Sava Transformation Chronicle (A)

Dark clouds were gathering above Labore, the industrial suburb of the small industrial city of Kranj, the location of the headquarters of Sava. The celebration of the 75th company anniversary was supposed to be a happy occasion, marking proud history of technological development and business success. Sava was among few successful tire and engineered rubber products in Central and Eastern Europe, commanding approximately 2% of European market share and enjoying the fruits of 25 years of close cooperation with Semperit (Austrian rubber and tire manufacturer, taken over by Continental from Germany in 1985), one of the industry giants. It recently had become an excellent transformation showcase, following the political and economic changes reflecting Slovenia's quest for independence. The appointment of Janez Bohorič as the new CEO, to take over the company in January 1996, was symbolically bringing together tradition and new managerial spirit. But the upcoming expiry of the JV contract with Semperit/Continental opened many demanding questions and threatened to spoil the festivities.

The first 75 years

Four Slovenian entrepreneurs had founded a rubber company in Kranj in 1920, seeing opportunity in the growing market for various rubber products in the aftermath of World War I. The first products were simple, such as erasers and rubber heels for the shoes. In 1931, the initial owners had decided to sell the factory to Austrian company Semperit, which extended the product portfolio, among others with the bicycle tires. Just before the start of the World War II in Slovenia, German company Continental took over the company and started the production of diagonal car tires in Kranj.

Slovenia, as part of Yugoslavia, came out of the World War II as a country under the dominance of the communist ideology. All the industrial companies were nationalized and the Continental plant in Kranj was renamed into Sava (the name of the largest river in South East Europe, flowing near the company). In the first period, the company depended on its own technological development, which restricted the product portfolio and focused the company primarily to serving the local market. Despite severe constraints of the Yugoslav economic system trying to find middle ground between communist planned economy and fully free markets but never being effective, the industrial tradition combined with solid technical education gave Sava some space for development. With further loosening of the ideological straitjacket (partially driven by influence from Austria and Germany, with whom Slovenia had strong economic ties), Sava looked for an opportunity to get access to the most advanced rubber technology as well as to the western markets. As a result, Semperit had entered the company in 1971 as a Joint Venture partner and holder of 28% of equity (under complex legal system in former Yugoslavia, Semperit was not allowed to freely dispose with this equity and all the rights it received were

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the ones explicitly stipulated in the JV contract), transferring the radial tire technology and opening its distribution channels to Sava products. Further growth ensued, with the brand Sava strengthening its position in local markets and JV products being exported elsewhere. The takeover of Semperit by Continental had no direct impact on the joint venture contract, signed for the period of 25 years.

Slovenia gained its independence in 1991, at the very beginning of the violent break-up of former Yugoslavia. Sava immediately faced a number of challenges, such as loss of the market in other parts of former Yugoslavia, which had to be substituted almost overnight with exports. The local business environment proved not to be supportive, with complex legislation, weak financial markets, improvable labor efficiencies and underdeveloped managerial competences. The privatization process, which was started in 1992, followed the voucher privatization approach. All Slovenian citizens received a certain amount of vouchers. The scheme gave the employees and retirees of a company priority rights in using their vouchers to buy the company stock. If any stock would be left, it would be open to sales to other voucher holders. That led to rise of employee ownership, but later, once employees started selling the stock, to non-transparent second round of privatization through voucher management funds. At the same time, traditionally strong entrepreneurial spirit in Slovenia led to many start-ups and new business initiatives, often finding inspiration in examples from Western Europe.

Despite all of these challenges, Slovenian business community saw Sava as a success story for the first period of its restructuring. By 1995 its revenues grew to more than 220 million US$, 86% of which was sold in export markets, which was taken as the key evidence of company’s strong performance. At the same time, productivity benchmarking was not so flattering (see Exhibit 3). With close to 4 thousand employees, many in sizeable overhead functions, Sava’s sales per employee was comparable to its East European competitors, but lagging almost threefold behind the global best, Japanese giant Bridgestone. Productivity and cost efficiency at standard quality levels being among key drivers of success in tire industry, that benchmark alone meant Sava had a long way to go to become truly competitive in global markets. Otherwise, the only advantage it could manage against major competitors would be low labor cost, which was already at that time not seen as a sustainable proposal in Slovenia.

Some observers questioned its decision to diversify its product portfolio to as much as 18 different product groups. For a rubber product company of medium size it was difficult to keep all of them competitive, as well as to develop effective distribution channels for products varying from adhesives to rubber rolls for print industry, rubber profiles for doors and windows, artificial leather or tires for many different applications. Car and truck tires made close to 70% of all sales. See Exhibits 4 through 6 for the information on the product portfolio in 1995.

Independent industry analysts in late 1995 mentioned quite a few strengths of Sava:
- Strong export orientation (86%)
- Technological know-how and business experience in the area of car and truck tires, obtained through JV cooperation with Semperit / Continental
- Niche brand position of Sava tires in Europe, with up to 2% market share
- Leading Sava tires brand position in the regional markets of South-East Europe
- Own sales network in Slovenia and other countries of former Yugoslavia, as well as Check Republic, Germany, Hungary, Italy, Poland and Slovakia
- Solid product quality, comparable to competition
- ISO 9001 covering 80% of processes
- Favorable production location position

- Fairly high share of employees with university education, high loyalty of key employees
- Relatively solid financial strength of the company.

At the same time, the company was burdened with numerous weaknesses:

- Large number of product groups with questionable competitiveness and loss-making history (see Exhibit 6)
- High (fixed) costs per product making majority of product groups costly in comparison with competition
- Inefficient customer service
- Partial and largely ineffective marketing and sales planning process, not well supported with data (some jokingly said it followed "management by hope" principle)
- Limited market research activities and intelligence, not allowing for valuable insights about potential high growth market opportunities and leading to fairly poor quality of long term business / market development, distribution channel development or price positioning discussions
- Managerial decisions related to complex issues of growth and company strategy were too often based on power relations and personal influence, rather than data analytics or research
- Unclear value proposition in a number of product-market segments
- Cost based pricing and fairly rigid accounting system, not in line with industry best practices regarding pricing and profitability analysis, as well as business case analysis

With existing JV contract nearing its end, Sava leadership decided to perform a systematic review of the company and weigh its options for future development. Understanding where the industry was heading became critical element of that exercise.

Global rubber industry in 1995

Global industry of rubber products had all the characteristics of a highly mature industry, in particular slow growth (around 2%) except in few niches, few technological innovations, sophisticated manufacturing processes, proliferation of many sizes and types of product to meet OEM demands, and the dominance of a few large global players with the scale to meet the global demands. Manufacturing costs were heavily influenced by production ticket rationalizations among a portfolio of factories, which thus enabled longer more efficient production runs and less changes to equipment and processing. Although the industry was very capital intense, it was also sensitive to labor and energy costs. This is why major players by 1995 already started relocating parts of their production (in particular more price sensitive product segments or brands) to low-cost countries. However, largest part of global production was still located in Europe, and European players were net exporters.

Constant investments, partly due to increasing environmental regulation pressures, as well as the increasing number of acquisitions as part of industry concentration left the large players exposed to financial risks. Debt to equity ratio of 4:1 was quite common in the industry, which was generally plagued with low profitability. Therefore, intense cost containment projects became part of daily routine and further fueled M&A activities. Global players could exploit many beneficial effects of acquisitions, including market penetration and distribution network strengthening, better portfolio and risk management, lower R&D, technology and marketing costs per unit, as well as better purchasing conditions.

Since some of the features of the two most important segments of rubber industry, tires and engineered rubber products, were complementary, global players tended to be present in both, using the available synergies.

Tire industry represented 56% of global output of rubber products measured by volume (in tons), but only 50% measured by value. Average profitability was below 5%, with some of the best players reaching 8%. The volumes were clearly driven by the trends in car industry, which was in mid-'90s in developed countries fairly stagnant. Strong competition led to closure of a number of factories which could not improve their cost base, leading to overall reduction of workforce.

Standard view of the tire market divided it into the OEM market (tires mounted on the new cars) and the replacement market. OEM market was extremely competitive, with technical characteristics, price and geo-political criteria dominating. It required greater R&D costs to meet new sizes and types of tires for new and every changing vehicles and performance characteristics. Manufacturers had to bet that the greater margins in the replacement market would compensate the low margins in the OEM market. Replacement market required significantly higher marketing costs and sales effort, but allowed for higher prices and required excellence in distribution channels, technical support and service. Quality and distribution costs still mattered greatly. The size of OEM market in Europe towards the end of '90s was estimated at around 100 million units, with the size of replacement market at around 125 million units. The dynamics of customer behavior change was expected to increase, as indicated in Exhibit 7. Environmentally friendly storage and reuse of winter tires, reprocessing of old tires for energy consumption (since they are mostly oil), and the retreading of truck tires, were all becoming a global issue.

With annual sales of around 1 billion tires, the excess production capacity was estimated at around 70 million units. Six largest players had almost 80% of global production capacity (see Exhibit 8).

Engineered rubber products was much more fragmented industry, both in terms of product markets (see Exhibit 4 as an illustration of product group diversity) and competition (majority of the manufacturers were companies with less than 200 employees, only a number of large units, employing more than 500 employees each, were part of multinational groups). Different market segments had different growth potential, ranging from a few percent (e.g. for most of the vehicle components) to double digit (e.g. for medical products). Despite of maturity of basic technology of rubber production, there was enough space for innovative niche products. While many of the products were sold in local markets only, market globalization was already present in large product groups such as car V-belts, industry conveyer belts, air springs or pressed rubber products for vehicle industry. A survey among industry executives indicated environmental issues, price competitiveness and product innovation as their main concerns.

Engineered rubber product pricing was strongly dependent on the product group, ranging from 3 to 30 US$ per kg. Prices per kg of engineered rubber products were, on average, up to 25% higher than prices of tires, which allowed this industrial sector to achieve higher profitability than tire sector. Due to production technology, however, productivity in tire sector was much higher than the one in engineered rubber, on average 105 thousand US$ per employee in comparison with 85 thousand US$

Trends in South-East European tire markets

The market potential for passenger car tires in the region of former Yugoslavia in 1995 was estimated at around 2.9 million pieces. Around 77% of the market belonged to the two price driven market segments (price and commodity, see Exhibit 9). While the buyers in the commodity segment were purely driven by the opportunity to buy conveniently at the best price, the buyers in the price segment, although having the price of the tires as the most important selection criterion, were still considering the brand they were buying. There was some overlap between this segment and value segment (both covering the “value for money” buyers), the latter being primarily driven by the brand and the price having secondary influence. At the top of the pyramid were price insensitive buyers in the premium segment, driven primarily by the brand and performance considerations. Safety, in particular handling characteristics such as braking and cornering and wet and snow traction, was the main performance criterion.

Market research indicated that in the period from 1995 to 2005 the premium and high performance segment was likely to double. Opposite to European trends, value segment was expected to grow from 14% to 18% market share in the same period. The growth of these two segments would come at the expense of price and commodity segments, which were expected to fall from 77% to 64% of the market share.

In terms of overall volume, the market was expected to grow above the global market growth rates, following faster growth of GDP and personal income. This would create the readiness of the buyers not only to replace the tire set more frequently, but also to change the vehicle every four to five years, or buy the second one (average driver covered 15 thousand kilometers per year). Since the buyers were on average quite knowledgeable of tire brands and their relative performance, it was expected that global brands would gain higher market share in that period. Distribution network in the region was mostly built around specialized dealers and tire service shops. Up to 70% of the customers were likely to follow the recommendation of the service shop personnel when choosing new tires. Sava had traditionally held very strong position with them, with 33% of overall market share in the regional passenger car tire market.

Where applied, custom duties on tire imports presented a major factor in final market price, distorting global price competitiveness patterns. There were no custom duties for Slovenian products. While it was not clear how fast would individual countries of the region drop customs barriers for tire imports from outside of the region, changes were likely to follow increase of political stability in the region and its gradual improvement of economic ties with EU.

Strategic options considered in 1995

At the time when Sava and Semperit (later acquired by Continental) had negotiated the 25-year Joint Venture contract, Semperit clearly had the upper hand. The investment of around 12 million US$ gave them 28% ownership share in Sava, along with disproportionally large influence on daily management of the company, since all of the important issues had to be approved with consensus at the joint Business Board.

On the other hand side, Sava was entitled to full technological support related to the production of car tires, as well as sales of 20% to 50% of the production to the JV partner. Sava had access for its own branded products to the partner’s distribution network, but also had to observe significant restrictions in developing own network in some territories (like Austria, Germany or Switzerland).

In the beginning of 1995 Sava had started intense negotiations with Continental as the most logical partner for the new JV, given that it was already familiar with the people and manufacturing capability of Sava. The aim was not to prolong the JV contract under initial conditions, but to use the fact of Sava's successful development for obtaining better conditions. That in particular meant further technological upgrade, production extension, extension of JV contract into the area of engineered products, as well as strengthening of Sava brand and distribution network in the European markets.

Continental did not react favorably to this initiative. A major factor in its position towards JV extension was certainly the fact that in 1993 Continental had acquired Czech tire manufacturer Barum, and started using it as a low cost manufacturing location. The following was the summary of Continental's proposal to Sava:

- Continental shall reach 51% of the ownership share of stay at the existing one, but additional equity cannot be higher than 15 million US$
- Independent marketing and sales of products under Sava brand is not allowed in the countries where Continental has its own distribution network
- Continental takes over full control over the company operations
- Sava products will be bought by Continental in case they have cost advantage over Barum
- All overhead functions (such as R&D and marketing) will be integrated into the headquarters functions, Sava will remain a low-cost production facility
- Continental has no interest in Sava's engineered products, since is estimated them not to be cost competitive
- Unless Sava management accepts the above conditions, Continental will use the option to terminate the JV contract in 1996.

Clearly, Sava management saw such conditions as unacceptable, but was not sure how much space for negotiations existed in reality. It was quite probable that Continental would improve its offer in case of another company appearing as a credible alternative for Sava. Therefore, Sava management decided to pause the negotiations with Continental and explore both the option of staying independent, as well as one of finding another partner. In doing that it turned for support to the International Finance Corporation (IFC, sister organization of the World Bank and part of World Bank Group) and engaged other international consultants. With his experience from negotiating major international deals and his personal commitment to Sava project, Mr. John Clarke from IFC soon became member of the core team crucial for preparing the company strategic response to the situation at hand.

Even the fairly basic analysis showed that the option of remaining independent would be quite challenging. On the one hand side, players of Sava's size had problems in keeping the needed level of investment into the development of production technology, new products and brand support. On the other hand side, staying in commodity segment was likely not to be easy for Sava, since it was based on high volumes and low production costs, both difficult to sustain.

On the positive side, Sava had some very promising product categories among its engineered products, result of its own knowhow. At the same time, some of the product segments were utterly uncompetitive and would have to be abandoned, but high growth in remaining segment would have to be attained in order for significant employments cuts not to become necessary.

While Sava did not have strong financial backing of the global equity markets, in 1995 it had low level of debt and Slovenian growing banking system would likely be eager to engage in financing further company development. Needless to say, excellent political connections of the new CEO would serve well in such circumstances.

With limited number of large players in rubber industry and taking into account cultural distance and geo-political interests, it was not very difficult for Sava management to identify two potential partners who reacted favorably when approached discretely to check possible interest. They had very different profiles.

The first potential partner was Vredestein Banden B.V. from the Netherlands (now Apollo Vredestein). Although of a similar size as Sava, it would provide for complementarity and help Sava solve some of the challenges, which it faced as an independent company. Vredestein's management and main shareholders responded positively, but Sava management, after studying the offer carefully, decided to postpone the decision until it clarifies the prospects of cooperation with Goodyear.

Goodyear, based in Akron, Ohio, was one of the largest rubber and tire companies in the world. It had around 60 thousand employees (i.e. 15 times more than Sava) and around 24 billion US$ sales, having production units in 48 locations in 22 different countries. Goodyear was the second largest tire manufacturer in Europe, where it also had one of its two global innovation centers.

Sava approached Goodyear as early as of March 1995. It soon became obvious that, although interest for cooperation existed in principle, given partner's size and meticulous approach to M&As, including thorough due diligence process, it would take more than a year to come to any form of initial agreement. That would put pressure on Sava, since it would have to survive the period immediately after the termination of JV contract without having the alternative secured and with possible negative effects on tire sales in 1996.

While it was not clear how would Goodyear set the valuation of Sava in case of acquisition, as well as whether it would also acquire some or, less likely, all of the engineered products activities, the fit of the strategic position of the two companies in the tire segment was clear in several areas:

- Sava had high quality production of speed rated car tires, while Goodyear lacked capacities for that product category
- Sava had dominant market position in the markets of former Yugoslavia, where Goodyear was hardly present, thus representing growth in new markets for Goodyear
- Sava brand was well received in West European commodity segment, where Goodyear did not have sufficient coverage
- Goodyear had excellent global distribution network, while Sava did not manage to develop its distribution network in Western Europe and missed market opportunities there
- Goodyear had extremely strong product development capabilities and manufacturing scale among multiple factories in the European region in all tire ranges, while Sava's mix of profitable products was under threat of obsolescence
- Goodyear had strong marketing orientation and excellent brand position in premium segment, where Sava was weak and did not have adequate offering for the regional markets.

Goodyear showed initial interest in some of the engineered product groups within Sava portfolio, but the discussion in that area was likely to be even more demanding given the broadness of Sava portfolio and likely gap in interests.

By early 1996 it was clear to Mr. Bohorič and his team that all scenarios should for the time being remain opened, but most effort should be put in the discussions with Goodyear. They were confident that progress could be made, although the detailed negotiation platform was still not formed and had to be adjusted to the progress of talks with Goodyear.

Ready for the challenge

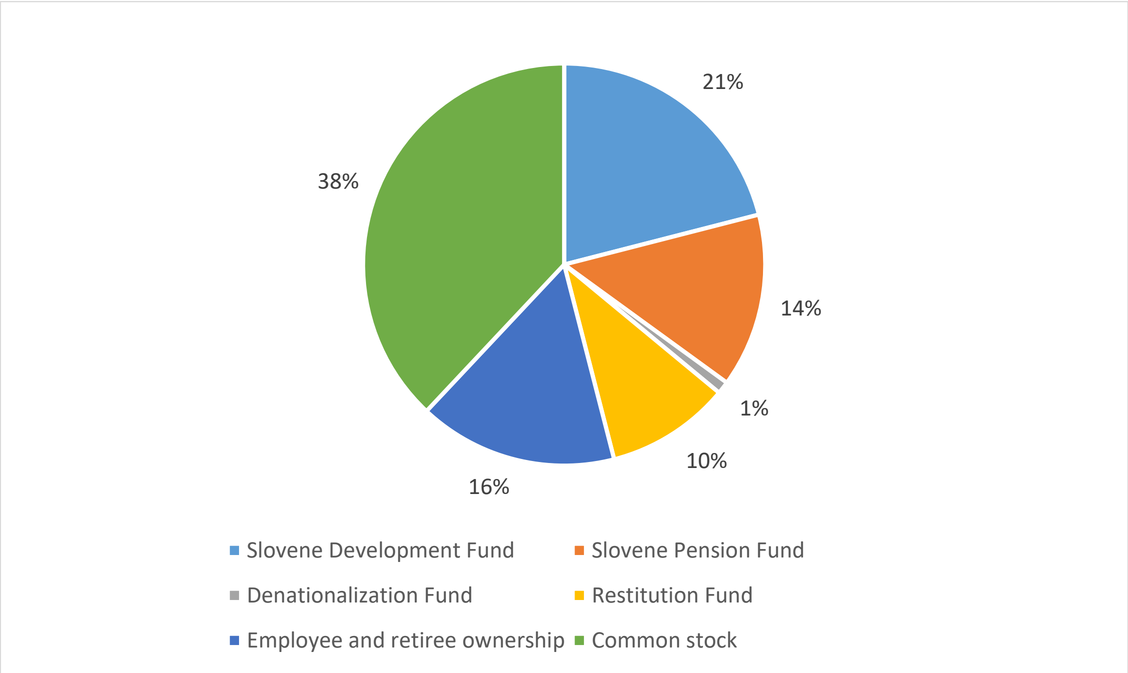
The incoming CEO, Mr. Bohorič, was not only a seasoned businessman, but he also enjoyed the benefits of a successful career in politics. After joining Sava as a young chemical engineer and leading the business development of its artificial leather unit, at the age of 36 he became the General Manager of the whole company, one of the youngest in such a position in Slovenia. Six years later he decided to step out of Sava and join Slovenian Government, where in the period from 1984 to 1990 he had served as the Vice-President in charge of economic affairs. Being part of a more liberal political faction at that time, he soon got positive media coverage and became one of the opinion makers in Slovenian society. Media often quoted his opinion on the critical issues related to economic transformation of the country.

With former communist party losing its dominance in Slovenia in the first multiparty elections in 1990, Mr. Bohorič returned to Sava to lead its marketing activities. He kept high media profile, which was further enhanced by his numerous philanthropic activities, such as starting the Lions Club in Slovenia, as well as the fact that, opposed to many of his colleagues, he took no personal benefit from the first wave of privatization in early '90s. He was seen as part of the "leftist establishment", but was not related to numerous scandals, which seemed to be inevitable during the transition from post-socialist to West-European style capitalist society. While some of his colleagues from the Managers' Association of Slovenia were not attracted to his personal style, said to reflect his huge ambition and large ego, they were ready to admit his managerial performance was outstanding.

Used to exercising the power of his position in order to make tough decisions and implement them with little consideration for opposing voices, Mr. Bohorič seemed not to be impressed by the challenge he would be facing as the new CEO of Sava. He and his core team started methodically examining the available options and getting ready to select the one they would see as the best for the company. While partnership with Goodyear seemed promising, experience with Continental told them that dealing with huge multinational companies was not easy and making a wrong move could prove to be fatal for the future of the company.

Exhibit 1

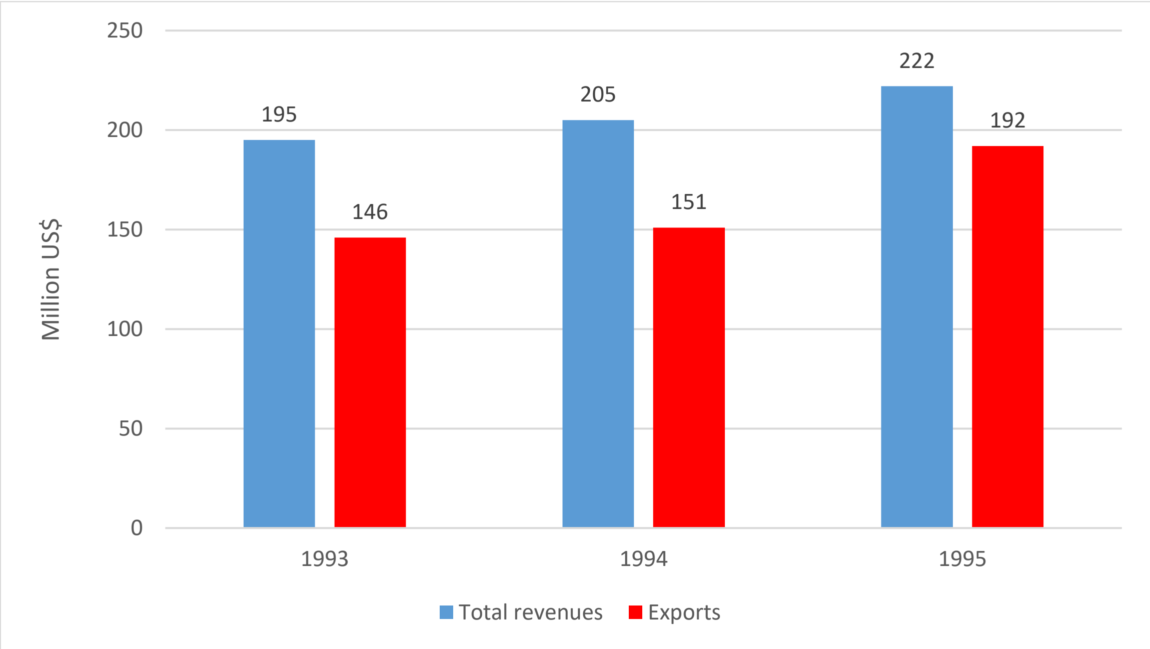
Sava ownership structure in 1995



Source: Case writers' data

Exhibit 2

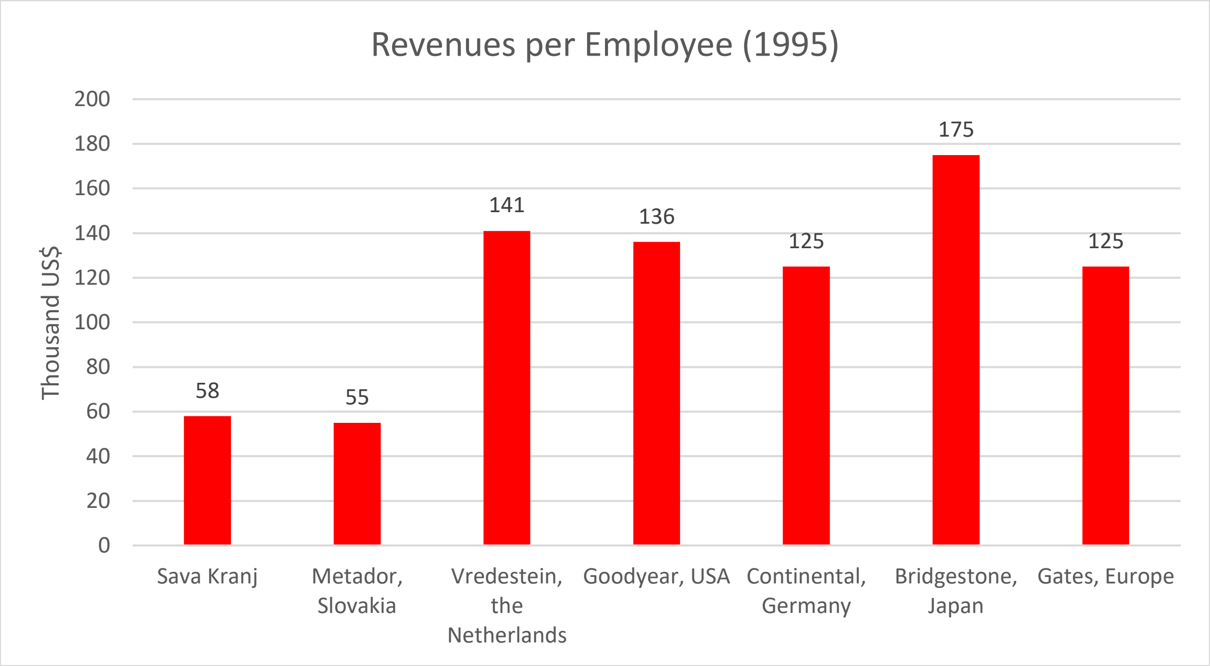
Sava Revenues



Source: Case writers' data

Exhibit 3

Productivity benchmarking of selected tire manufacturers



Source: Case writers' data

Exhibit 4

Sava sales programs / product segments in 1995

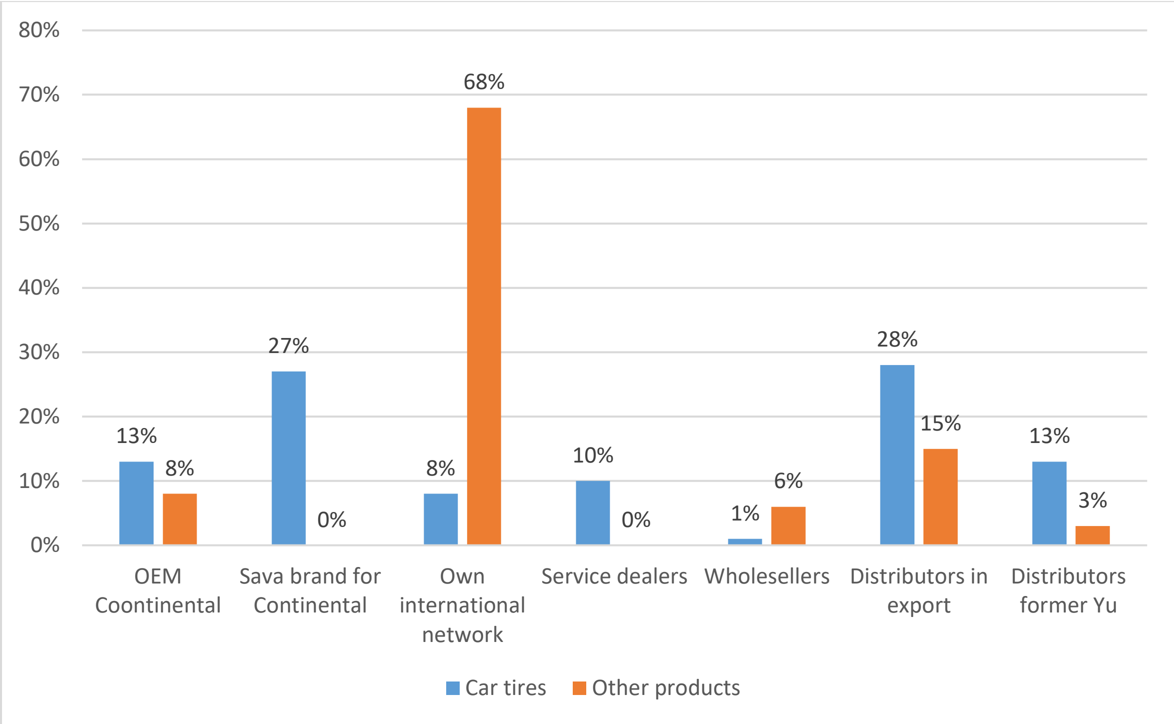
Sales program	Product-market segment	Sales (in million US$)
Car tires	Personal vehicles	93.3
	Heavy trucks	41.1
	Pick-ups and light trucks	21.2
Bike tires	Bicycles, mopeds, scooters, motorbikes	16.1
Vist artificial leather	Car industry, shoe industry, furniture industry, fashion industry	13.7
Conveyer belts	Construction industry, mining, cement industry, agriculture, food industry	9.1
V-belts	Car industry, agriculture mechanization, home appliances	7.2
Rubber profiles	Window and door industry	5.7
Roll covers	Paper industry, printing	3.4
Eco interventions	Utilities, ambulance vehicles, ecology	3.1
Air springs	Trucks	2.5
Adhesives and chemical products	Shoe industry, retail	1.7
Surface protection	Various industrial applications	1.5
Sava Print	Printing	1.2
Pressed rubber products	Car industry, agriculture mechanization, construction industry, retail	0.8
Rubber hoses	Industrial applications, home appliances, retail	0.7

Sales program	Product-market segment	Sales (in million US$)
Sava Medical	Healthcare, pharmaceutical industry	0.4
Construmat	Bridge construction	0.3
Rubber plates	Various industrial applications, retail	0.3
Rubber wheels	Forklift industry	0.2

Source: Case writers' data

Exhibit 5

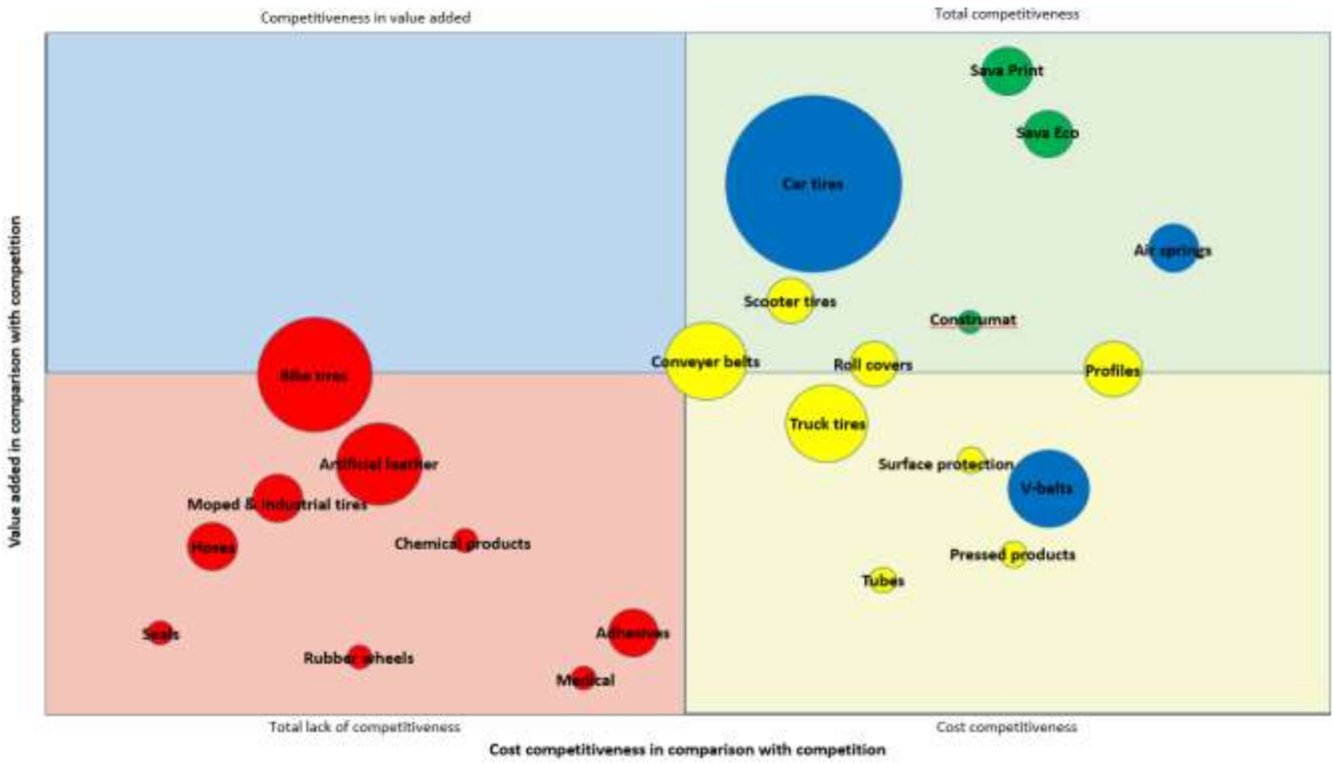
Sava sales structure by channels in 1995



Source: Case writers' data

Exhibit 6

Competitiveness of Sava sales programs in 1995

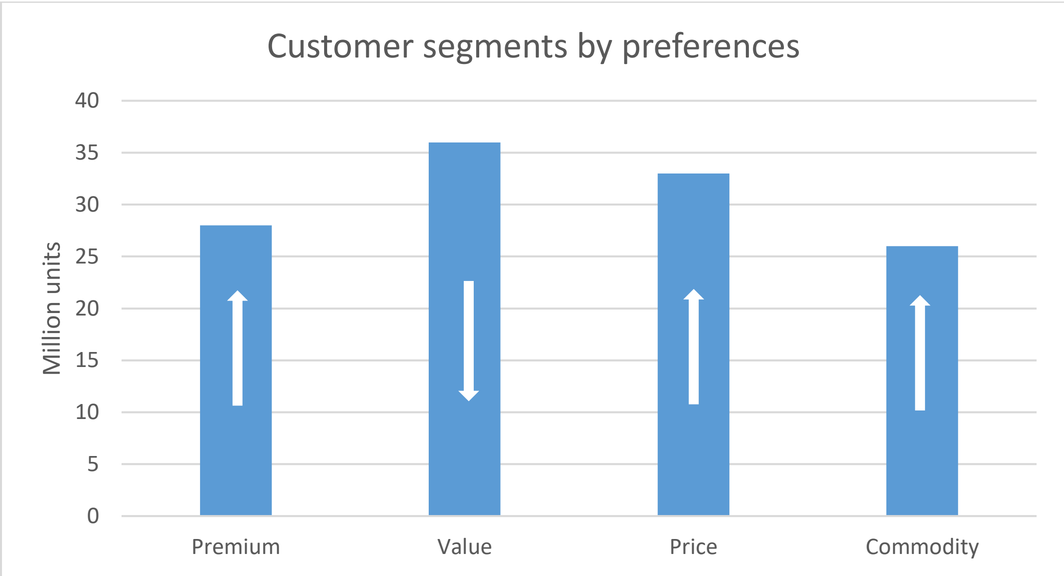


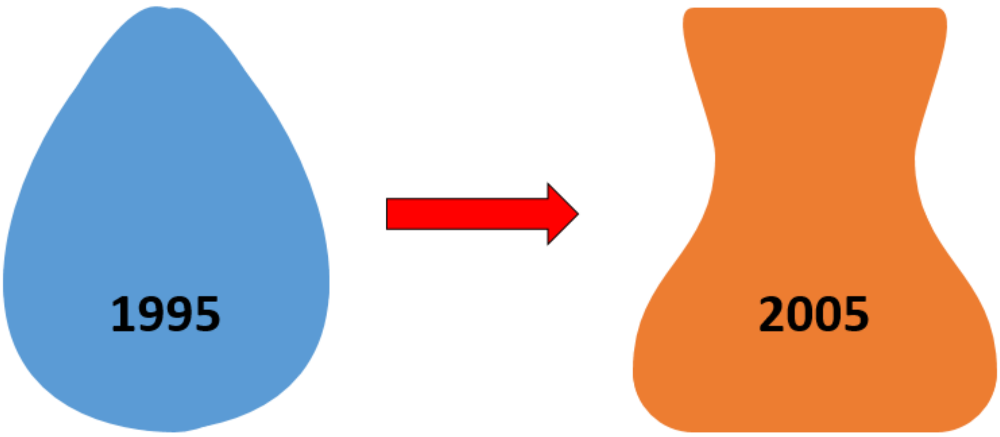
- **Segments to terminate**
- **Segments to keep**
- **Segments of interest for strategic partner**
- **Segments with highest development potential**

Source: Case writers' data

Exhibit 7

Tire replacement market structure and dynamics





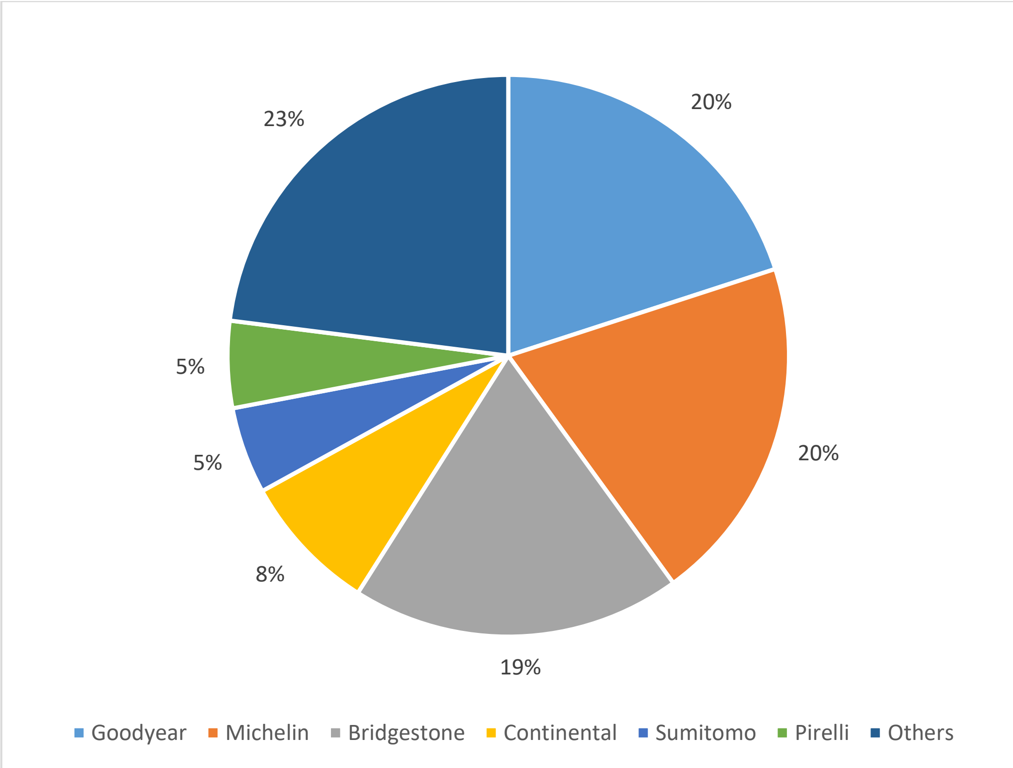
The "new customer":

- **Well informed, has access to product benchmark test results**
- **Critical**
- **Under strong influence of mass media**
- **Price sensitive**
- **49% take brand as #1 purchasing criterion, 51% take price**
- **Middle range segment is disappearing**

Source: Case writers' data

Exhibit 8

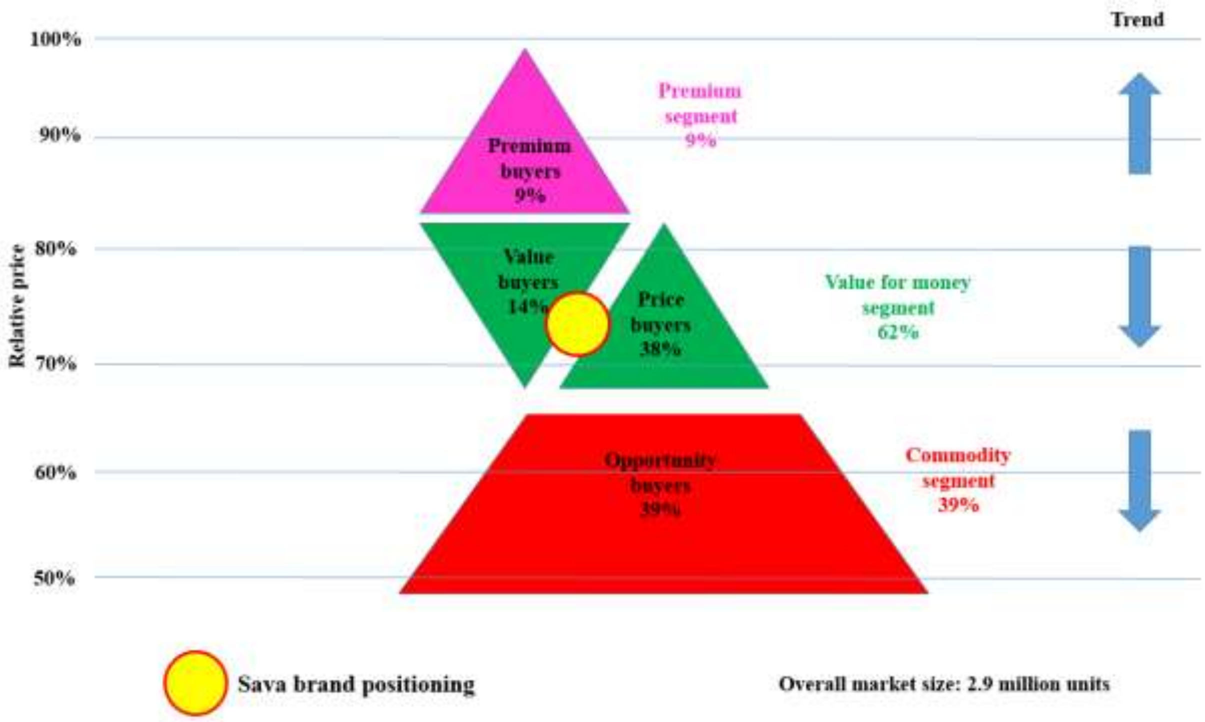
Global market shares in tire industry in 1995



Source: Case writers' data

Exhibit 9

Tire market structure in the countries of former Yugoslavia in 1995



Source: Case writers' data

Sava Transformation Chronicle (B)

Early spring of 1996 brought more clarity to the dilemmas facing Sava management. The JV contract with Continental had expired at the end of 1995. While the Continental management made symbolic improvement of their offer aimed at bringing the position of the two companies closer, it was obvious that, due to prior acquisition of Czech company Barum, it lacked real interest in strengthening the cooperation with Sava. Therefore, the proposed concessions were minor, giving no strategic potential to the extended JV. With the standalone position seen as close to non-sustainable by majority of the core management team, Sava management, supported by IFC expert John Clarke, decided to put all of their efforts behind closing a favorable deal with Goodyear. Getting there, however, proved to be a "long and winding road", the prospects of better future remaining elusive. In the meantime, Sava had to get ready for all the adverse effects of cutting off the relationship with Continental, before the positive effects of the new partnership would kick-in.

Setting initial negotiation positions

The members of Sava management team, which was in 1995 still led by Viljem Žener, during 1995 agreed on the need to find solution for the expiring JV contract, but were not ready to agree on what the solution was. Franc Balanč, Finance Director of Sava and likely the most strategically oriented member of the team insisted on engaging external advisors who could help the team that had no experience in international M&As. Three of them proved to be instrumental: John Clarke, IFC expert with strong track record in international financial deals, Marko Fajfar, Slovenian M&A expert, as well as German corporate lawyer Matthias Blaum.

The negotiations with Goodyear were started upon suggestion of Clarke. He arranged the first visit of that time head of Goodyear in Europe, Bill Sharp, taking place in March 1995. Sharp was received by the whole Sava management team. Since the JV with Continental was still active, the company visit was organized discretely, and the involvement of the part of the team directly related to JV operations was minimized. It was important, however, that Sharp got direct evidence of fairly advanced production technology Sava was using, which immediately raised his interest in using Sava as a low cost manufacturing site for Goodyear in Europe, lack of which was one of the clear weaknesses of the company. Furthermore, Sava was attractive because of its strength in markets wherein Goodyear was largely not present (partially due also to the domination of Sava), as well as market growth od Sava brand all over Europe, Middle East and parts of northern Africa.

That visit had open doors for further discussions. A numerous team of Goodyear experts visited Sava in July 1995, performing detailed examination of Sava's technological competences and

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market position. Their initial conclusions were favorable, since they saw the combination of Goodyear's technological strength and Sava's production efficiency and low cost manufacturing platform as a winning proposal for market success in Europe.

Understanding Sava cost structure remained Goodyear focal interest in the subsequent discussions. Another visit followed in December 1995, with 20 experts from both tire and engineered products areas led by Sharp and Clark Sprang, Senior Vice-President for Business Development, who was to become Goodyear's chief negotiator in charge of preparing the deal with Sava. The delegation presented detailed cost analyses of sample products, which could be manufactured in Sava, serving as the basis for a very rudimentary business plan proposal. That also included an initial idea of the engineered products portfolio of interest for Goodyear, which was critical for Sava to understand which parts of its business would be sold to Goodyear and which would remain in Sava.

A cordial letter with Christmas greetings, which Sprang sent to Bohorič in December 1995, indicated positive impressions obtained during the visit and asked Bohorič to arrange for Goodyear CEO meeting with the President of Republic of Slovenia, Mr. Janez Drnovšek, during his visit to Sava in January 1996.

At the same time, internal memos prepared by the members of Sava negotiating team clearly indicated many open issues and potentially demanding consequences of the deal. If part of product lines would remain with Sava, it would require sharing infrastructure or relocating part of the production. Although relocating the production of any of the future units would clearly be costly, and thus an inferior option, coming to a good solution for infrastructure sharing was far from easy. Many pieces of infrastructure, such as rubber mixing or energy generation and usage, were important part of the core processes, with high influence on quality and cost. Others, such as catering, guard or medical services, building maintenance or parking were necessary part of an industrial site, but setting the scope of their usage and a fair split of cost sharing in many cases tends to be source of friction among the involved parties.

It was also becoming clear that Goodyear saw Sava organization as overly complex and its overheads as grossly oversized. Sava team came to the estimate of at least 750 employees to be made redundant in case of the deal! On top of that, Goodyear was using management tools (such as product costing systems) which were completely new to Sava and required their team to learn them fast in order to understand the logic behind Goodyear's negotiating position and be able to come with convincing counter-proposals.

The long march

The visit by the CEO in early 1996 with the board members of Goodyear, signaled the very real possibility that Goodyear's investment in Sava could well become the largest FDI in Slovenian history.

By March 1996 key stakeholders of Slovenian politics and business, orchestrated by Bohorič, came to the consensus that Sava should take the next steps making the deal possible. Given many interests involved this was not a small achievement and it served as a proof of Bohorič's political prowess.

Based on the available data Mr. Fajfar prepared two separate extensive reports for the needs of the management team, one on the situation related to Continental and the other related to

Goodyear, which also included the description of necessary steps that had to be taken in order to close the deal. The report on Continental was clear: the partner had no strategic interest in Sava's development and would present a wrong choice. The report also indicated that some members of Sava management team were "uncritically loyal" to long-standing relationship. The report on Goodyear was highly positive, but it also indicated that relationship with Continental had to be legally clarified before Goodyear would make the final commitment. Ho to prevent the transfer to Goodyear of proprietary Continental technology acquired over the years was identified as one of the potentially critical stumbling blocks.

Bohorič decided to send a harsh-worded letter to Continental CEO, in order to get the final offer on possible future cooperation, as well as to clarify the alternatives. The final meeting with Continental took place in Frankfurt. Although the JV contract had already expired, Continental still owned equity share in Sava and, at least formally, it was also kept as an open option to solidify the negotiation positon towards Goodyear. Sava management wanted to make the terms of the Continental exit from company ownership clear.

Given existing frictions in the Sava management team, Bohorič had to organize management team meeting and formalize the conclusions. An internal ten-page document, drafting all key elements of the situation at hand, was distributed to twelve members of the extended management team for review. Finally, on March 26, 1996, all members of the core management team supported the decision to drop the partnership with Continental in favor of the one with Goodyear. Several team members were charged with preparing emergency financial, marketing and sales plans to be able to bridge the gap following the end of sales of Sava products through Continental sales network. Another huge topic looming was the switch of technology, since according to the JV contract Sava would have to stop using Continental production technology, the backbone of its tire manufacturing process in the very moment it engages with another partner.

With the formal management team decision in favor of partnership with Goodyear out of the way, Bohorič could take the next move, which proved to have unforeseeable long-term consequences: change the ownership structure.

Until April 1996, Sava had several groups of owners with very diverse interest: four funds controlled by Slovenian Government on behalf of the Slovenian state as the owner (46%) Continental (28%), employees and retirees (16%) and small investors (10% in total). The Government had decided to exit the ownership, selling its share to institutional investors. That marked the start of the new era of Sava as a joint stock company, with governance bodies realigned to reflect it. Bohorič lobbied with the institutional investors to create the ownership structure favorable for the company, as well as to set a friendly Supervisory Board[1] consisting of 14 members (unusually large for that time Slovenian standards). Finally, he was appointed as the first President of the newly composed Management Board. He also got the open mandate to lead further negotiations with Goodyear. Obviously, institutional investors had speculated that the deal with Goodyear would enhance the value of Sava, more than justifying their investment.

[1] According to that time Slovenian legislation, two-tier governance system was in place following the German model: in large companies General Assembly appointed 2/3 of the Supervisory Board members and 1/3 were employee representatives. Supervisory Board then appointed the whole Management Board in charge of daily operations of the company.

With the negotiations seemingly entering the final stage in August 1996, a number of open issues worried Sava Management Board. Despite positive tone of discussions, Sava had not received a binding offer or even an indication that it would be at an acceptable level. The position of some influential stakeholders (such as unions) remained unclear. Sava was interested in keeping statutory control over the new JV, which would require 25%+ ownership stake, but it was not clear whether Goodyear was ready to accept it. Many important "technical details" were still open, too, such as final structure of engineered products portfolio to remain in Sava, sharing of the infrastructure needed for manufacturing units of both parties, transfer pricing policy or the ownership of Sava brand.

The proposal received from Goodyear in late August 1996 was a big disappointment for Sava. John Clarke was in particular critical, citing lack of strategy and clear goals. Goodyear presented the future cash-flows used for price calculation as lower than the ones in previous years, and the only driver of future profit increase was the decrease of labor costs. Clarke even suggested he would review once again the "status quo" option, in which Sava would remain standalone, using technology support from Vredestein.

The discussions were continued in autumn, with a major breakthrough achieved during the visit of Sava's managers to Akron in September. It appeared that Goodyear team appreciated direct, no-nonsense style of their counterparts, as well as their obvious expertise. Significant part of the conclusions reached in that meeting found their place in the final JV contract, solving some of the most delicate technical issues like formal split of the production facilities or details on technological processes. As a result, the parties agreed to keep three manufacturing units at the Labore factory site: Tires, Goodyear Engineered Products Europe and Sava-Tech (the latter comprising all of the Sava engineered products portfolio that were not transferred to Goodyear). All the infrastructural costs were to be divided among the three legal entities according to a detailed shared services contract.

Goodyear's decision to close its plant in Greece in early autumn 1996 without prior notice threatened the negotiation process. Sava had strong employee representation in its Supervisory Board. When unions learned about the developments in Thessaloniki, they questioned the trustfulness of Goodyear and asked the management to obtain formal assurance that something similar would not happen to them. As a result, Goodyear sent European GM, as well as production and HR managers to explain the situation and calm down the unions.

Remaining issues were resolved with increased speed, allowing the parties to set the basic principles of JV as well as key sales and profit targets for the first five years. Goodyear opted for soft approach to labor optimization, valuing employee motivation more than fast cost reduction. Although the initial valuation was rejected by Sava as too low, the parties stayed committed to come to a mutually acceptable deal.

Bohorič was working on three fronts. He was representing Sava towards Goodyear, but he left most of the work to Clarke, Fajfar and his colleagues from Sava Management Board. He spent much more time ensuring the lasting support of the external stakeholders (which seemed the easier task) and calming down the internal frictions, with some of the old-time managers (including several sitting on the Supervisory Board) reluctant to accept change of partnership and some others resisting changes because of likely loss of influence. That was in particular true for the influential Accounting and Planning function, which was used to run the company from behind the scene and had huge problems to adjust to Goodyear transparent style.

With Clarke and Fajfar preparing critical documents such as 8-year business plan and detailed evaluation of all issues that remained open in previous negotiations, Sava moved forward to close the negotiations. Clarke was particularly forceful, pushing both Sava experts to prepare better for the negotiations and Goodyear side to accept his views on company valuation, using all the expertise he had as IFC Senior Investment Officer. When Sava managers failed to produce the counteroffer he asked for, he prepared it himself.

Several more rounds of negotiations were needed in spring 1997 to resolve all the open issues. Finally, on May 12, 1997 Goodyear issued the formal Letter of Intent, which Sava signed four days later. All the contracts were finished by the end of 1997.

The result

Sava and Goodyear agreed to invest into two new companies, as presented in Figure 1.

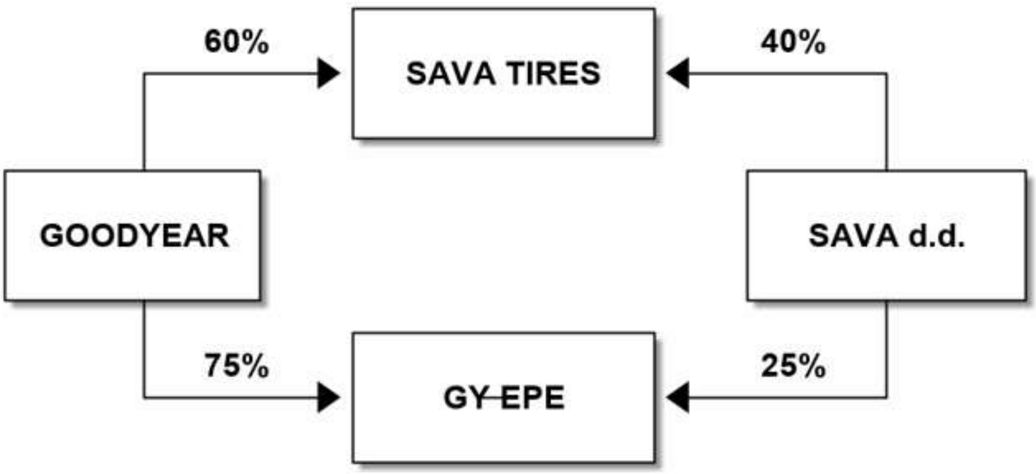

Figure 1: Ownership structure of newly formed companies

Goodyear – Engineered Products Europe started operations on January 1, 1998, while Sava Tires started on July 1, 1990. Goodyear paid 100 million US$ for its share in Sava Tires, with the 4-year option to buy out the remaining 40% of Sava shares. The price for 75% of shares in EPE was 12.5 million US$, with the same buy-out conditions.

What next

After more than two and a half years of negotiations, the partners could enjoy the successful closure of the deal. However, that just opened the new round of important challenges.

Goodyear faced the challenge of bringing in the new technologies and making the companies fully viable within its global organization. Although soft approach used during the negotiations seemed to be beneficial for gaining the initial trust of the employees and local management, it was also clear that both companies had to undergo significant changes in order to raise their competitiveness and remain sustainable. Goodyear managers were warned that Slovenian culture was status-quo oriented and that implementing changes could prove to be very difficult. Goodyear decided to put its European CFO, Richard Johnson, in charge of making things happen in Slovenia.

Sava Management Board had seemingly nicer challenge: receiving more than 110 million US$ for the assets transferred to the JV companies, Sava was suddenly sitting on significant amount of cash (with additional 70 million US$ expected within the next four years). It also remained in possession of several engineered products programs, some of which were seen of having solid developmental potential. Clearly, the management was eager to come with interesting investment proposals, since otherwise it could expect the owners, Slovenian (private) institutional investors, to take the money out of the company as extraordinary profits. With Janez Bohorič strongly in command, Sava could be certain to persuade the owners to follow the strategy of the management. The question was, however, what should that strategy be: investing into remaining rubber programs, buying some related businesses, going after unrelated diversification or even forming Sava's own investment fund and engaging financial professionals to run it?

Sava Transformation Chronicle (C)

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 also 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 living outside the US and a career thus far in finance. Richard Johnson was well known and

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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 the Sava people and internal culture and was looking 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 employee 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 are symbolic and simple things that demonstrate care and trust. They also aligned better with work flow 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. Today Sava Tires is source of the highest quality manufacturing and distribution services. Goodyear continues 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 (D)

As opposed to many other countries with the economies in transition from former communist or socialist model to free-market economy, the Slovenian government and the media influencing (or reflecting) common sentiment were looking unfavorably on Foreign Direct Investment as the vehicle of economic development. Foreign owners of established local companies were, at best, not very welcome. That is why the positive public reaction to sales of large part of Sava assets to Goodyear was seen by industry observers being close to a miracle, a clear proof of the influence that Sava management, led by Janez Bohorič, had on Slovenian politics.

Closing the deal with Goodyear in 1997 left Sava cash rich. It had received more than 110 million US$ and was expecting further at least 100 million from cashing in its put option to sell the remaining stake of Sava in Sava Tires and Goodyear Engineered Products Europe. At the same time, it also left the company management facing several demanding issues including, above all, what should be the new strategic orientation of the company.

1998 – 1999: Initial considerations and restructuring

With the production of tires, V-belts and air springs sold to Goodyear, Sava was left with a wide portfolio of engineered rubber products, whose strategic potential the management understood well, since the thorough analysis of it was part of the preparation for negotiations with Goodyear. Still, there were several new elements present, which had to be taken into account when making the final decision about the future of engineered rubber production in Sava.

For many years Sava management had procrastinated on making the decision about the upgrade of technological infrastructure needed for the production of engineered rubber products. The needed investment into rubber mixing plant was sizeable, estimated at around 40 million US$. Sava also needed a new facility for the production of semi-finished products. When it became clear that Goodyear was interested in buying part of the engineered products portfolio and was ready to share the cost of infrastructure with the production unit remaining in Sava, the management finally moved and made the needed investments, which proved to be critical for efficient future production.

The other big issue was the way Sava looked at the cost position of individual elements of the portfolio in determining their competitiveness (see Exhibit 1). Despite clear signals from Goodyear and quite obvious interpretation of the most basic benchmarking, product costing practices were burdened with blatantly oversized corporate overhead costs. After carving out

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operations bought buy Goodyear (included necessary support functions), costs per unit further increased, since practically no effort was made immediately after the closure of JV contract to reduce the overheads to normal level. Without optimizing these costs, however, it would be difficult to be competitive, especially on the more price-sensitive segments of the portfolio such as bicycle tires or artificial leather..

Finally, Sava had to decide whether to use the proceeds of sales to Goodyear primarily to improve the production technology and develop a range of new products in selected niches, or to join the consolidation process going on in global rubber industry and try to reach global niche dominance through buying few (smaller) international players. Such a purchase would potentially bring the benefit of advanced know-how, as well as international distribution network and B2B contacts. However, Sava had to evaluate whether buying them was better than developing them on its own, which clearly depended on many factors such as target availability, price and timing, along with the M&A integration competence. These strategic issues were not new to the management team, since for several years they had been engaged in discussions with companies from Germany and (former) Czechoslovakia, but without going beyond expressing general interest for such talks.

Deciding to strengthen at least a selected part of remaining engineered products portfolio clearly meant going for known territory, but also committing to further global expansion, since none of the niches would be of the sufficient size just in the regional markets. On the other hand side, the available funds could have been used for diversification, either a “semi-related” (such as venturing into chemical industry) or a completely unrelated one. In the latter case Sava would likely look for an industry that was offering consolidation opportunities in Slovenia, as well as the average returns on the employed capital above the fairly meager ones characterizing rubber industry. The management was well aware that they faced the classical “risk – reward” dilemma (see Exhibit 2).

The initial strategic course seemed to be a highly conservative one. In 1998 and 1999 Sava disengaged from 11 engineered rubber product segments (see Exhibit 1), including several that were for years subject to controversy in the evaluation of their potential, such as artificial leather or bicycle tires, both requiring very large volumes and low costs in order to yield satisfactory returns. That still left 10 different product groups that were to be the basis for future company growth. However, Sava did not attempt any international acquisition to strengthen the position of that portfolio. Instead, it further invested in production equipment and development of several new products, as well as tried to further expand its international sales network and maximize the market share in the remaining product categories. The growth ambition was set to 5-10% annually, which many saw as insufficient for an aspiring player with high investment potential.

Since not all of the available funds were used immediately, Sava management decided that the free cash should be temporarily placed into the financial markets, as short-term financial investments, before proper acquisition targets or other “real sector” (i.e. manufacturing) investment opportunities were identified. That would keep the company close to the areas management felt comfortable dealing with, but at the same time condition of sufficient return on investment had to be satisfied. While sound on paper, this approach came with a major problem, typical of M&A oriented strategies: there were very few companies in Slovenia satisfying both criteria, international equity markets, for some reason, seemed not to be that interesting for Sava management.

2000 – 2008: The period of high growth

In 2000 Sava management made a significant turn in its growth philosophy. The company executed a number of acquisitions and started with significant activities in as much as five different industries:

- Chemicals (such as paints and surface treatment, as well as chemicals used in various production processes in textile or artificial leather)
- Trade (with main focus on specialized retail outlets for paints and other chemical products)
- Tourism (including hotels in prime locations in Slovenia, but also smaller facilities such as a golf course and a camping site)
- Financial industry (starting with the purchase of a major share in Gorenjska banka, a regional Slovene bank headquartered in Kranj, which at that time was ranked in the middle section of top ten Slovenian banks in terms of balance sheet size)
- Real estate (Sava became significant player in real estate market).

While media and public opinion remained positive about Sava strategy, some industry experts questioned both the broad choice of industries, as well as the choice of individual targets.

> "One would expect that Sava used its investment potential for obtaining at least a dominating regional position in one industry. Instead, it went for a fairly large number of relatively weak players across several very different industries, for none of which Sava management can claim expertize. From risk diversification perspective, such choice may have merit, but achieving sustainable high performance may prove to be difficult."

Sava Management Board wanted to acknowledge the new nature of the company and its own priority of managing the investment portfolio. Consequentially, in 2002 Sava was transformed into a holding company with 23 subsidiaries and renamed into a joint stock company "Business Group Sava, company for management and financing". At the same time, the management style did not change much, since the Management Board kept "hand-on" approach, engaging in all important decisions made in subsidiary companies despite the lack of particular industry experience.

The key decisions were made within the Management Board and, more or less, rubber-stamped by the Supervisory Board, which had remained under strong influence of Mr. Bohorič. However, the Management Board seemed not to be completely aligned across all decisions. One of the early acquisitions, the local paints and coatings company Color, led to disagreement whether or not the price paid was too high. This very likely contributed to a major embarrassment, when Helios, a company similar to Color, but larger and better performing, rejected Sava's take-over offer as inadequate. That acquisition would make a perfect match, allow for significant synergies and create a European level player in paints, coatings and surface treatment products. Having Color in its portfolio without having Helios did not make strategic sense, thus Sava sold Color in 2004.

Further divestments of remaining chemical businesses followed in the period from 2004 to 2006, as well as the equity swap of Sava's chemical retail subsidiary for increased ownership stake in Merkur, leading Slovenian technical retail company. Several hospitality companies were taken over, primarily thermal water resorts in north-east Slovenia.

Shift away from chemical industry was not interpreted as a failure, but as the confirmation of careful selection of investment opportunities, which required focus on industries with high returns. To be truly consistent, that would require existing tourism and rubber, which was never executed, although Mr. Bohorič several times used that argument in both internal and public debate as a realistic possibility. Instead, he decided to engage majority of available investment potential into increasing Sava position within financial sector in Slovenia.

After Slovenia had joined EU in May 2004, in the period from 2005 to 2008 it experienced a boom of speculative investments and high returns in financial industries. Sava management was able to secure the political support needed in acquiring position in strongly regulated, government influenced banking sector. It also had full support of the Chairman of the Supervisory Board, Mr. Stane Valant, who himself was owner of NFD, one of the private investment funds. This ultimately led to (surprisingly) intertwined interests of NFD and Sava, including some cross-ownerships (see Exhibit 3).

The only exception from the newly found focus was the remaining part of engineered rubber business, consolidated in Sava Tech. It received more than 100 million € of investment into new technology and new product development, but still received no support through M&A activities of Sava. Sava Tech management team prepared a project of acquiring Czech company Rubena, which showed that the investment would be paid back in several years and would allow for leadership in European markets. The proposal was turned down by Sava management in favor of taking equity position in Abanka, another mid-size player in Slovenian baking market. However, Sava Tech could at least rely on strong professional expertize existing in the company and was successful in organically developing its business, increasing its revenues from 48 million € in 1999 to 120 million in 2012.

The transformation of the kind and size described above was not possible only with the funds received from the sales of rubber business to Goodyear: With more than 510 million € spent on acquisitions, Sava had to take significant debt in the process (see Exhibit 4). Having ownership position in two banks and enjoying strong political support in the country, where dominant economic philosophy was relying on national champions, money in the banks fairly cheap and lending rules "flexible" made this not only possible, but seen as smart business strategy, resulting in obvious change of revenue structure (see Exhibit 5). It seemed that nobody from Sava governance structure paid attention to several hazardous caveats.

Except for its core business (Sava Tech), which managed to grow organically, the growth of revenues in the period from 1999 to 2008 was reflecting more or less only M&A activities. The acquired hospitality companies, supposed to become new core business, were historically underinvested, while the business as such yielded low returns. Sava had to spent more than 100 million € in the modernization of the hotel and spa facilities, but still none of the acquired companies managed to perform well. Thus, the only profits from newly acquired businesses in that period came from minority positions in financial sector.

While banks in Slovenia, in line with the high GDP growth of the country, performed extremely well between 2000 and 2008, they were financing their expansion from low cost international sources rather than from long-term domestic savings. As a result, in order to keep their books showing matching terms of sources and uses, they preferred to give short-term corporate loans, often in the form of revolving loans, granting "almost automatic" loan extension in the next short-term period. Sava management, saw no risk in that and gladly accepted such terms, being confident of their business judgment and political clout. In practice that led to D/E ratio of close to 1 in 2008, which in itself was not seen as exaggerate, but the ratio of short-term loans to long-term ones was 2:1 and the short-term loans became higher than overall Sava revenues in 2007!

2009 – 2016: Crisis, decline and demise

The initial reaction of the Slovenian government to 2008 global financial crisis was a surprisingly naïve one: “our banks hold no toxic instruments, so our economy will not be hurt”. Truly, crisis came with the delay, but when it exploded in 2009 it turned into a disproportionally severe one, compared to mainstream EU countries. Slovenian banks lost external financing and the central bank panicked. Short-term corporate loans were not prolonged, many companies started defaulting and, for Sava, the nightmare scenario followed.

The short-term debt that suddenly had to be serviced, although itself disastrous, was not the only problem. Sava’s investments in financial sector became a huge burden to the company. To make things worse, Sava’s equity share in Merkur became toxic, too, since the company also went down under the burden of debt and a botched attempt on privatization. The affair ended with Merkur CEO, glorified by the Slovenian business community just a year before the crisis as one of the true captains of the industry, receiving lengthy jail sentence for financial manipulations he had performed in his attempts to save his investments.

The whole Sava strategy collapsed. From that moment on the company entered a prolonged agony, trying to reach some kind of settlement with the banks. In 2010 the loss was a staggering 100 million € on the revenues of 176 million, driven primarily by impairments of minority stake financial positions in Merkur, Abanka, Gorenjska banka nad companies from NFD circle. Losses in 2011 reached more than 150 million € (see Exhibit 6). Due to losses and capital impairments, its balance sheet structure soon became unsustainable.

In April of 2012 the Shareholder Assembly accepted the business results and decided not to pursue any liability claim sof the Management Board members. All three members of the Management Board resigned and received financially attractive exit packages, for the first time creating unison negative media coverage. Supervisory Board composition was changed, too, and Mr. Matej Narat, a former banker, was appointed as the new President of Management Board. Sava started selling off individual parts of the group. The first to go was Sava Tech, its only consistently profitable business. In almost a cynical twist of history, it was sold to the same Czech company that was the potential acquisition target several years before. The price achieved was extremely low by industry standards (70 million € on annual sales of 120 million), which was the source of new rumors on lack of transparency of Sava M&As[1].

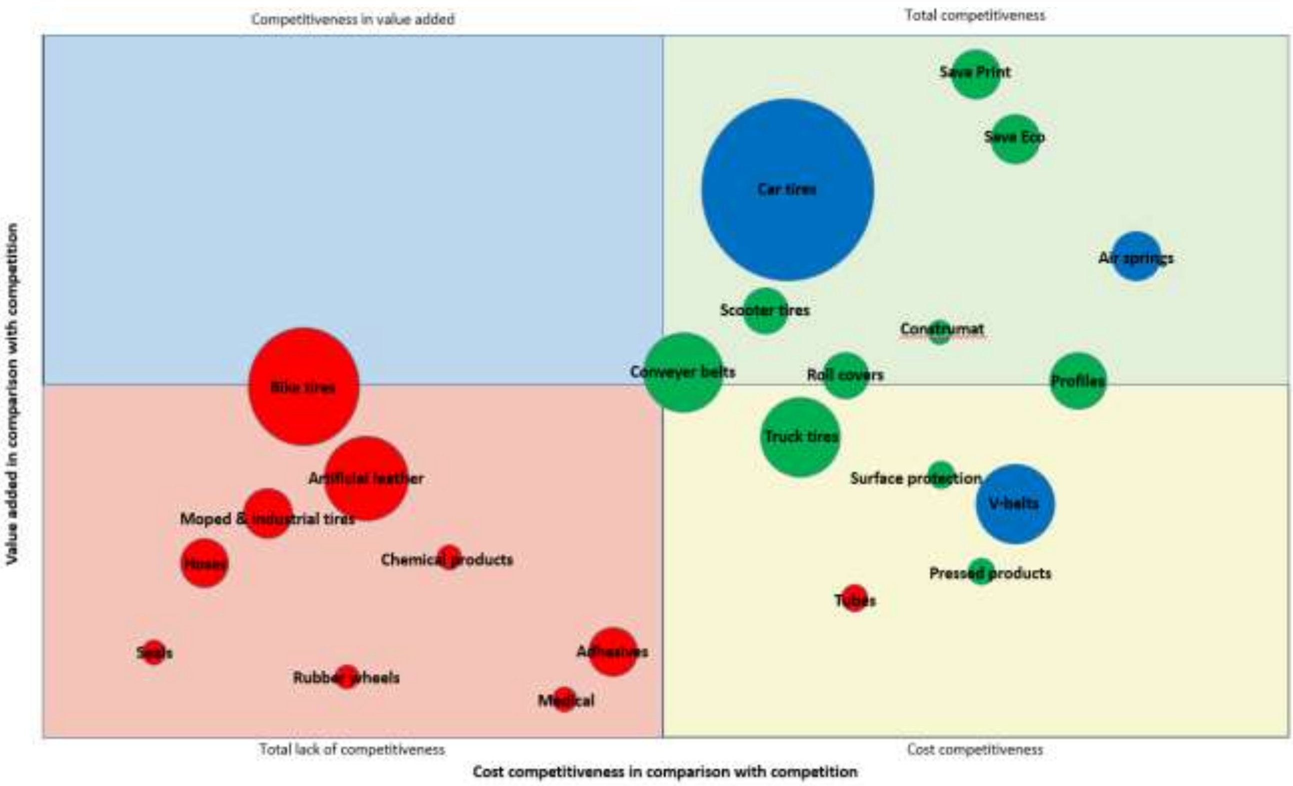
With debt piling and negative equity rising, the company entered into Slovenian version of Chapter 11 procedure (“forced settlement”), with close to 42% of its equity bought by a specialized US fund York and 45% transferred into the ownership of two state funds. The only remaining assets of some value were the hotels and thermal resorts, which became target of speculative appetites of several players from local politics and business community.

After almost a century of company existence, trading with Sava stock was stopped in August 2016.

[1] Four years later this seemed to be confirmed, since the Czech owners sold Sava Tech to Trelleborg at the price said to be more than 110 million €.

Exhibit 1

Competitiveness of Sava sales programs

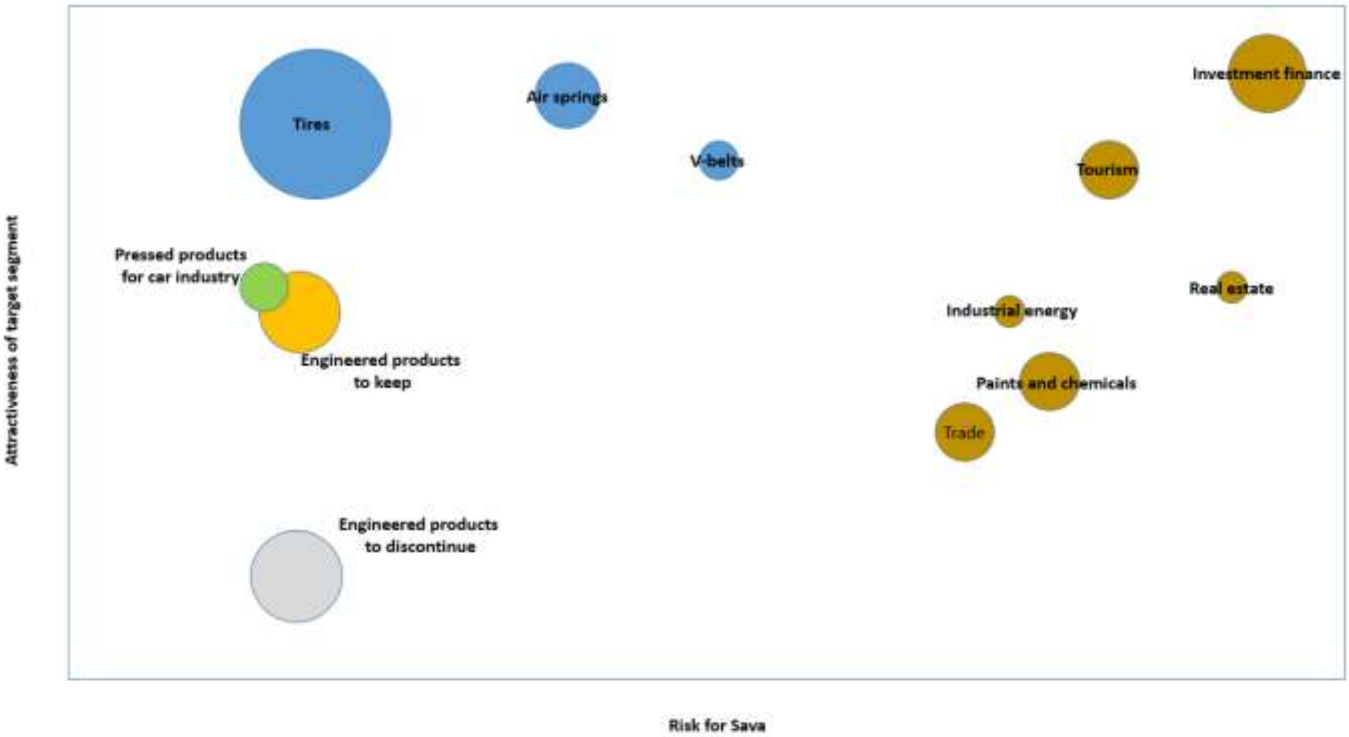


- Segments to terminate
- Segments to keep
- Segments sold to Goodyear

Source: Case writers' data

Exhibit 2

Estimate of investment potential and risk per target segment considered by Sava management in 1998



Source: Case writers' data

Exhibit 3

Major cross-ownership positions (end of 2011)

Partner	**Sava's share in partner's equity**	**Partner's share in Sava's equity**
Gorenjska banka	45.90	2.81
Abanka Vipa	23.83	0.22
NFD Holding	24.65	4.33
NFD 1 investment fund	23.35	5.03
Maxima Invest*	21.77	1.70
Merkur**	8.20	6.72

* Maxima Invest was associated with NFD Holding, investment group controlled by Stane Valant, Chairman of Sava's Supervisory Board
** Retail company Merkur had headquarters close to Kranj, approximately 10 km from the headquarters of Sava, Merkur CEO Bine Kordež was seen as having same political affiliation as Sava CEO Janez Bohorič

Source: Case writers' data

Exhibit 4

Excerpts from Sava Balance Sheet

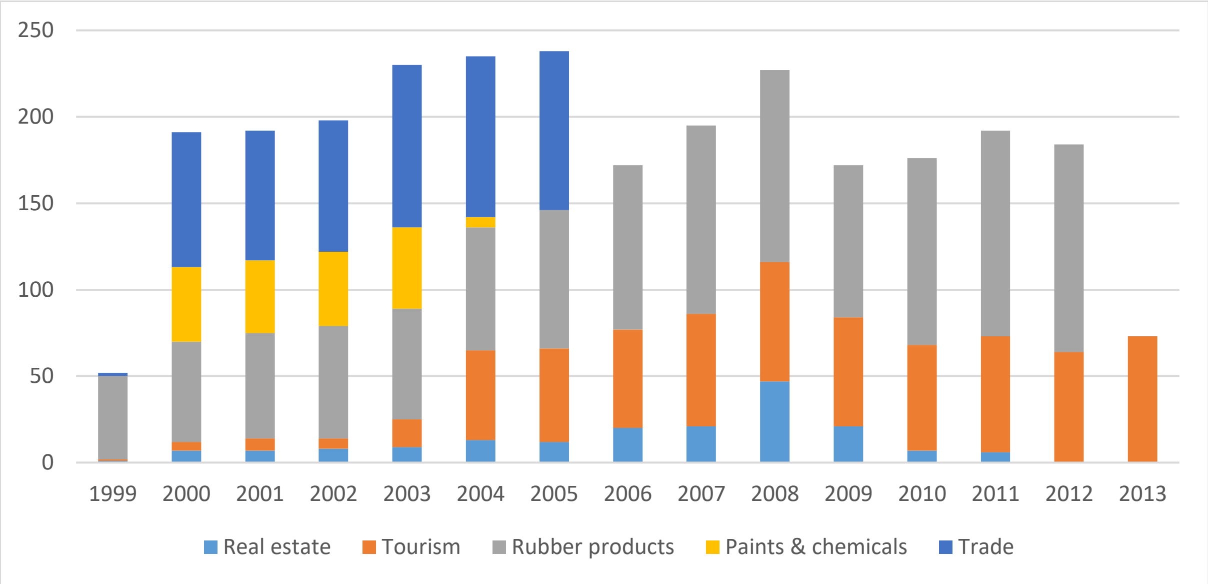
Year	Equity (mil. €)	Debt (mil. €)	Total liabilities (mil. €)
1999	222.3	67.9	290.2
2000	244.2	177.5	421.7
2001	250.3	162.1	412.4
2002	235.5	178.9	412.4
2003	233.7	186.3	420.0
2004	377.9	215.4	593.3
2005	392.9	258.1	651.0
2006	432.5	242.1	674.6
2007	545.4	406.3	951.7
2008	482.4	439.2	921.6
2009	475.4	466.0	941.4
2010	323.3	437.5	760.8
2011*	165.8	442.5	611.4
2012	67.3	413.6	480.9
2013	16.2	310.1	326.2
2014	-21.2	306.7	285.5
2015	-24.5	307.6	283.1

* At the end of 2011 Sava had 361.1 million € short-term and 81.4 long-term debt

Source: Case writers' data

Exhibit 5

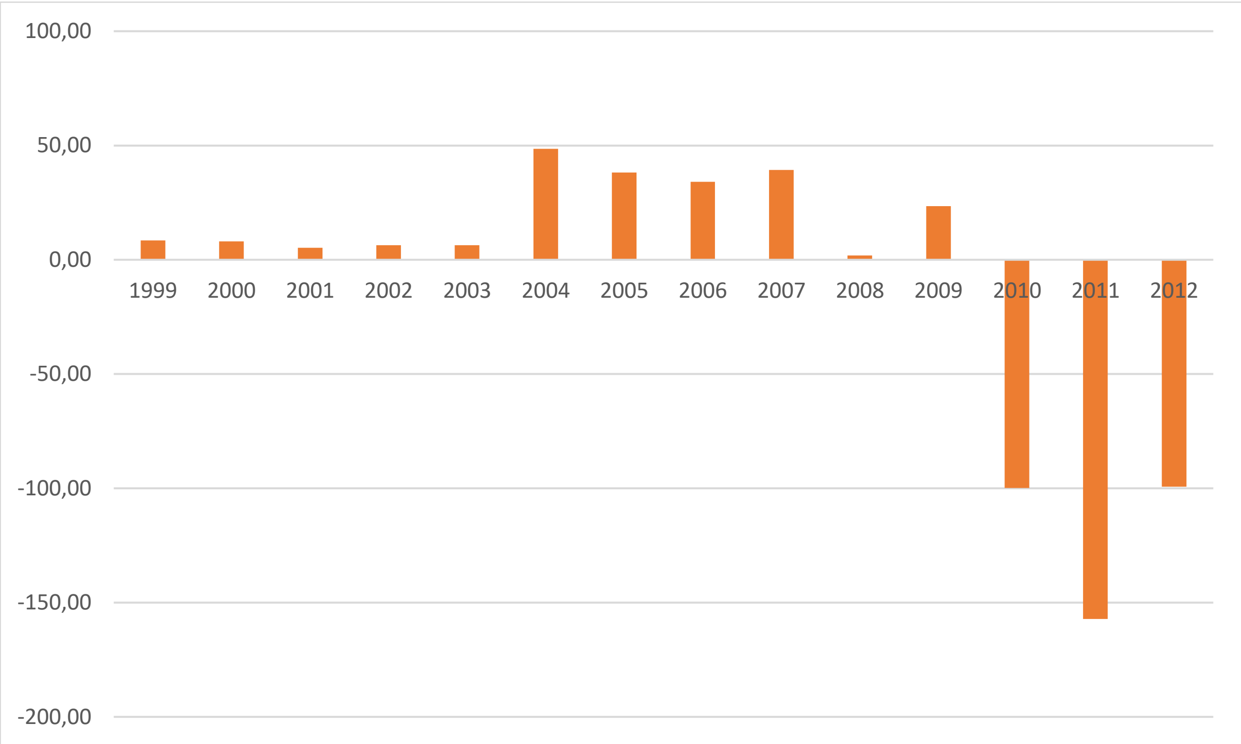
Structure of Sava revenues
(in million €)



Source: Case writers' data

Exhibit 6

Sava profit / losses
(in million €)



Source: Case writers' data

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, external 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.

Stanko Cvenkel, Richard Johnson and Slavko Koren prepared this case under the supervision of 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 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 t o2015) 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.

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?