other Goodyear companies. The Managing Director of Sava Tires had to bring all the functions, including marketing, sales, finance, production, logistics, HR, purchasing, and corporate governance in line with Goodyear standards and values. In keeping with Goodyear philosophy, the managing director for EPE and most other key management were transferred from Sava. The only other Goodyear employees sent to Slovenia in the next few years were several technical and engineering experts on temporary basis, to assist with technology transfer.

The Goodyear selection for managing director was a career Goodyear employee with many years of living outside the US and a career thus far in finance. Richard Johnson was well known and trusted by senior management and most recently had been the CFO of Europe and part of the due diligence team from the beginning. Richard knew the region, believed he understood the sensitivities of Sava people and internal culture and was looking forward to move to a managing director position. After extensive discussions with regional and corporate management, Richard set the following as his priorities as he arrived for the transition:

1. Management reporting and profitability analysis
2. Building trust within the new company (Sava Tires)
3. Evaluating people and getting the right people in each position
4. Separating from Sava internally (employees) and externally (customers and public). This may seem odd as first but given the possible future direction of Sava, Goodyear

and Sava Tires wanted to make sure their corporate identities were distinct and separate.

Richard saw the sales and marketing moving smoothly and picking up the additional brands of Goodyear and Fulda to their channel strategies in the home markets of Slovenia and former Yugoslavia. In the export markets, Goodyear country managers would likewise over time pick-up the Sava brand in their country portfolio of brands. This would allow optimum control of brand pricing and channels by the country or regional management, and would assure the best sell out price positioning. Similarly, manufacturing would simplify and focus the production ticket while adding brands of the same type and size tire already in the production ticket. New equipment and product specifications would be added to match other manufacturing locations. Both the sales and marketing and manufacturing transitions would take time but had a clear direction.

Building trust however required keeping the positives of the Sava culture such as the long tradition of service recognition celebrations, Christmas parties, bonus pay, etc. so that employees felt they had not lost anything. At the same time changing organizational structure and evaluating people would have to be done quickly for each key position. Head count would have to be reduced as productivity improved in every area.

To reduce the anxiety of the change, Richard met in small groups (10 to 40 employees) face-to-face with as many of the 1,500 employees as possible. Sometimes these meeting were in conference rooms and sometimes in the factory or warehouse, wherever people could be easily brought together and made to feel comfortable. The Goodyear philosophy was simple as he would explain (and as borrowed from Stan Gault): “Customers, employees, shareholders like a three legged stool. Each had to be taken care of in order for the stool to bare weight. We will be fewer over time, but better paid if we are successful. We will be successful if we have high quality and improving productivity in all that we do.” He only spoke about 5 minutes with the help of the manager of public relations and internal communications. And then he asked for questions.

At first there were little or no questions, but later as word got out there were many very good questions. Many changes in governance came from these sessions such as flexible work hours; communications internally and externally, job posting, performance management, and much more. But most importantly, anxiety was released and the big American company was started not to be seen as a two headed monster but as balanced corporation building for long term success on the traditions of Sava. Later, as part of the organizational changes the office was cleared of old wood paneling and replaced by modern furniture and glass partitions, conference rooms, free coffee and tea, proper smoking areas, and air conditioning. These were symbolic and simple things, which demonstrated care and trust. They also aligned better with workflow and organization structure. The message: provide employees the tools and atmosphere to perform well, and treat them with respect and trust until you have a good reason not to.

The Sava people responded well. Sava Tires made money from the first month and continued to make money thereafter as it grew each year. Within the first few years, productivity in every area reached levels to match the best Goodyear companies anywhere. Sava Tires became source of the highest quality manufacturing and distribution services. Goodyear continued to invest heavily in new technology and plant and equipment, and Slovenia managers and executives work all over the European and Middle East region. Some have left Goodyear to take executive positions in other Slovenian companies further attesting to the quality of people and the experience at Sava Tires.

Public acknowledgment that Sava Tires was a different company from Sava, with a different business strategy, and different governance was a public relations (internal and external) challenge. Within a year or so, Sava Tires people were proud to be part of Goodyear. People in Sava Tires were more trusted, encouraged to disagree based upon facts and data, and encouraged to take initiative even if they sometime made a mistake. “Learning comes from making mistakes” Richard would say, “Just try hard not to repeat it.” This culture multiplied by managers emulating good managers allowing the organization to mature and be more productive.

The aftermath

The transformational change of organizational culture happened hand-in-hand with the consistent improvement in business performance. Over years the productivity of Sava Tires employees doubled, the revenues more than tripled in the period from 1998 to 2019 and the company remained consistently profitable. Given the intense technology changes in the industry, Goodyear kept investing into manufacturing technology and processes, the overall investments reaching more than 200 million US$ in the same period. From the marketing perspective, Sava Tires effectively followed multi-brand strategy, while in production it gradually focused on the high-end products.

Goodyear Engineered Products Europe, after initial successful development, had more volatile history. Local management and technical team proved to be highly competent, and the company kept two core product groups (V-belts and air springs), adding rubber hoses for car air-conditioning. Following the changes in corporate philosophy it changed the ownership three times, somewhat shrinking its size in the process. As result of global takeover of company’s that time owner, Veyance Technologies, in 2015 it became part of ContiTech, the engineered products division of Continental, which in the meantime became target of the hostile takeover by Schaeffler AG. As mature as it was, the industry in many ways kept re-inventing itself.

Sava Transformation Chronicle

Teaching Note

Sava Chronicle sequel of cases (A to D) describes the challenges and outcomes related to the process of strategic transformation of Sava, a rubber products manufacturing company from Slovenia, in the period from 1995 to 2016. The cases deal with the following main situations:

- Case A: Briefly recounts the history of Sava and presents the external setting in 1995, as well as the challenge of the expiry of JV contract between Sava and Continental, which puts in jeopardy Sava’s ability to stay a viable player in car tire and engineered rubber products market;
- Case B: Summarizes the thinking behind the selection of strategy responding to the challenge presented in Case A, leading to negotiations between Sava and Goodyear, successful closure of new JV contract and resulting challenge of transforming both the JV part and the remaining part of Sava;
- Case C: Presents the challenge of transforming Sava Tires, the newly formed JV between Goodyear and Sava, from the point of view of Richard Johnson, newly appointed Managing Director, as well as actions taken to (successfully) resolve these challenges;
- Case D: Presents the challenge of selecting the right strategy for Sava of using the proceeds from sales to Goodyear to achieve sustainable, profitable growth; details the three

phases of transformation: initial hesitation, unrelated diversification and final crisis, allowing for discussion about reasoning behind individual choices taken and causes of ultimate transformation failure.

The sequel can be used in a number of courses, typically on the MBA level or within executive education programs. Some examples of the usage include:

- Strategy course, focusing on the topic of sources of sustainable growth;
- Strategy course, focusing on the topic of diversification challenges;
- Strategy or change management course, focusing on the topic of transformation priorities;
- Leadership course, focusing on the role of charismatic leader in corporate transformation and the tendency of charismatic leaders to derail due to hubris induced by prior successes;
- Corporate governance / Business ethics, focusing on ethical challenges related to large-scale transformation and critical role of corporate governance in managing them.

The use of various conceptual frameworks, such as SWOT, five forces analysis, portfolio management, diversification typologies, risk management matrix, or transformation management can be illustrated through the case analysis and discussion process .

The sequel allows for ample discussion on core issues related to and illustrated in individual cases. Using role play is possible for every case (for example - but not limited to - Sava vs. Continental in Case A, Sava vs. Goodyear in Case B, management vs. employees in Case C, Management Board vs. Supervisory Board vs. management of subsidiaries in Case D). While some understanding of the setting (manufacturing industry, Central Europe in the period from 1995 to 2015) is beneficial, it is not mandatory, since core issues are universal. If the whole sequel is used, two 90-minute blocks might be appropriate for class discussion, not including the preparation time.

Stanko Cvenkel, Richard Johnson and Slavko Koren contributed the material for this case written by Professor Nenad Filipović solely as a basis for class discussion. The case is not intended to illustrate either the effective or ineffective handling of a business situation. Some information may have been disguised to protect confidentiality.

The preparation may be structured around the following questions:

Case A:

1. What options are available for Sava management in response to the challenge of expiring JV contract with Continental?

2. Should Sava management try to narrow down these options to as few as possible as early as possible, or try to keep them open as long as possible? Why?

3. How should the industry dynamics and market trends influence the management's thinking about the options?

4. How should the Sava competences (or lack of them) influence the management's thinking about the options?

Case B:

1. Did the Sava management handle the negotiation process appropriately? Would it be beneficial for the parties to do anything else in the preparation for the deal closure?

2. What should Goodyear see as the priorities immediately after the contract came into force?

3. What should Sava see as the priorities immediately after the contract came into force?

Case C:

1. What do you see as rationale behind Johnson's initial priorities? Would you modify the list? If yes, how? If not, why not?

2. What were the principle strengths of the change process, leading to positive outcome?

3. Does the choice to have a production unit in a small EU member country appear as sustainable over long run? What might be the pros and cons of moving it to a low labour cost or a large local market country?

Case D:

1. How do you see the arguments in favour of the growth strategy chosen by Sava management? Against it?

2. Was the final failure primarily the result of unexpected turmoil in financial markets due to 2008 global financial crisis, or you see other factors being more important? If latter, which factor were decisive?