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Acquisition of Škoda Auto Company by Volkswagen Group

(Bakalářská práce)

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Prohlašuji, že jsem tuto bakalářskou práci vypracoval samostatně a uvedl úplný seznam citované a použité literatury.

In Olomouc on the day

I hereby express my gratitude to Dr. Joseph Ference for his patient, enduring guidance and priceless advice and suggestions in this endeavor.

List of Abbreviations

4WD	Four-wheel drive
ASAP	Akciová společnost pro automobilový průmysl (Joint Stock Company for Automotive industry)
AZNP	Automobilové závody, národní podnik Mladá Boleslav (Automobile Works, National Enterprise Mladá Boleslav)
BCC	British Broadcasting Company
BMW	Bayerische Motoren Werke
CAD-CAM	Computer-assisted design
CEE	Central and Eastern Europe
CEO	Chief executive officer
CKD	Completely-knocked-down
COTY	Car of the Year award
DM	Deutsche mark
DMG	Daimler-Motoren-Gesellschaft
FWD	Front wheel drive
GM	General Motors
GmbH	Gesellschaft mit beschränkter Haftung - company with limited liability
HR	Human resources
JV	Joint venture
KdF	Kraft durch Freude. Strength through joy
L&K	Laurin & Klement Co.
Mk	Mark, generation
MKD	Multi-knocked-down
PR	Public relations
R&D	Research and development
RAF	Reichenberger Automobile Fabrik
RWD	Rear wheel drive
SKD	Semi-knocked-down
USD	US dollar
VW	Volkswagen

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1. Introduction

In modern free market economies, no company is able to survive without expanding its boundaries and target markets, which is demanding enough, yet almost unfeasible in the context of global automotive industry, a fiercely competitive and cut-throat environment.

Far and wide growth of customers' demands, not only in European markets but world-wide, make it even more challenging for a single car company to survive in uncertain and ever changing environment. Eventually, a company finds itself, often by no particular fault of its own, on the verge of bankruptcy, due to persisting fluctuations. In context of current agglomerating and coalescing markets, it makes it an imperative to the companies to seek out and sail into various joint-venture operations to boost and widen its activities in order to endure.

Forming JV with other car manufacturers has been a means of survival ever since the automotive industry has began. From then on, automotive mergers and acquisitions became a common sight, crystallizing the initial automotive clusters into a global industry. As the law of supply and demand puts it, when one hand reaches out, the other one has to give over the contrived product.

By the end of 1980s, traditional Czech car manufacturer Škoda found itself in that very situation, when its future was murky and unclear. Impending decline of the company, due to decreasing demand for company's products, was only avoidable by finding it a plausible and potent partner.

The purpose of this thesis is to zoom in to the process of acquisition of Škoda Auto by Volkswagen Group. Although the venture seemed demanding to say the least, the potential that lay within Škoda, in terms of Eastern European and Asian market penetration, made it appealing enough. When VW eventually overtook Renault in the acquisition of the company, a lengthy and demanding task has been erected in front of it.

Eventually however, Volkswagen had pulled it off and managed to transform Škoda from the bottom to the top. Originally a stiff, inflexible and inferior manufacturer that was nothing more than laughed at has been thoroughly, yet gradually transformed into a stable and full-strength company that has managed to elbow its way into the European free market economy

and beyond, solidifying its position and becoming a key player in the global automotive industry. The following lines will therefore concentrate on this development.

2. Mergers and acquisitions

As this paper deals with acquisition of Škoda car company by Volkswagen group, it would seem appropriate to briefly define the term merger first and differentiate it from the term acquisition, both of which being casually used in the same sense of JV - joint venture (i.e. a contractual agreement joining together two or more parties for the purpose of executing a particular business undertaking. All parties agree to share in the profits and losses of the enterprise.)¹, though the nature of the terms differ slightly more than it is apparent at first glance. Then, we will concentrate on what could be the intentions behind such business process and pros and cons of it, especially in relation to the automotive industry in its global context. Ultimately, we shall note the current state of global automotive industry in context of automotive alliances and mention a couple of examples of such processes that had already happened

2.1. Distinction

The terms merger and acquisition both refer to a process of purchasing selling of companies, yet they differ slightly:

- **Merger** refers to a process, when statutory bodies (i.e. top management, senior managers, shareholders etc.) of two or possibly more companies agree on such incorporation.² The target company is formally “swallowed” by the buyer, ceases to exist and the buyer takes control of the target company’s capabilities, management and premises to use it for its own advantage. Alternatively, the two merging companies could create a new and distinct company, named and managed differently from scratch.³
- **Acquisition** on the other hand differs from merger in a way that when the purchasing company acquires the target company (an object of acquisition), it gains control of the target company often on a higher management level, however the target company

¹ "JointVenture". InvestorWords. 27 Aug 2010 <http://www.investorwords.com/2671/joint_venture.html>.

² Hlaváč, Jiří. Fúze a akvizice – proces nákupu a prodeje firem. Praha: Nakladatelství VŠE, 2010.

³ "Merger". The Free Dictionary. 27 Aug 2010 <<http://www.thefreedictionary.com/merger>>.

retains its distinct identity, function and partially its decision-making authority (Hlaváč 5).

2.2. Automotive Industry Context

Mergers and acquisitions are carried out by companies, whose goals are to reach certain strategic, entrepreneurial or financial targets. The companies can generally differ from each other in legal identity, company culture, system of values, target market segments etc. In the context of the automotive industry in particular, companies' management could be motivated for such a procedure in several ways, as listed below: ⁴

- To expand its market to other areas (countries) or to different market segments (low-end, high-end etc.)
- To gain access to broader range of assets, either of material or financial nature
- To acquire access to various sources of activity and sequentially of income, thus to enhance financial stability
- To expand its product range or to further modify and develop it
- To gain access to wider marketing and distribution channels
- To expand its production capabilities and enhance productivity
- To gain access to certain technologies that would be otherwise lengthy or costly to research and develop or to extend research facilities
- To improve and enhance a perception of a brand of either the purchasing or target company, thus to evolve brand management
- To enhance management (low, mid, high) and human resources

2.2 (a) General Reasons for Mergers and Acquisitions Survey 2009 ⁵	
Availability of attractive acquisition opportunities	62.8%
Availability of capital	42.8%
The state of the economy	38.6%
Current and predicted financial results	29.7%
Add-on acquisitions	30.3%
Credit availability	29.7%
Global growth	23.4%
Moving into/out of new lines of business	22.8%
Regional growth	18.6%

⁴ "Automotive Mergers and Acquisitions". reportSURE. 27 Aug 2010
<<http://www.reportsure.com/automotive-reports/automotive-mergers-acquisitions.aspx>>.

⁵ "Mergers and acquisitions 2009". Directors and Boards. 27 Aug 2010
<<http://www.directorsandboards.com/BBSummer09.pdf>>.

Interest rates	11.7%
Other	5.5%

Global automotive industry has witnessed waves of mergers and acquisitions in the past, especially in 1950s and 1960s and of most significant ones in 1990s. Although large acquisitions and mergers are a current day reality of especially financial, healthcare, energy and biotechnology market sectors⁶, further similarly extensive acquisitions, or so called “mega deals”, are however unlikely to be seen in the automotive industry, because the automotive industry has already crystallized into six major alliances: GM Alliance, Ford-Mazda, Daimler-Chrysler Alliance, Toyota, VW Group and Renault-Nissan.⁷

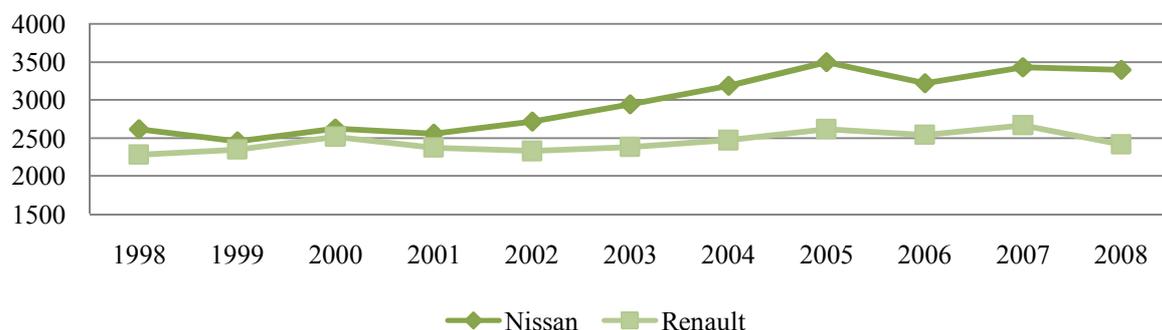
Examples of such large automotive mergers (Renault-Nissan Alliance and Daimler-Benz/Chrysler Alliance), their key principles, main objectives and results are described below:

2.2.1. Renault-Nissan Alliance⁸

This alliance has been established in 1999 as a result of extensive debate and planning. It was the first partnership involving manufacturers from Europe and Japan. Both companies agreed with the merger for fairly similar reasons. The results of this JV for both companies are apparent as follows:⁹

2.2.1 (a) Nissan-Renault Production Figures 1998-2008

(Thousands of units)



⁶ "Mergers and acquisitions 2009". Directors and Boards. 27 Aug 2010
<<http://www.directorsandboards.com/BBSummer09.pdf>>.

⁷ "YEAR 2009 WORLD RANKING OF MANUFACTURERS". OICA. 27 Aug 2010
<<http://oica.net/wp-content/uploads/ranking-2009.pdf>>.

⁸ "The Renault Nissan Alliance". Renault. 27 Aug 2010
<<http://www.renault.com/en/groupe/l-alliance-renault-nissan/pages/l-alliance-renault-nissan.aspx>>.

⁹ "Production Statistics". OICA. 27 Aug 2010 <<http://oica.net/category/production-statistics/>>.

Both companies retained their company identities, yet agreed to share resources, technologies and research facilities due to economies of scale and reduction of costs. The Alliance aimed to rank among the top three general automakers in terms of quality and value of their products and services in each region and market segment. Furthermore, they share key engine technologies, electronics and operating profit.

As a result of this merger, both companies recorded a steady growth and are in mutual cooperation in developing petrol and diesel engines, cars and cars' platforms and design. As a consequence of their combined research endeavor, they both produce one of the most advanced and economical small diesel engines in the business. Aside from these major benefits, both companies accessed previously unexploited marketing and distribution channels, due to the combination of their dealer and service networks across Europe. The enterprise in question consequently proved effective and the resulting alliance is still in operation to date.

2.2.2. Daimler-Benz and Chrysler Alliance ¹⁰

The merger of the two world-class car companies took place in 1998 and the resulting corporation was entitled DaimlerChrysler. Although this enterprise has not met expectations of the dealmakers to produce a trans-Atlantic automotive giant, it was a significant merger on the field of global automotive industry, both in scale and importance. Two merging companies, Daimler-Benz (owner of Mercedes-Benz and Smart Cars car brands, as well of non-automotive businesses such as Daimler-Benz Aerospace (aerospace and aeronautical engineering business) or Daimler-Benz Interservice (financial and telecommunications services) to name a few) and Chrysler (owner of Dodge and Chrysler/Plymouth/Jeep automotive divisions) agreed to the joint venture with similar targets and intentions.

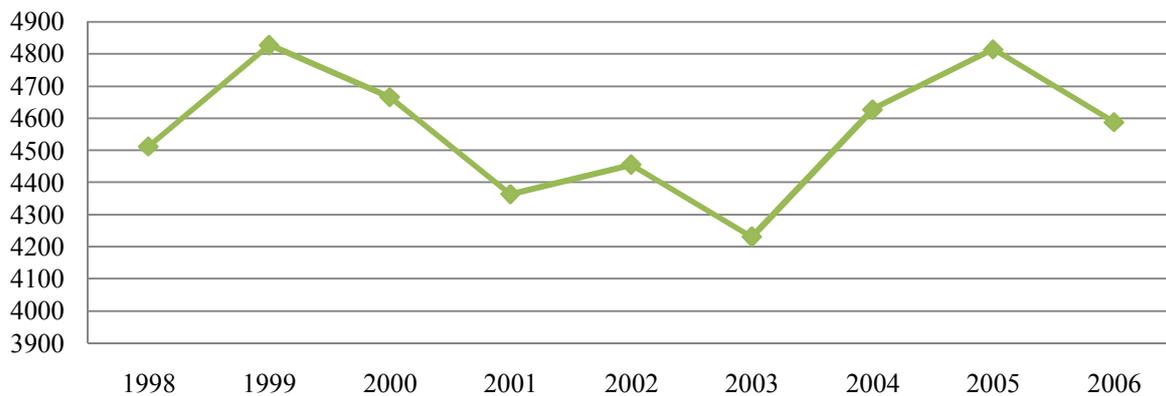
The dealmakers involved in this merger hoped to create a world-leading automotive company that would reach the top-three car makers, although the resulting enterprise failed to do so. The intentions behind the JV were that Daimler-Benz and Chrysler car brands offer various ranges of products that would perfectly complement each other to neatly comply with all automotive market segments world-wide, from low-end "cheap and cheerful" cars, through sports-utility-vehicles, high-performance sports-cars to high-end luxury limousines. When sharing the companies' R&D capabilities, Daimler-Benz's in particular, the DaimlerChrysler

¹⁰ "Daimler-Benz and Chrysler Merge". The Auto Channel. 30 Aug 2010
<<http://www.theautochannel.com/news/press/date/19980507/press012154.html>>.

also ventured to research and develop highly advanced and sophisticated safety features fit for its high-end products, as well as various alternate-energy powered prototypes.

Although the joint venture promised significant results in leading both technological and production areas, unfortunately, DaimlerChrysler corporation failed to meet the expectations and the corporation recorded stable yet disappointing figures throughout its operations:¹¹

2.2.2 (a) DaimlerChrysler Production Figures 1998-2006 (Thousands of units)



Due to unsatisfactory records, DaimlerChrysler made a decision on May 14, 2007 that it would sell Chrysler to Cerberus Capital Management of New York, a private equity firm specializing in restructuring troubled companies.¹² Although this particular automotive industry alliance proved fairly functionless and it had resulted in grand failure, this instance from the other end of a scale splendidly demonstrates motives and intentions that set these “mega deals” in motion and that are still valid to date.

3. Škoda – History and Background

After the introduction to the automotive acquisitions issue, this chapter will guide the reader through the history of the car manufacturing company Škoda and its background, from what has become the germ of the enterprise in 1895 in a form of a bicycle manufacturing company called Laurin & Klement, through a post-war merger with Škoda Plzeň works in 1925 and transformation into ASAP corporation five years afterwards. Then past the Nazi-managed war

¹¹ "Production Statistics". OICA. 27 Aug 2010 <<http://oica.net/category/production-statistics/>>.

¹² "Cerberus Takes Over Majority Interest in Chrysler Group and Related Financial Services Business for EUR 5.5 Billion (\$7.4 billion) from DaimlerChrysler". Daimler. 30 Aug 2010 <<http://www.daimler.com/dccom/0-5-7145-1-858191-1-0-0-0-0-11979-0-0-0-0-0-0-0.html>>.

efforts and a consecutive nationalization in 1949, and through the following formation into state controlled AZNP the same year. Then beyond somewhat dull and contemptible period of the communist governance that lasted for essentially four decades, right up to the events of the 1990s that preceded the decision to privatize the company.

3.1.Laurin & Klement

In 1891, a Czech entrepreneur Václav Klement (Born in October 16, 1868¹³) got down to business and bought a poky bookstore in a city called Mladá Boleslav. At that point, he decided that he would sell - alongside with books, musical appliances and sheets of music - bicycles, a popular and fashionable means of transport among young men of his era. Overall, his business worked out well. Subsequently, in 1894, after an unsuccessful attempt to make a claim on his own bicycle, he realized that he could not only sell bicycles, but he could manufacture them as well. Indeed he realized that he could not start such a business alone.

At the time, an exceptionally experienced bicycle designer and engineer Václav Laurin (Born in December 27, 1865¹⁴) terminated his partnership with Josef Kraus in a bicycle-manufacturing business. Taking his previous experience into account, he decided to stick with bicycles. Unfortunately, even though he was a brilliant engineer, he was, to be honest, a poor businessman. Soon, by this turn of events, the faith of these two young men would cross.

Václav Klement gained knowledge of Václav Laurin and came to realize that he represents a chance that should not . The two men met in 1895 and the same year made a decision to establish Laurin & Klement (L&K) a bicycle-manufacturing company. Despite incipient problems with acquiring a permission to establish a manufacturing plant, eventually, they set about their business, employing 5 people (themselves included).

The company started to expand fairly rapidly, thanks to a low-cost production strategy of purchasing various parts from abroad (mainly from Britain) instead of manufacturing them independently. After renting new premises in 1897, all banks in Czechoslovakia refused to grant a loan to the company. This circumstance led to a decision to plea for the loan abroad. Ultimately, a German bank Länderbank granted the loan to L&K under a condition, that it

¹³ "Václav Klement: (16.10.1868 – 13.8.1938): Výrobce prvních českých motocyklů a automobilů". Životopisy Online - Osobnosti, celebrity. 30 Aug 2010 <<http://zivotopisyonline.cz/vaclav-klement-16101868-1381938-vyrobce-prvni-cesky-motocyklu-a-automobilu/>>.

¹⁴ Baboráková , Ilona. "Václav Laurin zakladatel českého motocyklového a automobilového průmyslu". Financnici.cz. 30 Aug 2010 <<http://www.financnici.cz/vaclav-laurin/>>.

would be able to observe the investment.¹⁵ As it is clearly apparent, it was the first and, crucially, not the only remedy for what would become a Škoda car company from a German subject.

Consequently, the construction of yet new premises allowed L&K to expand its production to motorcycles, yet fairly undiscovered but significantly potential market. After initial marketing problems, a company called Hewetson (on behalf of German company Benz) ordered 150 units of L&K motorcycles (Herčík 119). This success in the new motorcycle market brought with it a complete halt in bicycle production by the year 1905. From then on, L&K concentrated on motorcycle production only.

The shift into motorcycle production did not signify the end to the development of the company's product range, and in 1906, the company introduced its first motorcar named Voiturette type A which, despite being based loosely on motorcycle components, was still significantly cheaper than its rivals of Benz, Mercedes and Spitz brands.

The Voiturette type A was an instant success and soon afterwards, the company expanded its production to heavy trucks and buses. Nearly 30% of L&K's production was exported into Russia and the company's products were exported into countries such as Japan, New Zealand and Mexico even. Later on, the company expanded its production to aeronautical engines and motorized plows.

For a product range this wide, the company needed to expand its premises and therefore make further investments. Consequently, the genuinely privately-owned business transformed into joint-stock company in 1907, which provided the possibility to emit stocks. Václav Klement became a managing director and Václav Laurin a technical director. The expansions allowed the company to merge with Reichenberger Automobile Fabrik (RAF), a Czechoslovak car manufacturer, in 1912, expanding the company's technology and licensed production.¹⁶

When the First World War broke out in 1914, the Austro-Hungarian Empire's war efforts required L&K to shift its production to mortar and artillery shells, alongside with heavy trucks and ambulance cars. The production of passenger cars had to be severely restricted, but thanks to growing requirements of the military, the company further expanded its premises and

¹⁵ Herčík, Karel, and Králík Jan. *Mladá Boleslav: Továrna ve městě – město v tovar*. Brno: Moto Public, 2005.

¹⁶ Kožíšek, Petr, and Králík Jan. *L&K – ŠKODA: Part 1*. Prague: Motor Press, 1995.

equipment, despite the difficulties. As the war neared its end, the company began to prepare for peacetime production.

In 1918, after the Austro-Hungarian Empire collapse, L&K encountered severe problems with its exports, as the newly formed countries, as well as the rest of Europe, fortified themselves with severe customs and duties. Furthermore, the domestic demand for passenger cars dramatically dropped as the country recovered. Governmental contracts were virtually the only source of income for the company and the murky era for the company was topped up by a large fire that broke out in the company's premises in 1924.

3.2. Škoda Plzeň - ASAP

Because of this wretched turn of events, a decision was made that L&K needed to merge with some large, financially secured concern in order to survive. Consequently, L&K merged with the Czech engineering giant Škoda Plzeň in 1925, which marked the end of the L&K brand and the beginning of a new era¹⁷. The development of L&K is best described by the following chart:¹⁸

3.2 (a) Development of L&K company in Numbers			
Year	1895	1905	1925
Total area of the company's premises (m ²)	120	10.000	60.000
Machinery drive power (hp)	2	12	2.100
Number of machine tools	3	200	800
Number of staff	7	500	1.800

In 1930, Škoda Plzeň transformed in the Joint Stock Company for Automobile Industry (Akciová společnost pro automobilový průmysl – ASAP) when 99% of the company's stock was held by Škoda and 1% formally by the managing director.¹⁹ Afterwards, the domestic automobile market consisted of companies Praga, Tatra and ASAP (with ASAP having the smallest market share).

Even though the competition was significant, it was not cut-throat and the three companies soon attempted to form a cooperation resembling the one of Citroën and Opel or of carmakers

¹⁷ Kožíšek, Petr, and Králík Jan. L&K – ŠKODA: Part 1. Prague: Motor Press, 1995.

¹⁸ Štílec, Břetislav. Světové automobilky, jejich historie a výrobky. Prague: Nakladatelství dopravy a spojů, 1975.

¹⁹ Herčík, Karel, and Králík Jan. Mladá Boleslav: Továrna ve městě – město v tovar. Brno: Moto Public, 2005.

in the USA at the time. Eventually Tatra withdrew and the merger resulted in a company called Motor. While the concept seemed promising, the enterprise failed after just two months and the two participating companies backed out of it, giving no official reasons.²⁰

The world economic crisis hit Czechoslovakia in 1932 with its full force and consecutive governmental measures that were carried out compromised the automobile industry. This called for new measures and eventually, the company brought out two new and conceptually advanced models Škoda 420 Standart in 1933 and Škoda 418 Popular in 1934.

They were considered to be a significant leap forward and thanks to their technical superiority, low selling price and appealing advertising, ASAP reached the biggest share of the domestic market in 1936, after just two years. In 1938, ASAP produced 7.223 cars and sold 4.990 of them on the domestic market, giving it 39% market share (in 1933, it was only 14%). In the same year, 30% of the production was exported (2.180 units) and the selling price of the cars was successfully lowered to just 25% of the comparative average selling price in 1929. (Kožišek 150)

3.3. Second World War period - AZNP

During the Nazi occupation 1939-1945, Škoda Plzeň was incorporated into Reichswerke-Hermann-Göring group and the military production set off in 1941. In Škoda Plzeň's premises, components for fighter planes, artillery guns, tanks and shells were made. A heavy bombardment by undesignated bombers in May 9, 1945, prior to the end of the war, was a severe disaster for the company on one hand, but on the other, it signified a new chance for recovery and renewal.

In 1945 after the war ended, ASAP got nationalized, and in 1949, it was renamed Automobile Works, National Enterprise Mladá Boleslav (Automobilové závody, národní podnik Mladá Boleslav, or AZNP), yet the cars were still branded as Škodas. The company benefited from having a monopolistic position on domestic market, as the governmental regulations eliminated all the potential foreign competitors. These benefits were however outweighed by the complete loss of independence in decision making in areas such as production and development.

Production and sales were severely limited, yet took off slowly again under government quotas. Instruments of production were modernized and the company was given, uncommonly

²⁰ Kožíšek, Petr, and Králík Jan. L&K – ŠKODA: Part 2. Prague: Motor Press, 1995

at the time, professional management. Overall, however, the state ownership and centrally planned strategy had severe and negative consequences for the company for another four decades, during which Škoda cars dropped far behind its Western European competitors.

In 1964, new Škoda 1000 MB was launched and instantly it was considered to be one of the best cars in its class and the future seemed promising. However, concept of its drive train – rear mounted engine, rear wheel drive instead of front mounted, front wheel drive – limited the potential of the model to be modified to a hatchback or a station-wagon. RWD concept was due to the lack of a suitable manufacturer of FWD joint shafts in Czechoslovakia in early 1960s and a ban to import components from capitalistic West.²¹

Despite the relative forwardness of Škoda 1000 MB, further research and development (R&D) practically halted and stagnated. Even though there were a few concepts developed over the 1970s and early 1980s, they never went into production because the government refused to allocate necessary funds, thus all the consecutive models were a mere variation of their predecessors. The Škoda 105/120 (1976) was only an upgraded version of the Škoda 100/110 (1969) which in essence was an upgraded version of the Škoda 1000/1010 (1964). The later Škoda 105/120 was supposed to be just a temporary solution, but it remained in production for 13 years. In principal, for almost 20 years, every new model shared approx. 80% of the parts with its predecessor (Pavlínek 68). Despite this stagnation, monopolistic position of the company in the domestic market ensured its economic stability.

3.4. AZNP in Trouble

In early 1980s, due to poor quality of manufactured cars, AZNP's exports faced a serious decline and the company was in grave need for a new model, which would have a front-mounted engine and FWD. In 1982, the government therefore stipulated that a new model had to be researched and developed in just over two years (1983-1985), which was, considering the production and research possibilities of AZNP, a gallows dead line. As a result, AZNP was allowed cooperation with foreign companies (Italian designer Nuccio Bertone or German manufacturer Porsche to name a few).²²

Ultimately, AZNP's engineers managed to pull it off and in September 1987, a new Škoda Favorit was introduced prematurely, because only 200 units were made by the end of the year.

²¹ Pavlínek, Petr. A Successful Transformation? Restructuring of the Czech Automobile Industry. Heidelberg: Physica-Verlag, 2008.

²² Pavlůšek, Alois. ŠKODA. Prague: Computer Press, 2004.

Exports of RWD Škodas severely dropped, because the customers were expecting the new model, but it was not exported until 1989.

Despite the introduction and production of the new Škoda Favorit, the premises, production capabilities or staff was in no way extended. By the year 1989, only 10% of the staff was working, alongside approx. the same amount of Vietnamese workers (1.520) and roughly the same amount of convicts (1.600), who had their own prison established within the AZNP premises in 1970s.²³

After the Velvet Revolution, the presidential amnesty for employed convicts paralyzed the production (Favorit assembly line's daily production dropped from 212 to 57) and production was stopped altogether in June 1990. There were not enough necessary premises, no competent workers, insufficient funds for R&D combined with insufficient production capabilities. Furthermore, the high expenses that accompanied the launch of Favorit (422 million USD at the official exchange rate in total) resulted in high debt (6 billion USD in total by the end of 1989).²⁴ The newly formed government therefore made a decision that the best solution to the problems would be to privatize the company and give it a strong and secure partner. Only that way would the company survive in newly open free market and offer a competitive and decent quality products made by qualified staff.

4. Volkswagen – History and Background

This chapter, concentrating on the background and history of Volkswagen, will guide the reader through the most significant events in the development of the company. We will set off with a description of a situation prior to the foundation of the company and a rather unpopular issue of its origins connected to Nazi Germany and Adolf Hitler himself in 1930s. Then, we will go through the Second World War and the company's rather murky era immediately following the end of the war and we will familiarize ourselves with the company's growth in the post-war era connected to the Beetle model. This will be followed by two mergers with Audi/Auto Union and NSU Motorenwerke companies in the late 1960s and an introduction of VW's new FWD product line in 1970s. Ultimately, we will zoom in on a question of what lead the company to decide to expand to the Central and Eastern European (CEE) markets,

²³ Herčík, Karel, and Králík Jan. *Mladá Boleslav: Továrna ve městě – město v tovar*. Brno: Moto Public, 2005.

²⁴ Pavlínek, Petr. *A Successful Transformation? Restructuring of the Czech Automobile Industry*. Heidelberg: Physica-Verlag, 2008.

mirrored by a merger with Seat in late 1980s and early 1990s and a consequent decision to acquire Škoda at the same time.

4.1. Ferdinand Porsche

As Škoda has its routes traceable back to the company called L&K, the brainchild of Václav Laurin and Václav Klement, so has VW his own godfather. Dr. Ferdinand Porsche (Born in September 3, 1875) is generally considered to have been a brilliant designer both of “cheap and cheerful” cars and of numerous race cars as well. His credentials of a brilliant designer became apparent first in 1897, when, just 22 years old, he invented new and radical room-saving wheel hub electric motor, that provided for a successful development and production of the very first hybrid electric car the world has ever seen called Lohner-Porsche in 1899.²⁵

His success in a field of engineering was swiftly accompanied by his positions of a chief designer in Austro-Daimler in 1906 and a managing director of the very same company 10 years afterwards.²⁶ This was followed by a job as a Daimler-Motoren-Gesellschaft's (DMG) technical director in 1924.²⁷ While in this position, he experienced a merger that resulted in a corporation Daimler-Benz. Three years later, he left the company and started to work for Steyr Auto. Apparently, he sought his fortune elsewhere and two years later, in 1931, he established his own construction and consultancy company Dr. F. Porsche GmbH, Konstruktionen und Beratungen für Motoren und Fahrzeugbau, an early foundation of the present-day Porsche.²⁸ Later in 1931 and 1933, he made unsuccessful attempts to enforce his very own affordable car design in two companies, which were basically making bicycles at the time, Zündopp and NSU Motorenwerke for production due to poor economic conditions in the country. Fortunately, his cheap car design did not fall into oblivion.

4.2. Volkswagen Program

In the 1930s in Germany, the local automobile market consisted largely of luxury car manufacturers. Large, lush cars, destined only for the well-off and unattainable for an average German worker, were made. This obvious and alarming gap in the market called for measures

²⁵ Bergsson, Kjartan . "The first Hybrid Vehicle by Dr. Ferdinand Porsche". Hybrid Vehicle.org. 25 Aug 2010 <<http://www.hybrid-vehicle.org/hybrid-vehicle-porsche.html>>.

²⁶ "Austro Daimler". Masterpiece-Automotive Replicas. 25 Aug 2010 <http://www.masterpieceautoreplicas.com/austro_diamler.php>.

²⁷ Deppe, Philipp. "Daimler-Motoren-Gesellschaft and motor racing". Mercedes Benz Passion eBlog. 25 Aug 2010 <<http://eblog.mercedes-benz-passion.com/2010/01/daimler-motoren-gesellschaft-and-motor-racing/>>.

²⁸ "For the Love of the Sports Car". Porsche Cars Great Britain. 25 Aug 2010 <<http://www.porsche.com/uk/aboutporsche/pressreleases/pcgb/?pool=uk&id=2009-09-18>>.

and various car manufacturers from Germany and abroad realized the potential within this market sector. They swiftly reacted and began to emerge with all sorts of small cars (or rather car projects) that were supposed to be affordable (e.g. Mercedes 170H or Steyr 55 to name a few).

Subsequently, as a result for the demand for affordable cars among average Germans, in 1933, Adolf Hitler addressed this issue and brought about an idea for a state-sponsored affordable people's car, an endeavor which came to general knowledge as the "Volkswagen program". The government's requirements were fairly simple – the car should carry 2 adults and 3 children comfortably and being able to travel at 100km/h (62 mph) simultaneously, while the car's price should be roughly the same of a small motorcycle at the time.²⁹

After evaluating the selection of designs, in 1934, the German government, or rather Adolf Hitler himself, appointed Dr. Ferdinand Porsche to be in charge of further research, development and production of such people's car and consequently of establishing a suitable car factory, simply because Porsche submitted the best design.³⁰ This very design was a foreshadowing of what would become the ubiquitous Beetle.

4.3. Volkswagenwerk GmbH

In 1936, after just two years of development and having spent 1.7 million Reichsmark, Porsche brought out a pre-production prototype labeled KdF (Kraft durch Freude – Strength through Joy) and in 1937 the Deutsche Arbeitsfront (German Labour Front) established a company called Gesellschaft zur Vorbereitung des Deutschen Volkswagens GmbH. It was renamed Volkswagenwerk GmbH a year afterwards and the premises were established in the newly-build KdF-Stadt, a town purpose-built for to accommodate the factory, later known as Wolfsburg³¹. Thus formally began what is known nowadays as Volkswagen.³² Its first product was named Volkswagen Type 1.

²⁹ Bytwerk, Randall . "Hitler and the Volkswagen". German Propaganda Archive. 25 Aug 2010
<<http://www.bytwerk.com/gpa/vw.htm>>.

³⁰ Hawranek, Dietmar. "Porsche and Volkswagen's Nazi Roots". Spiegel Online International. 25 Aug 2010
<<http://www.spiegel.de/international/business/0,1518,637368,00.html>>.

³¹ "KdF-Stadt - Wolfsburg". AIRRECCE. 25 Aug 2010
<http://www.airrecce.co.uk/WW2/imagery/Wolfsburg/USAAF_Wolfsburg.html>.

³² Bernstein, Marty . "The VW Story". Bloomberg Businessweek. 25 Aug 2010
<http://www.businessweek.com/autos/content/may2006/bw20060509_200145.htm>.

In 1945, after being involved in the Nazi war efforts during the Second World War, the company's only premises at Wolfsburg were bombarded and subsequently taken over by the American armed forces, who later handed it to the British military hands. Namely, Major Ivan Hirst was charged to manage the company. By then, the company made the civil Type 1 in scarce numbers, making off-road vehicles derived from the Type 1's design and various other military productions simultaneously.

For another three years, from 1945 to 1948, the company ran on 10% of its production capacity according to the Morgenthau Plan³³, making successive military production in charge of the British. Eventually, Volkswagen made it through the uncertain post-war times and in 1948, when it was given back to German hands, it played a crucial role in German economic post-war recovery onwards.

4.4. Post-War Growth

Heinrich Nordhoff (Born in June 6, 1899) took charge of the company after the British as a managing director. With the company's nearly 2/3 of the premises in Wolfsburg destroyed after an allied bombardment, prior to the end of the war, the company initiated the production of the Volkswagen Type 1 – the Beetle.

Nordhoff, prior to his management of Volkswagen, visited the United States of America countless times to observe GM's production, management and marketing techniques as a commercial and technical director in Opel.³⁴ Perhaps thanks to his experience with advanced car production techniques and his scrupulosity, or perhaps thanks to the post-war recovery boom, Volkswagen began to record some rather impressive numbers, as shown in the following two charts:^{35 36}

4.4 (a) Volkswagen Company Post-war Growth in Numbers			
Year	Total production of cars	Cars exported	Number of countries exported to
1948	19.244	4.464	5
1951	98.709	35.742	29

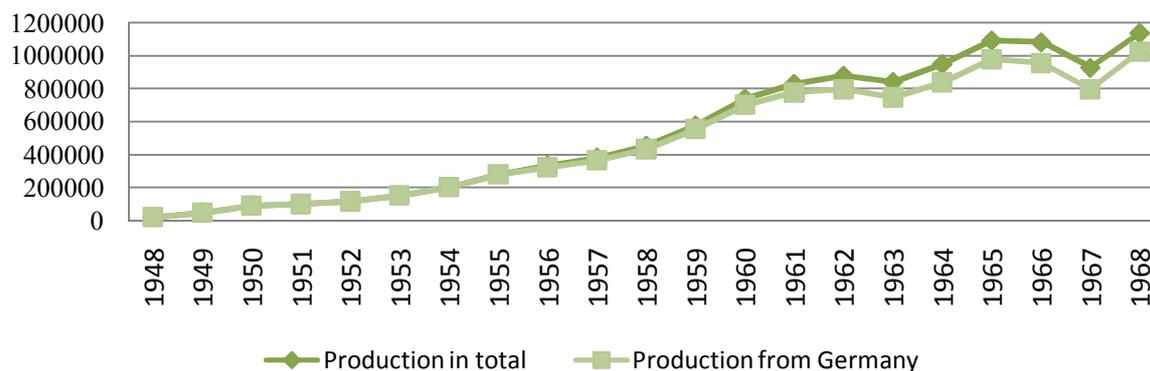
³³ "Morgenthau Plan". Everything2. 25 Aug 2010 <<http://everything2.com/title/Morgenthau+Plan>>.

³⁴ "Heinrich Nordhoff". WorldLingo. 25 Aug 2010 <http://www.worldlingo.com/ma/enwiki/en/Heinrich_Nordhoff>.

³⁵ Tuček, Jan. Volkswagen včera a dnes. Prague: Svět motorů, a. s, 1991.

³⁶ Barnes, Everett . "Beetle Production Figures". TheSamba.com. 25 Aug 2010 <http://www.thesamba.com/vw/archives/info/beetle_productionfigures.php>.

4.4 (b) VW Beetle Total Production 1948-1968



Nordhoff enforced the “one model” policy throughout most of his years in top management, where the main production of the company was based on the Type 1. Put simply, the majority of the company’s capabilities were concentrated on production of Type 1 and its derivatives and research and development concentrated solely on elaborating the company’s products.³⁷ Apart from the Beetle, the company produced the Type 2 commercial vehicle and a new car, called Karmann Ghia Coupe. The cars’ mechanics and drive-trains were vastly derived from the Type 1, due to the Nordhoff’s policy.

4.5. Volkswagen in Trouble

After the initial boom in production numbers of Wolfsburg factory in 1950s and early 1960s and an introduction of further new yet unpopular models, due to the “one model” policy of Volkswagen’s management, the company encountered a rather serious decline in the demand for its technically gradually outdated products. The resulting situation called for R&D of new and modern FWD drive-train concept. For the record, the comparatively same policy was enforced by the communist government management in Škoda at the time and consequently lead to severe problems for the company (see chap. Škoda history).

This urgent need for development of new FWD models to meet the declining demand for Volkswagen’s air-cooled, rear-mounted engine and RWD models was eventually realized by the management and it set out to seek further ways to address this problem.

Eventually, the company’s top management came with a solution and they decided to purchase the Auto Union in 1964 and in 1969, Volkswagen merged the company with NSU Motorenwerke, thus taking control of the brand Audi. This acquisition enabled Volkswagen to

³⁷ "Volkswagen Heritage". Unique Cars and Parts. 25 Aug 2010
<http://www.uniquecarsandparts.com.au/heritage_volkswagen.htm>.

gain necessary knowledge of water-cooled engines and FWD drive-trains, possessed by Audi, essential for the company's further development.³⁸ Moreover, Volkswagen took control of the Auto Union's factory and premises in Ingolstadt which, combined with a construction of Endem factory in 1965, enabled it to expand its production capabilities significantly.

The acquisition of new technology and new premises allowed Volkswagen to develop new and technically advanced models to meet the demand and thus nibble at the rapidly growing FWD car market. Starting with the Passat model in 1973, derived from Audi 80, the company entered a new and fairly significant era of expansion. The Passat was followed by the Scirocco a year later and by the well-known Golf the year afterwards and Polo in 1975. These were the cars' names for European market elsewhere they were sold under altered names (e.g. Santana or Quantum for Passat, or Caribe or Rabbit for Golf, etc.).

All the above mentioned models were mere derivations of Audi products, redesigned and rebadged. From then on, VW concentrated on further development of its products and introduced station-wagon, hatchback, diesel or even 4x4 (or 4WD) modification. This, combined with fairly new marketing techniques and radical TV advertising allowed the company to further expand its markets and production worldwide, concentrating a significant amount of effort and resources on exporting to the United States.

4.6. Way to the Top

The success of its new models also signified that the Beetle production was halted altogether in 1978 and moved to Mexico, thus enabling to fully utilize the European production capabilities of Volkswagen for its new models.³⁹ Although VW was relatively successful with its models in the USA, unfortunately, electrical problems emerged with its most popular Rabbit Mk2 (Golf) model sold in the States in early 1980s, damaging the company's reputation enormously. Sales of VW products in the American market started to decline steadily, as many of car consumers realized that Japanese brands were offering relatively more sturdy though far more reliable products.

Although VW addressed the issue, a flood of new Japanese products to the States meant that VW was being slowly pushed out of the market. This decline forced VW's management to

³⁸ "Audi NSU Auto Union Merger Anniversary". Sports Car Digest. 25 Aug 2010
<<http://www.sportscardigest.com/audi-nsu-auto-union-merger-anniversary/>>.

³⁹ Tuček, Jan. Volkswagen včera a dnes. Prague: Svět motorů, a. s, 1991.

reconsider and relocate the company's efforts and lead to the decision to initiate expansion into CEE markets, thus addressing the increasing gravity of the situation.

The movement up CEE markets was roused in 1982 by a decision to purchase Seat, a Spanish car manufacturer, when VW was run by Dr. Carl Horst Hahn. Such merger allowed VW to manufacture low-end cars, essential for the expansion eastwards. The acquisition process started off by signing a cooperation agreement and purchasing 51% share first and by the end of the year 75% share in the company by VW, finished by an outright purchase of the company in 1990.⁴⁰ This was followed by the acquisition of Škoda the same year, enabling VW to concentrate yet again on its primordial low-end market.

5. Privatization of Škoda

As was already briefly outlined in the chapter on Škoda's history up to early 1990s, prior to its privatization, Škoda was in poor and pitiable position. The backbone of the company's problems was within the socialist government-controlled management and irrationality and senselessness of it. The inability to expand the company significantly for almost 40 years, basically non-existent R&D (aside from what was necessary to develop "new" models, majorly derived from the previous ones) and the absurdity of the company's management led the company towards and almost certain bankruptcy that was only to be redeemed by finding it a strong foreign partner.

The following chapter will therefore concentrate on the process of privatization of Škoda, where governmental conditions and subsequent competition between VW and Renault is described. Furthermore, we shall note how the consequent decision was made and how the initial terms of acquisitions were settled.

5.1. Situation Prior to the Privatization

The major problem, most perceived by Škoda's final customers laid in Škoda's inability to meet the demand for its products in the domestic market (and further on foreign markets exported to) throughout the 1980s. Although the demand in the domestic market was estimated at 250.000 units in late 1980s, Škoda only produced 130.000 units plus the

⁴⁰ "Our history so far". SEAT. 25 Aug 2010
<<http://www.seat.com/com/generator/su/com/SEAT/site/company/history/main.html>>.

exports.⁴¹ This meant that the market had to set up appalling waiting lists that led most interested people towards despair, driving them eventually towards corrupt practices and bribery, as was so common through socialist period.

The company also faced a fierce indebtedness (reaching 7 billion Kčs or 251 million USD by early 1990s (Pavlínek 79)) and an inability to cover the costs of day to day operations, as well as an incapacity to pay the suppliers of components necessary for its product assembly. A prospective future for Škoda required it to expand and develop its premises, which required an immense amount of funds to be allocated yet nobody wanted to grant, be it the government or domestic and foreign banks, all of which refused the company's requests for a loan.

Aside from the inability to meet the market's demand and the immense indebtedness of the company and subsequent insolvency, Škoda had to solve a number of issues, essential for its survival. In a list, it also had to face the following problems:

- To gain staff enough technically skilled and qualified in sufficient numbers to meet the demand for expansion
- To expand the company's premises as well as the area of a market involved in
- To expand the production and re-establish R&D
- To improve the quality of its products, significantly inferior to the competition
- To bring the increase in debt to a halt, steadily decline the indebtedness
- Expand to other market segments as well as to Western European market
- Repay the debt and reach profitability

Finally, as a result of increasing problems within the company, the government decided to privatize the company as the only way to redeem it from bankruptcy. The public tender to privatize Škoda was announced in early 1990s. For potential foreign buyers, Škoda represented a considerable means of expanding to the CEE markets as well as to Asia, where Western car manufacturers had very little or no presence at the time, thus making the privatization process an alluring enterprise.

⁴¹ Pavlínek, Petr. A Successful Transformation? Restructuring of the Czech Automobile Industry. Heidelberg: Physica-Verlag, 2008.

5.2. Privatization Process

The difficulties that the company was in were by no means a secret and although the public tender for privatizing Škoda was announced in 1990, the alluring appeal of purchasing the company was fairly significant and the first, yet unofficial contacts between Škoda's management and foreign car companies regarding the privatization and possible JV were already established in December 1989. An incredible twenty-four different companies were registered for the tender, but only eight of them expressed a serious interest (including BMW, GM, Renault, Volvo, VW, Ford, Fiat and Mercedes Benz) (Pavlínek 80).

The immense interest in purchasing Škoda generated by Western car companies suggested that although Škoda was in serious trouble when resulting in privatization, the company itself, its heritage and history were profoundly respected and Škoda was considered and perceived as an overall successful company, despite the imprudent socialist government management and the isolated conditions that it had to operate under for 40 years. Furthermore, the companies interested were apparently eager to expand to CEE markets and Škoda was a brilliant intermediary to do so.

All the above mentioned meant that the Czechoslovak government had a significantly strong position for bargaining the terms of the privatization. The government was not ready to agree on "total merger", where the target company would be swallowed by the buyer, thus cease to exist. Škoda had obviously a significant heritage and bore a considerable legacy as one of the oldest car manufacturing companies in the world. It was obviously considered that it would be a waste to transform the company with such heritage to a mere assembly plant for foreign car models and that it was necessary to maintain the company's domestic position for suppliers. A foreign partner therefore had to meet a following list of requirement that was, though unofficial, compiled by the government (Pavlínek 81):

- Preserve brand name of Škoda
- Preserve the final assembly of automobiles in Mladá Boleslav
- Double the production capacity from 180.000 units in 1990 to 350.000-400.000 units by 2000
- Maintain the links with domestic suppliers
- Improve the produced engines that they would meet Western European emission standards

- Preserve the domestic R&D
- Maintain the number of staff at the time (20.698 in 1989, 19.800 in 1990)
- Construct a new engine plant, capable of producing 500.000 units in the long run

After tedious discussions with delegations of all the eight companies interested (VW's delegation was the first to visit Škoda in early 1990, represented by its president Carl Horst Hahn), the field was sorted out and eventually, two car companies, Volkswagen and Renault, were chosen to be the finalists for privatization in August 1990 by Czech Ministry of Industry and Electrical Engineering. From then on, the race to be allowed to acquire Škoda heated up.

5.2.1. Renault's offer

The delegation of the French car company Renault first offered to terminate the production of Škoda Favorit and instead, replace it with Renault's own model derived from R18 model or with an outright new small car called Renault Twingo. Additionally production equipment and premises were supposed to be rented to Renault and used to produce Renault branded products, thus eliminating the brand Škoda altogether and making it a "total merger" (Pavlínek 81).

The French organized banquets for press to represent their products and to mediate their political arguments, based on allegedly "naturally good" relationships between the French and the Czech, while speaking disparagingly about the negative experience of the Czech with the Germans, regarding the Second World War. Overall, apart from not very detailed production program, Renault played on an emotional note to persuade the Czechoslovak government to pick them instead of Volkswagen.

Apart from somewhat sloppy plans regarding the production program, Renault delegation's offer did not meet the government requirements not to make it a "total merger" and that, aside from many other points, the brand Škoda should not diminish altogether. Consequently, Renault was informed by the Czech Ministry of Industry and Electrical Engineering that they decline their offer, which was somewhat a shock for Renault. As a result, Renault requested to be given two more months to prepare a new offer that would meet the government's requirements. The government agreed.

Due to this turn of events, Renault withdrew to reconsider its requirements and eventually, they came up with a new offer more suited to the Czechoslovak government's needs. Newly, the merger was to be realized in form of a merger, where Škoda would transform into a new

company, 60% of which would be owned by Czech government and 40% by Renault and Renault's total investments in the company would top 2.6 billion USD by 1999.

The production of Škoda Favorit was to be retained and even increased to 250.000 units annually. Furthermore, Renault planned to produce its R19 Chemade in the premises of Škoda by 1993, side to side with Favorit. Eventually, the production capabilities of Škoda were to increase up to 400.000 annually, 60-70% of which was to be intended for export to CEE markets, meeting the government's requirements. Additionally, the chain of suppliers was to be retained and implemented by foreign ones. Renault also planned to increase the employment within Škoda's premises.

To address the issue of constructing a new production plan, Renault came up with a solution to build a plant not only for producing engine units at a rate of 500.000 units annually, but to produce gearboxes and other drive-train mechanical components as well. To crown the new offer, for late 1990s, Renault intended to introduce a new, concern-wide model, the body of which was to be designed by Škoda's design engineers.

5.2.2. Volkswagen's offer

VW's first and further only slightly modified proposal was formed when VW's managers worked closely with Škoda's managers, based on their links prior to 1990s, giving a significant advantage to VW (Pavlínek, 82).

VW's delegation was familiarized with the government's requirements and modified its offer accordingly, not because they had to, but because the government's requirements corresponded neatly with VW's own business strategy for CEE markets (To sell cheaper cars outside Western Europe without damaging the VW's brand image). As a result, VW's plans agreed nicely to the government's requirements.

Just like Renault's proposal, VW agreed to continue the production of Favorit and increase the annual output of the product to 250.000 units annually. But this instance was the only case in which the two offers of competing companies were parallel.

Unlike in Renault's offer, VW offered to establish a direct capital relationship JV of VW and Czechoslovak government. Furthermore, Škoda brand was to be preserved, being equal to other three brands of VW Group, Audi, VW and SEAT and was to retain and manage its own R&D, purchasing and sales. Furthermore, VW pledged to initialize the process of acquisition

by purchasing 31% of Škoda shares, then gradually increase it to 70% share (this was to be rounded out by a 100% ownership by 2000)⁴². VW planned to gradually increase the quality of Favorit, making it in a modernized new model (Škoda Felicia, based loosely on Favorit was introduced in 1994 and replaced the Favorit⁴³).

Additionally, VW planned to invest 3.9 billion USD by 1996 and 6.6 billion USD in total by 2000, allocating the funds on establishing a new engine plant that was to produce 1.400-2.000 cm² engines as well as on further development of Škoda car company. Distribution network was supposed to be developed under VW's guidance, yet distinct from the VW's and in return, VW required that all Škoda's domestic suppliers will comply with VW's standards and requirements and be able to join hands with VW's suppliers when appropriate.

When compared to the offer of Renault's delegation, VW's proposal was far more liberal and generous and, essentially, it was not so limiting for Škoda itself than the more reckless one of Renault. It meant that VW's was offering more independence for Škoda than its rival which was essentially what the government was looking for in the tender and as a result of VW's cooperation with Škoda when making the offer, VW had quite the convenience to pull ahead.

5.3. The Choice

When both proposals were submitted for evaluation, Škoda's unionists set off to visit both Renault and VW to assess their relationship with Škoda. They supported VW's offer because it offered significantly larger potential for development of the company, whereas Renault obviously did not care about Škoda brand's future. Furthermore, their support for VW was enhanced by somewhat greater familiarity between Czech and Germans, due to historical relationships and their consequences. Additionally, Germans were perceived as fiercely anti-communist, whereas Renault's unionists also consisted of communist unions, which, in context of post-socialism era, rather passed the ball to VW. To support the choice of Volkswagen, Škoda unions organized demonstrations on government's premises to express their keen support and point out the inadequacies of Renault's offer, whenever the government inclined on the French side. Furthermore, the question of unions' strike was hanging in the air.

⁴² Bílá, Lenka. "Intercultural management at Škoda Auto". TC World. 30 Aug 2010 <<http://www.tcworld.info/index.php?id=76>>.

⁴³ Králík, Jan. Škoda - od kočárů k limuzínám z vrchlabí 1864-2008. Prague: Moto Public, 2008.

Aside from the substantially important influence of Škoda's unions, the choice of VW was additionally backed up by recommendations, issued by renowned international advisory companies (the best known of which was Price Waterhouse Privatization Services) as well as by government's experts, Škoda's high and low-management, engineers and employees. (Pavlínek 83)

As a result of this mutual support for VW's offer, the government chose VW to form a JV with Škoda, announced on December 9, 1990. The first official agreement with VW was signed on March 28, 1991 and the resulting JV started its existence on April 16, 1991.

Škoda was split in two separate branches, first of which consisted of Škoda Plzeň heavy engineering and second of which Škoda car manufacturer, that has been renamed Škoda Automobilová, a. s. and sold to VW. Volkswagen's investments in the acquisition process are best described by the chart below (Pavlínek 84). As a result of VW's extensive investments in JV with Škoda, the Czech government granted two year tax holiday to VW by the beginning of JV in 1991.

5.3 (a) Volkswagen's Total Investments in Acquisition				
Year	% of equity in JV owned by VW	Investments in working capital	Investments in repaying Škoda's debt	Total investments
1991	31%	500 million DM	120 million DM	620 million DM
1994	50,5%	350 million DM	40 million DM	390 million DM
1995	70%	350 million DM	40 million DM	390 million DM
2000	100%	650 million DM	Debt free	650 million DM
Investments in total		2,05 billion DM		

6. Position of Škoda in VW Group

From the formation of Škoda-VW JV on, Škoda has been incorporated amongst other car brands of VW Group, playing a certain role in Group's brand strategy and market orientation. Throughout the JV, Škoda, along with its corporate colleagues, had to endure multiple organizational changes and shakeups according to the change in the Group's policy. The following lines will therefore describe the position that Škoda held and holds within the structure of VW Group and its obligations and function within the Group.

Volkswagen wanted to purchase the company for various reasons, the most important of which was to penetrate CEE markets by means of acquiring Škoda. After Škoda-VW JV was formed, Škoda was implemented amongst three car brands within VW Group – Audi, Seat and Volkswagen, thus supplemented for the fourth. Volkswagen Group, then consisting of four distinct car brands, made an effort and considerable investments in order to maintain the distinctive image and identity of each of its brands.

From then on, Audi was a car brand connected to luxury and exclusive cars aimed for high the end of the car market, making sporty executive cars of high quality standards and posh feel. Volkswagen brand had a position of a manufacturer, offering products of superior technical forwardness and engineering competence for higher end of the market, yet not so high as to compete with Audi. Seat, along with Škoda, were both intended to be entry-level brands offering reasonably low priced and comparatively basic cars for the lower end of the market.

Initially, VW Group was criticized for having two entry-level brands and analysts were concerned of the validity of this move. However, VW argued that having two entry-level brands would ensure high competitiveness on the lower end of the market, thus it would benefit the target customer in terms of value-for-money.⁴⁴

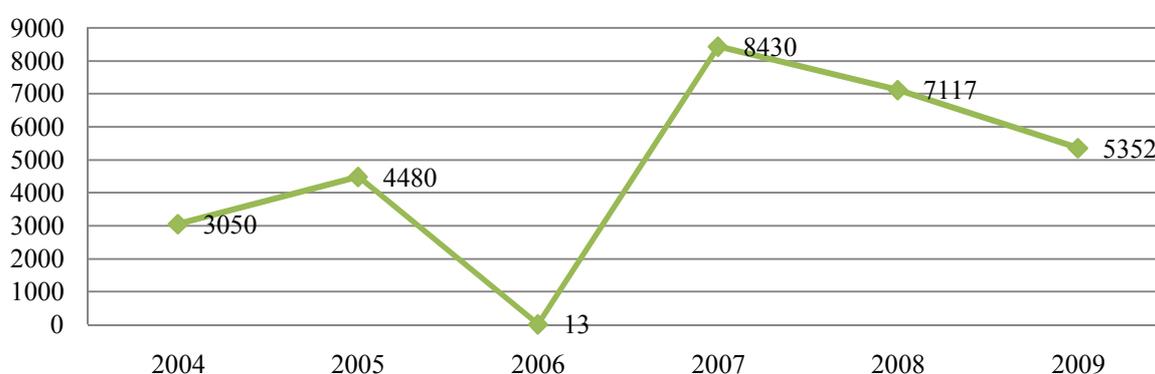
In addition, even though both brands were intended to be directed at the same end of the market, their market segments were supposed to be distinct by making Seat brand appeal to younger clientele due to its youthful and fresh image, whereas Škoda was supposed to mirror economic competence and sophistication, thus to appeal to a more mature clientele. Furthermore, all four VW Group brands were supposed to be managed separately, all under general directions of VW Group's CEO.

Although the original plan was to penetrate CEE and Asian markets via Škoda and less by Seat, the entire VW Group eventually suffered from having two entry-level brands and two higher-market oriented brands, all of which were managed very independently. All manufactured products within VW Group were recognized to be more or less alike in terms of mechanical components, yet differently styled on the outside and on the inside. Consequently, customers realized that by purchasing Škoda and Seat products, they get cut-price yet still high quality products.

⁴⁴ "Volkswagen's Acquisition of Skoda Auto: A Central European Success Story". IBS Center for Management Research. 01 Sept 2010. <<http://www.icmrindia.org/casestudies/catalogue/Business%20Strategy/BSTR262.htm>>.

In case of Škoda, its CEO Vratislav Kulhánek was replaced by Detlef Witting in October 2004, a former Škoda director, responsible for sales, finance and marketing.⁴⁷ From then on, Škoda had always a VW-appointed chairman of the board of directors, thus it lost its independence and became subordinated even more severely to VW Group. Furthermore, after the differentiation, Škoda, along with all the other brands, is obliged to send annual dividends to VW,⁴⁸ first of which were sent in 2004 amount to 122 million USD (Pavlínek 111). The outline of dividends paid to VW Group by Škoda as a subsidiary 2004-2009 are as follows.⁴⁹

**6 (a) Dividends Paid to VW Group
2004-2009 (million CZK)**



From the VW Group shakeup on, Škoda was newly placed as an entry-level brand of classic VW division. All significant and important aspects of the company's operations are submitted to the directions and general strategy of Volkswagen Group. Further and drastic, yet intended alterations the company's management were blocked by Škoda's unions.

The most significant way by which, aside from many others, Volkswagen Group mines from Škoda in terms of manufacturing is an assembly of three-cylinder engines in Mladá Boleslav, used concern-wide to supply entry-level low-cost cars of the VW Group.⁵⁰

As a solution to the cannibalism problem occurring prior to the restructure of VW Group, Škoda's aim was realigned towards CEE and Asian markets, so that VW Group could more easily and efficiently penetrate the emerging markets there, in accordance with original

⁴⁷ "Detlef Wittig Says Goodbye to Škoda." Škoda Auto. 09 Sept. 2010. <<http://new.skoda-auto.com/COM/about/info/news/News/Pages/DetlefWittigSaysGoodbyetoSkoda.aspx>>.

⁴⁸ "Přidáme Plyn,plánuje Nový šéf Škody." Ekonomika IDNES.cz. 09 Sept. 2010. <<http://ekonomika.idnes.cz/pridame-plyn-planuje-novy-sef-skody-db3-/ekonomika.asp?c=2004M289H01F>>.

⁴⁹ "Annual Reports". Škoda Auto. 8 Sept 2010 <<http://new.skoda-auto.com/com/about/investors/annual/Pages/Annualreports.aspx>>.

⁵⁰ "Skoda Introduces New 1.2L Three Cylinder, Coming to a VW Soon." Autoblog Green. Web. 10 Sept. 2010. <<http://green.autoblog.com/2009/07/03/skoda-introduces-new-1-2l-three-cylinder-coming-to-a-vw-soon/>>.

intentions. However, cannibalism problem still prevails, yet on the smaller scale. It is requested that the Škoda should concentrate on entry-level market even more than before and plans to abolish the development of Superb's successor are in motion.⁵¹

7. Analysis of the new Škoda

The following, rather extensive chapter will be focused on the transformation processes that were carried out throughout the years of JV with VW that changed the face of the only Czech car brand most significantly. Due to various issues that were outlined hitherto, Škoda had to undergo large-scale transformations in every aspect of its operations in order to successfully compete with western car makers. Therefore, the following subsections will hereafter analyze the transformation processes carried out in the areas of human resources management, production and quality improvement, new product development and positive image building, all of which had significant impact on Škoda as we know it today.

Škoda earned a significant domestic and even foreign awareness (although not always in a positive way) and since the Czech government requested not to let the brand diminish, its dissolution was no longer an option. Therefore, according to Vratislav Kulhanek, chairman of the board of management at Skoda Auto, the rebirth of Škoda had to be tackled in following three steps:⁵²

1. Improve and sophisticate the production and human resources management, increase the quality of the products
2. Charge at the market with new products of high quality standards (Octavia, Fabia, etc.)
3. Consolidate the company's brand image through relentless and highly-efficient marketing mix

The resulting process was estimated to take between four and six year, in order to substantially establish the improved brand image of the company.⁵³ But beyond the effort that

⁵¹ "Volkswagen Přistříhne Škodě Křídla, Je Moc úspěšná." Auto IDNES.cz. 09 Sept. 2010.
<http://auto.idnes.cz/volkswagen-pristrihne-skode-kridla-je-moc-uspesna-fsb-automoto.asp?c=A100903_165001_automoto_fdv>.

⁵² Ciferri, Luca. "New flagship model will complete Skoda rebirth". Automotive News Europe. 7 Sept 2010
<<http://www.autonews.com/apps/pbcs.dll/article?AID=/20010702/ANE/107020793>>.

⁵³ "In a Czech Plant, VW Shows How to Succeed in the East". The New York Times. 7 Sept 2010
<<http://www.nytimes.com/1993/06/22/business/in-a-czech-plant-vw-shows-how-to-succeed-in-the-east.html?pagewanted=2>>.

the company had to invest in order to tackle the issue, it was expected that the sole fact that VW owned Škoda would help improve the image of its own, due to VW's well established reputation for engineering superiority and state-of-the-art quality products.

7.1. Human Resources Management

After VW established JV with Škoda on April 16, 1991, it faced a serious issue of transforming the human resources management within Škoda (by that time outdated and archaic) to comply with standards common within Western companies, thus ensuring Škoda's long-term survival and prosperity. The default situation VW found themselves in required targeting, alteration and altogether transformation of essentially every aspect of the company's human resources management.

This "change management" was made necessary due to the social situation after the Velvet Revolution in December 1989,⁵⁴ which resulted in severe changes in political, economic and social structure of the country. The management practices applied beforehand proved ineffective and impracticable within newly established free market economy. Aside from obvious pressure resulting from political changes in 1989 and 1990, Volkswagen was further forced to restructure Škoda's human resources management due to the problems elaborated in the following lines.

The major problem resulted from previously applied political structure during the communist era. Although staff was technically skilled enough, lack of encouragement and a generally approved standard of "not sticking out is the best way to get around" contributed significantly to production inefficiency and overall substandard quality of products and components..

Furthermore, the social structure enabled average workers to hamper and complicate the work of low and mid-level management, which proved rather dysfunctional and incapable of understanding and leading its subjects.

VW's experience and expertise in transforming human resources management became apparent using the example of Seat, a brand of Volkswagen Group, which acquired ISO 9002 certification (Model for quality assurance in production, installation, and servicing⁵⁵) which acknowledged that Seat complied with international quality standards after having

⁵⁴ "Panic! on the Streets of Prague". Prague-Life.com. 31 Aug 2010 <<http://www.prague-life.com/prague/velvet-revolution>>.

⁵⁵ "What is ISO 9002?". ISO 9001 Experts. 31 Aug 2010 <<http://the9000store.com/what-is-iso-9002.aspx>>.

transformed its management under VW. As Hahn Carl, a former VW's CEO put it: *“With Seat, we proved that by acquiring a company we not only offer sufficient independence, that we not only keep the company alive but we also reinforce it and retain its cultural identity”*⁵⁶

To address the issues necessary for a successful transformation, a 5-member board of directors was established (the chairman and a human resources representatives being Czech, quality, marketing and inspection were represented by Germans) and a “kick-off” workshop was organized on November 1990, during which the problems existent were identified, targeted and allocated an appropriate solution. Both VW's and Škoda's management was involved in the process and the meeting identified 21 separate issues that were to be solved within following six months (Zadražilová 30):

7.1 (a) Chart of Issues Compiled After the Kick-off Workshop	
1) Create a new organizational scheme of human resources management	2) Amend working order
3) Create a new wage and premium system	4) Amend internal ordinances
5) Evolve principles of personnel work	6) Evolve concept of preparing dwelling space
7) Introduce data computer processing within human resources area	8) Analyze the structure of staff
9) Plan investments in human resources	10) Evolve concept of both qualitative and quantitative personnel planning
11) Build a good bargaining position for a further collective agreements	12) Standardize methods of selecting new staff members
13) Amend preparation and processing of forms (and contracts)	14) Optimize the management of new staff adaptation process
15) Analyze the necessity of establishing new contributory sickness fund Škoda	16) Describe existing processes
17) Evolve concepts of improving	18) Analyze the double occupation

⁵⁶ Zadražilová, Dana. *Tranformační procesy v řízení lidských zdrojů JV Škoda-Volkswagen*. Prague: VŠE v Praze, 1998.

foreknowledge of the staff	phenomenon
19) Optimize plan of working stations, description of activities and requirements imposed on the staff	20) Evolve the principles of guiding co-workers
21) Evolve motivational system of independent valuation	

Each of the 21 issues was allocated two members of management, a Czech manager responsible for execution and results and a German manager who was responsible for methodology and know-how transfer.

This “tandem management” principle was then applied on 48 key element (there were 48 teams in total) of transformation and the team was generally allocated for 3 years (from 1991 when JV became operational to 1994 when transformation process was to be finished). The German advisor administered know-how and the Czech representative was apprenticed to be gradually independent, and both team members were acquainted with each other 6 months in advance. The transfer of responsibility from German to Czech was gradual. Furthermore, job rotation techniques were commonly applied. The tandems had 4 basic pillars – cooperation, honesty, sympathy and directness, all of which were essential for wholesome functioning of the tandem.

7.1 (b) Tandem Teams Allocation in Škoda	
Sector	Number of allocated tandems
Human resources	1
R&D	8
Marketing	19
Business and controlling	12
Chairman of the board of directors and subject sections (e.g. planning, revision, PR)	8

Between 1991 and 1994, when tandem principles were applied, 48 teams were established, occupying above mentioned company sectors. Among many changes carried out during that three year period, most significant ones are as described by the following subsections (Zadražilová 39):

7.1.1. Acquiring New Staff

Alluring the potential workers and staff had to be planned attentively and executed cautiously, because resemblance with communist era slogans and practices was feared. The involvement of the applicants within party's activities was no longer assessed as a key factor and applicants were chosen based on their expertise, experience and growth potential.

Furthermore, Škoda had workers purpose-educated in Škoda's own training college. Various school graduates were allured by organizing scholarly lectures, company scholarships and by establishing trainee (150 working places) and graduate (cooperation on theses) programs. Furthermore, applicants were chosen based on a motivation based in their area of studies.

7.1.2. Mid and High Management Development

Potential managers newly underwent intense programs of personal development in form of 2-3 week seminars, on-the-job training and other methods. Such people elaborated their learning skills, initiative, creativity, responsibility and various other "people skills". Furthermore, they learned to use just the right rate of encouragement and pressure to maximize the productivity of their subjects.

7.1.3. Low-level Management Development

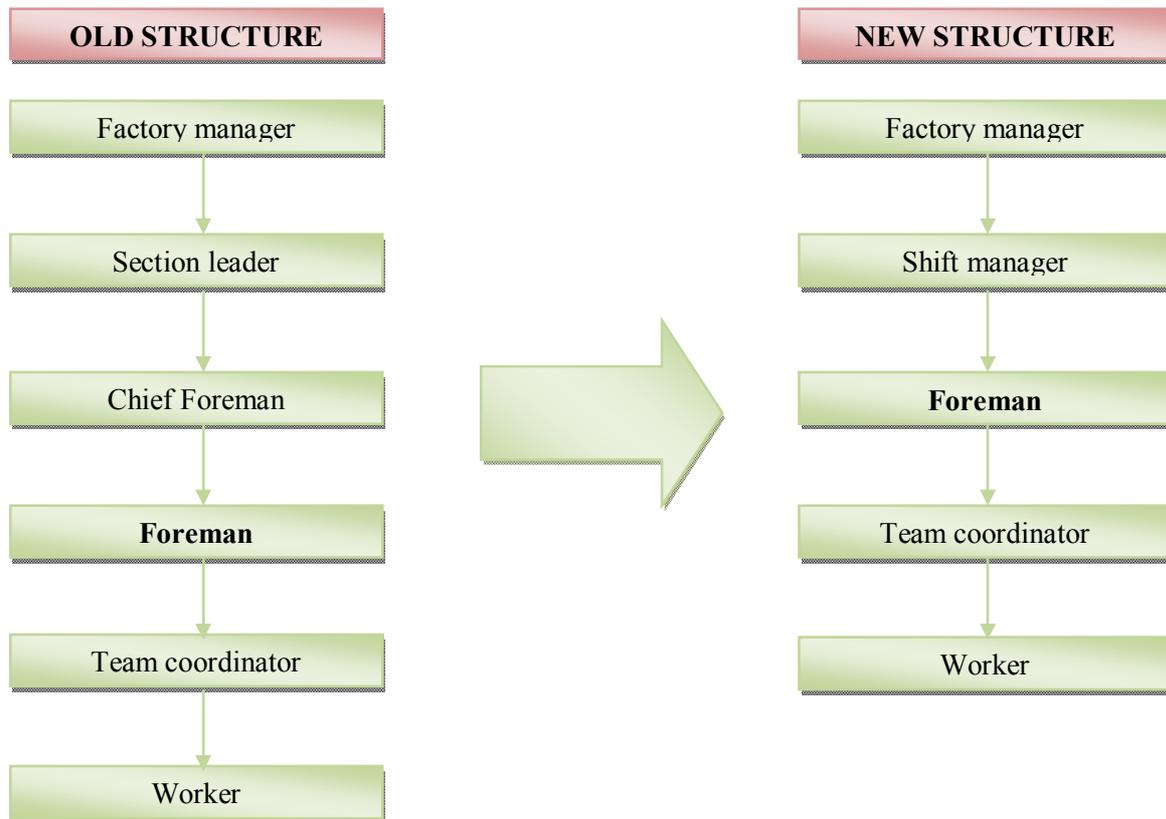
VW recognized the significant importance of low-level management in relation to productivity, efficiency and quality. Due to poor low-level management organization prior to the acquisition, it made it imperative to radically transform the area in order to enhance and improve overall productivity.

There were 560 foremen in total in low-level management in 1991. As the redundancies were unacceptable, all 560 foremen were divided into three groups as following (Zadrazilová 61):

7.1.3 (a) Foremen Capability Structure	
27%	Unfit for people management
30%	Fit for people management without further necessary development
43%	Fit for people management though further development was necessary

The foremen, who found themselves in the first class, unfit for people management, were relocated elsewhere to lower positions. The people from third class underwent on average 10 days of seminars and lectures to develop their general (time management, development of abilities etc.) and expert skills (business principles, health and safety etc.). The people fit for the job of foremen were further educated as well, yet on lower scale.

7.1.3 (b) Change in Organizational Structure of Production Division



Additionally, since May 1994, weekly meetings of groups of 3-6 foremen took place to solve up-to-date problems and issues, while under watch of psychology advisor to ensure maximum efficiency. Furthermore, 150 of them were chosen to undergo a series of observational trips to Audi Ingolstadt in 1994-1995 to enhance their technical competence. Consequently, the most talented and ambitious from the group were chosen to be employed in mid and high level management.

As a result of changes in low level management, the organizational structure of production division changed and simplified accordingly, as described by the diagram above (Zdražilová 61-62).

7.1.4. Creating Wage System

Prior to the acquisition in 1991, due to political and social structure, evaluation of management staff and workers differed only by 10% and average workers, due to overtimes and so popular double occupation (one employee occupying two job positions simultaneously) in one factory commonly out-earned their superior, making management position unappealing. Consequently, poor, reluctant and inactive management was very

common. To address the issue of inefficiency, the wage system had to be significantly redesigned.

The model of wage system within Škoda was formed when utilizing the inspiration that came from inside of VW as well as from the outside. The system had to be reformed in order to comply with Western European standards. Newly, next to a tariff sum, performance bonuses, company bonuses, superior bonuses and consideration of labor market were introduced, making the wage system as stimulating and inspiring as possible in order to enhance efficiency and productivity.

7.1.5. Innovation of the Company (Innovatory Movement)

A system of continual optimization had to be introduced in order to sustain company's growth and continual progress towards the top. VW therefore adopted its "Der Kontinuierliche Verbesserungs-Prozeß hoch Zwei" (Continual perfection process squared) principle which conveyed various methods of streamlining the production process, thus making most of the available resources.⁵⁷

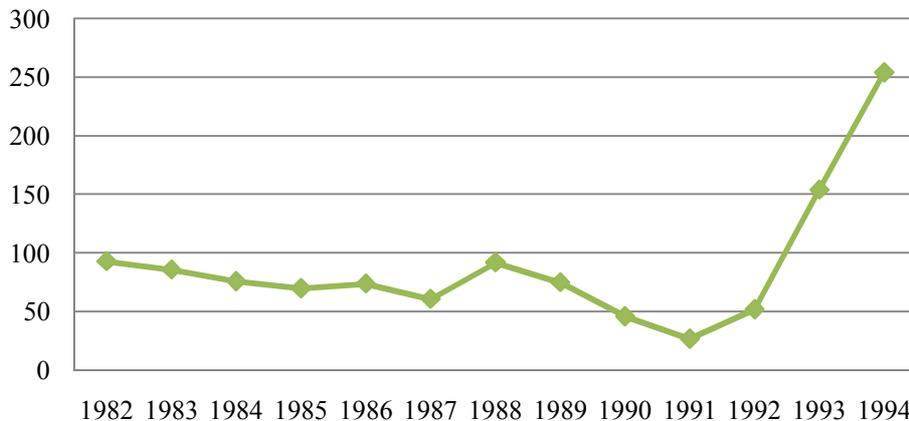
In conformity with the principle, the company had to make best of each and every qualified employee and the field of action of all low managers was significantly widened in order to apply all the potential.

Furthermore, 75% of all amendatory proposals (initialized by even the lowest employees in order to improve efficiency), submitted since the adoption of the principle, were carried into effect in three months after the submission. From then on, all amendatory actions were to be encouraged by the management on all levels, followed by various bonuses for all the people involved. Although the overall quality of human resources management skyrocketed upwards, further issues in production quality had to be tackled to be worthy of the desirable ISO 9002 quality certificate.

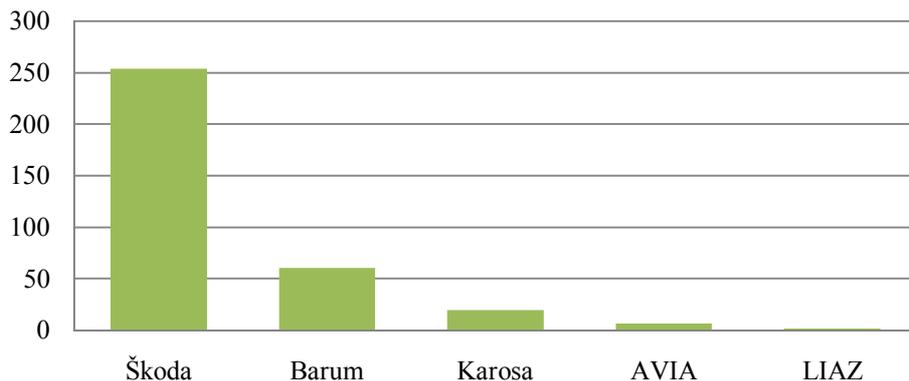
The effect this encouragement brought along with it, within Škoda and in context of other major manufacturers within the automotive industry in the country, is apparent from the following three charts (Zdražilová 83):

⁵⁷ "Total Quality Management: A Continuous Improvement Process". PHCC Educational Foundation. 31 Aug 2010 <<http://www.foundation.phccweb.org/Library/Articles/TQM.pdf>>.

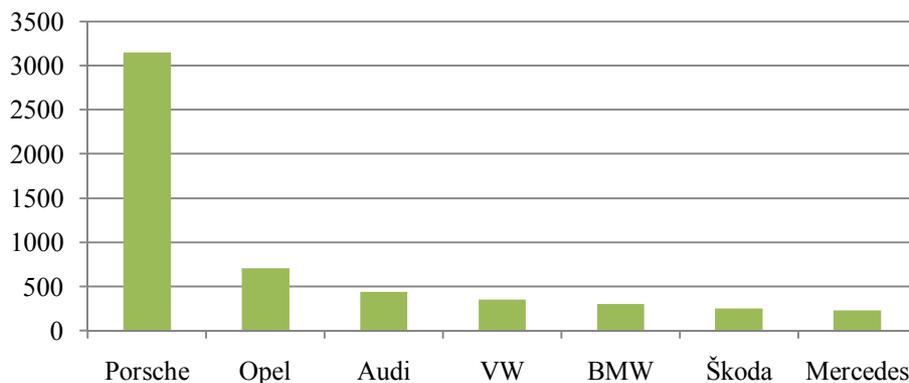
7.1.5 (a) Number of Amendatory Proposals per 1.000 Workers



**7.1.5 (b) Number of Amendatory Proposals per 1.000 Workers
1994 Czech Automotive Industry**



**7.1.5 (c) Number of Amendatory Proposals per 1.000 Workers
1994 Global Automotive Industry**



7.1.6. Results of HR Management Transformation

Results of this human resources management transformation influenced Škoda from 1994 onwards quite significantly. The employee has been given a completely new, innovative role in the company. The structure of the staff changed rather considerably during 1991-1994 period, as described by the following chart (Zadrazilová 22 and 86):

7.1.6 (a) Staff Structure Development 1990-1994				
	1990	Consisting of	1994	Consisting of
Employees in total	19882	24,5% administrative employees 75,5% workers	17024	32% administrative employees 68% workers
Portion of female workers		32,3%		29,2%
Foreigners		10%		1%
Trainees		10%		6,4%

The staff identified themselves with the company, its products and culture. This movement towards company pride became apparent in 1994 during the introduction of a new product, Škoda Felicia. Over 800 exhibitions have been organized to represent the product to over 14 000 employees of the company that were involved in production process, making them feel proud for the result of their endeavor. Moreover, the average wage within the company exceeded the national average wages of 295 USD in 1995 by 40%.⁵⁸

The resulting company culture of Škoda is nicely apparent from various elements, compiled from company documents and quotes of managers (Zadrazilová 106):

- We not only want to be good, but thanks to innovation, we want to be the best in class
- We belong to Europe, we want to get to the EU, the most important market for us is right there
- Through dialogue and support of VW, we find our successful way
- Dereliction of hierarchical structure is necessary, “no ranks – no titles” is the new way
- We are severely customer oriented – all our actions are aimed at making best of our customers, in and out

⁵⁸ Flek, Vladislav, and Večerník Jiří. Employment and wage structure in the Czech Republic. Prague: Czech National Bank, 1998.

- The company needs our boundless devotion. Our personal interests often have to withdraw
- We can retain Škoda brand only by orienting ourselves on performance
- We want to represent the “green” way of thinking in Czech Republic

7.2. Production and Quality Improvement

To succeed in the European markets in context of fierce competition, it made it an imperative to increase quality of production significantly, in accordance with the three step plan of rebirth. Up until JV with VW, Škoda had no defined quality management and its production methods were sloppy and outdated. Furthermore, Škoda's products were mocked all over the Western Europe for their inferior quality and notorious unreliability.⁵⁹ Just to put that in perspective, while VW Polo owner made two claims on average on his car during the first year of running, Škoda Favorit owner made eight claims on average over the same time period.⁶⁰ In addition, before forming JV with VW, approx. 70% of assembled cars had some sort of defect that had to be repaired on factory floor (Pavlínek 94) and after the Velvet Revolution, almost 1/3 of all the cars' chassis were rendered spoilage due to incapable staff.⁶¹ The inferior quality of the company's products was an increasing burden to face Western markets with.

Quality was and still is increasingly one of the most sought after aspects of automotive products, right aside from safety and economy.⁶² And as the target of every modern company is to satisfy its customers, hand in hand with sales, Škoda was forced to comply. In order to ensure the competitiveness of its products on European market scale and even beyond, Škoda's production techniques and methods had to be dramatically redefined. Only by that could the company achieve the ISO 9002 quality certificate.

7.2.1. Rationalization of Production Process

To tackle the issue, VW had to replace stiff, traditional centralized hierarchical structure of production organization typical for manufacturing organization in socialist environment with a more decentralized model. Taking the inspiration initially from Japanese production organizational principle of Kaizen and subsequently from its own yet far less severe

⁵⁹ "SkodaJokes". The Czech Pages. 01 Sept 2010 <http://web.ukonline.co.uk/k.frost/czech/skoda_jokes.html>.

⁶⁰ Králík, Jan. Škoda - Od kočárů k limuzínám 1864-2008. Prague: Moto Public, 2008

⁶¹ Kožíšek, Petr, and Králík Jan. L&K – ŠKODA: 2. Prague: Motor Press, 1995

⁶² Machan, Jaroslav. Aplikace metod kvality ve fázi vývoje výrobku. Prague: VŠE v Praze, 2008.

production techniques, VW introduced a fractal organization of production that came along with an introduction of a new product called Felicia in 1994 (Pavlínek 96), a car that was to replace the outdated Favorit and exceed it both in quality and reliability.

The basic principle of a fractal organizational system lies in flexibility and adaptability. Although the classic production organization used prior to the JV seemed functional, its structure was rigid and incapable of reflecting changing conditions. The fractal organizational system then is based on creating small and easily manageable groups that fall under a higher, autonomous production unit. These teams consisting of 6-8 people were to work independently of other teams and have their own responsibilities. Furthermore, their focus was to concentrate on the task as a whole, not on individual aspects, thus enhancing efficiency, optimization, flexibility and capability to react on changing aspects of the market.

Moreover, a production concept of “strategic resourcing” was introduced to the company. The key principle behind it was to incorporate production suppliers to the assembly operations within the company floor, thus reducing time demands and logistic costs. In essence, key components for the assembly of a car (e.g. seats, doors, cockpit units etc.) were brought to the assembly line in preassembled modules and were installed by Škoda workers, although a proposal to install them by suppliers’ workers was refused by the unions. Aside from this, just-in-time supply of the assembly lines was adopted.

At the time, Škoda was the only European plant under VW Group to introduce the above mentioned principles that all fall within the fractal organization of production, since it was rejected by the unions of other plants. An unpleasant side of the rationalization process was that 800 Czech workers (followed by foreigners) were made redundant in late 1994, although the process rendered it necessary (Pavlínek 97).

The process of rationalization and cost-cutting was fully implemented in a newly built plant for new car called Octavia, which came along in 1996. The construction of the premises began the previous year and took a year and a half to finish. Production and rationalization has been pushed to the limit, harnessing the CAD-CAM technologies (computer assisted design system allowing on-line discussions with VW and Audi departments), SKD principle of assembly (Semi Knocked Down – exported car was partially assembled thus to avoid severe customs (Králík 172)) and employee spine concept (assembly line was organized in a ring pattern with information centre in the middle (Pavlínek 100)). Furthermore, from Octavia model onwards, all of the comparatively sized products within VW Group were to share the

base platforms, in order to exploit economies of scale and reduce the number of suppliers (share of domestic produced components dropped from 70% to 31%).

Although significant automation technologies were available at the time, the factory chose to employ manual labor force for the better part of assembly process instead due to comparatively low costs of domestic labor force throughout 1990s.⁶³

As a result of Škoda's relentless efforts to improve and enhance both production process and quality of its production, the company was awarded ISO 9002 quality certificate in 1994 in context of Felicia model. Eng. Klaus Solbeck, the president of TÜV Cert auditing company, handed over the certificate to the representatives of the plant and consequently, Dr. Gerald Weber, a member of the board of directors, responsible for R&D and production, commented it to be an utter accomplishment of management's strategies and plans by all the employees while adjusting the production process (Kožíšek and Králík 192).

7.2.2. Component Quality Improvement

Overall product quality required not only streamlining the production procedures, but it required tackling the issue of quality of each assembled component, thus to turn the attention to suppliers. As a solution, Škoda adopted VW's supplier grading system to address the issue of quality within its supply chain.

When the company implemented the grading system, only 1% of all the suppliers were rated "A", making it a shocking revelation.⁶⁴ The quality standards required by Škoda shot up, making it hard for the suppliers to respond abruptly. Furthermore, it was demanded that higher quality of supplied components would not be accompanied by higher costs.

Consequently, Škoda encouraged its suppliers to form JVs with Western companies and VW suppliers in particular. As a result, over 50 JVs were formed and 40 new suppliers' plants were constructed (Pavlínek 103). In addition, most of Škoda's major suppliers (e.g. Siemens, Meritor, Peguform etc.) set up their own plants within Škoda's factory complex and linked themselves with computerized production system thus enhancing their flexibility.⁶⁵ As a

⁶³ Mudd, Tom. "The Last Laugh". Industry Week. 01 Sept 2010
<<http://www.industryweek.com/CurrentArticles/asp/articles.asp?ArticleID=898>>.

⁶⁴ Mudd, Tom. "The Last Laugh"

⁶⁵ "Volkswagen's Acquisition of Skoda Auto: A Central European Success Story". IBS Center for Management Research. 01 Sept 2010 <<http://www.icmrindia.org/casestudies/catalogue/Business%20Strategy/BSTR262.htm>>.

result, by the end of 1990s, over 70% of Škoda's suppliers were rated grade "A", when compared to 1% in 1991.⁶⁶

7.3. New Product Development

After tackling the issues of HR management and production process, the next step in the three step plan of the company's rebirth was to develop new, high-quality and thanks to enhanced production methods low-cost products to further consolidate and strengthen the company in the European market. Introduction of new models and sophisticated models to the market was to ensure the competitiveness of the company in the context of Western and Central European markets and beyond.

Prior to the introduction of the Škoda Favorit in the late 1980s, Škoda's models were named in a numerical fashion (e.g. Š110, Š105/120, etc.). With Favorit however, this traditional approach to the product line nomenclature disappeared and ever since, Škoda has adopted the classical form of naming its products – so called "individual brand" where company's brand is superior to the product name.⁶⁷ From then on, the products' names were consisted of something as a name and surname (e.g. Škoda Felicia, Škoda Octavia, etc.) which is supposed to be easily memorable and familiarly talked about.

Furthermore, for its new products under the JV with VW, Škoda has adopted the names of its products from 1960s (e.g. Octavia or Felicia), thus to emphasize the company's heritage from the past. Additionally, in occasional promotion materials, co-branding with VW was employed to note the existing JV with VW as a part of VW Group. To show the success of Škoda car developed and produced after the Škoda-VW JV and the principles behind it, the following part will concentrate on the most important models that were supposed to improve the image and reputation of Škoda brand as the second part of the three step rebirth plan, Felicia, Octavia and Fabia, to be specific.

7.3.1. Škoda Favorit

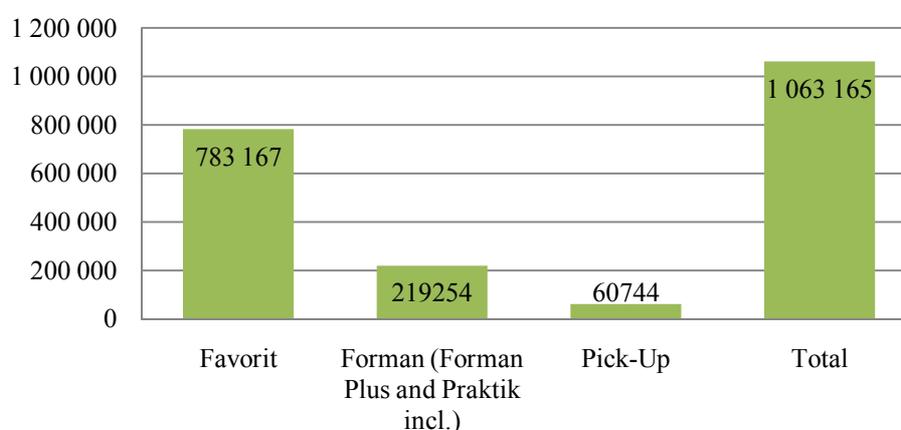
Although Favorit was not an entirely new product when JV with VW was established, VW's management decided to further continue the production of Favorit and gradually increase its quality and reliability, as well as its production. Multiple action models were introduced:

⁶⁶ Mudd, Tom. "The Last Laugh"

⁶⁷ Hesková, Marie. Brand Management - značka jako nehmotné aktivum firmy. Mladá Boleslav: Škoda Auto University, 2008

Komfort, Marathon, Excellent, Sport Line, Silver Line, Black Line, Komfort Line and Solitaire.⁶⁸ The millionth Favorit produced was celebrated on June 16, 1994, a couple of weeks before the production of Favorit was completely stopped in August 12, 1994. Although some exports to the Western market took place, majority of exported production went to the Eastern European markets, where Favorit's inferiority was not perceived as a limiting factor and the low price was the key element. The total production numbers of the Favorit are as follows.⁶⁹

7.3.1 (a) Škoda Favorit Total Production 1989-1994



7.3.2. Škoda Felicia

The first new model developed and produced under the JV with VW adopted its name from the 1960s. The first Felicia was introduced in September 5, 1994 after three years of development and was to replace the outdated Favorit. The car ranked itself as an entry-level supermini and was based loosely on Favorit, although both the interior and exterior were different (Králík 158). However, even when it was the first new model produced under Škoda-VW, large-scale component-sharing with VW Group did not take place and the majority of suppliers were the domestic ones.

Furthermore, for the first time in the company's history, the car included several elements of active safety. Additionally, the production process of Felicia included fractal organizational system and basic CAD-CAM computer designing, thus enhancing the quality when compared to Škoda's previous product, the Favorit.

⁶⁸ Králík, Jan. Škoda - od kočárů k limuzínám z Vrchlabí 1864-2008. Prague: Moto Public, 2008.

⁶⁹ "Škoda Auto - Favorit". 8 Sept 2010 <<http://minosurkala.webpark.cz/Skoda/favorit.htm>>.

The Felicia was almost an instant success and the demand for it on domestic and foreign markets exceeded the supply considerably due to its value-for-money and low selling price (Pavlínek 105). Additionally, unlike Favorit, Felicia was offered with a range both of petrol and diesel engines, the optional choice standard to the Western car makers, yet previously unknown to the Škoda's customer.

Aside from traditional hatch-back and estate versions of the car's body, the version called Fun was introduced in 1996, a funky and fresh-looking pick-up version capable of transporting 2-4 people, that was aimed to appeal to the younger clientele thanks to its bright yellow colors and flashy body kit. The production of Felicia Fun was terminated in 2000, after approx. 4.000 units were made.

The pickup version of the Felicia was named Felicia Pick-Up and offered an enormous value-for-money especially to the self-employed. Notable is to say that the export version of the Pick-Up was rebadged as Volkswagen Caddy and exported to the Western and CEE markets. Additional utility model was Škoda VanPlus with enclosed bed.

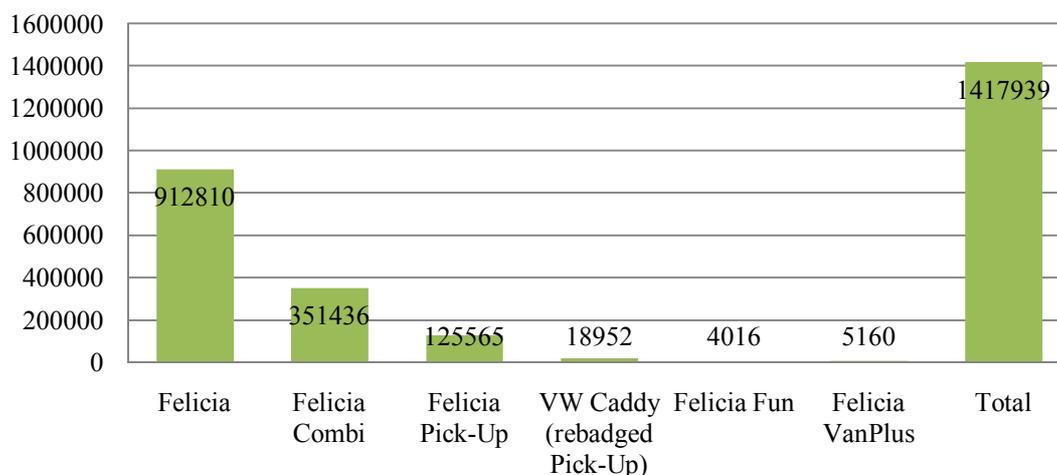
The production of the whole Felicia product line was terminated on June 20, 2001 after seven years of production. The main reason for this move was, next to the one with insufficient quality, that Felicia did not comply with newly introduced EU emission standards.

The Felicia was an enormous success for the company and an essential step towards more demanding Western European markets. Throughout the whole production, Škoda adopted "1/3s" sales plan, where 1/3 of the production went on the domestic market, 1/3 to the CEE markets and 1/3 to the rest of the world (Pavlínek 105).

Almost immediately after the termination of Felicia's production in 2001, the departure of this enormously successful value-for-money model caused a severe decline in Škoda's sales and consequently production. As a result, Škoda's production had to be significantly limited and in some cases even completely stopped, due to low demand for more expensive models. In addition, approx. 1.000 foreign works were made redundant due to the downturn in sales. However, the introduction of succession models turned the situation round back to Škoda's advantage (Pavlínek 108). The total production figures of the Felicia are as follows:⁷⁰

⁷⁰ "Škoda Auto - Felicia". 8 Sept 2010 <<http://minosurkala.webpark.cz/Skoda/felicia.htm>>.

7.3.2 (a) Škoda Felicia Total Production 1994-2001



7.3.3. Škoda Octavia

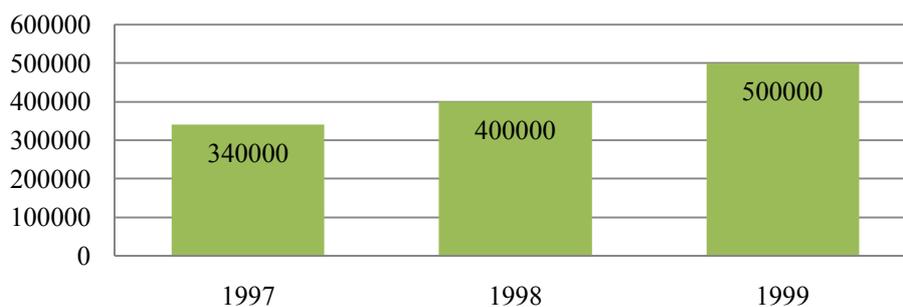
The Škoda Octavia is considered to be a ground-breaking model for Škoda and analysts mark it as a model that successfully rid the Škoda of its image of poor quality.⁷¹ Introduced on September 3, 1996, it was the first Škoda's product to be based on VW Group's corporate platform (on which Audi A3, VW Golf IV, VW Bora/Jetta IV and Seat León I/Toledo II were based) and to fully utilize the available economies of scale, due to component sharing (Králík 168). The car was placed on the lower end of the upper-segment of the car market and priced accordingly.

The development of the car took three years and by 1994, the company had the first working prototypes to test. The production was located in the newly-built production plant that was built in accordance to the fractal organization and employee spine concept. The plant was considered to be cutting-edge and equal to the highly efficient Japanese production plants. Even president of the Czech Republic Václav Havel and the CEO of VW Ferdinand Piech attended the opening ceremony. Additionally, in 2007, the Octavia production plant in Vrchlaví was awarded the first place in the prestigious VW Group's VW Excellence price. The plant in Kvasiny was second and Mladá Boleslav fourth. 36 VW Group plants were included in total (Králík 180).

⁷¹ "Volkswagen's Acquisition of Skoda Auto: A Central European Success Story". IBS Center for Management Research. 01 Sept 2010 <<http://www.icmrindia.org/casestudies/catalogue/Business%20Strategy/BSTR262.htm>>.

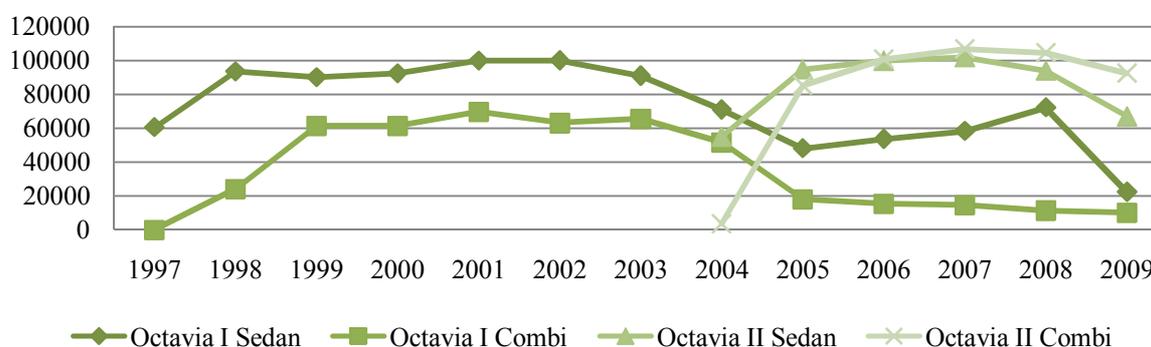
Thanks to the full-scale adoption of the fractal organization of production, SKD and CAD-CAM production techniques, the production rate sky-rocketed almost instantly from initial 90.000 units to 160.000 units annually, in one year after introduction.⁷² This rapid expansion had a dramatic effect on the total company's output, as described by the following graph (Pavlínek 105-107):

7.3.3 (a) Škoda's Total Production Annually



The first generation of Škoda Octavia was, due to its quality and low selling price, such an enormous success that it remained in production for almost 14 years, being produced in Vrchlabí plant parallel with the new generation Octavia, being labeled as Škoda Octavia Tour.⁷³ The first generation was the longest-produced model in Škoda's history and it solidified Škoda's image of mass market manufacturer producing high-quality value-for-money cars in CEE and Western European markets. The total production statistics of both Octavia Mk1 and Mk2 are as follows.⁷⁴

7.3.3 (b) Škoda Octavia MkI and MkII Production 1997-2009



⁷² "Slav Motown". The Economist. 7 Sept 2010 <<http://www.economist.com/node/464948>>.

⁷³ Žemlička, Martin. "Poslední rozloučení s Octavií. Skončila po 14 letech". Novinky.cz. 8 Sept 2010 <<http://www.novinky.cz/auto/210100-posledni-rozloucení-s-octavii-skoncila-po-14-letech.html>>.

⁷⁴ "Annual Reports". Škoda Auto. 8 Sept 2010 <<http://new.skoda-auto.com/com/about/investors/annual/Pages/Annualreports.aspx>>.

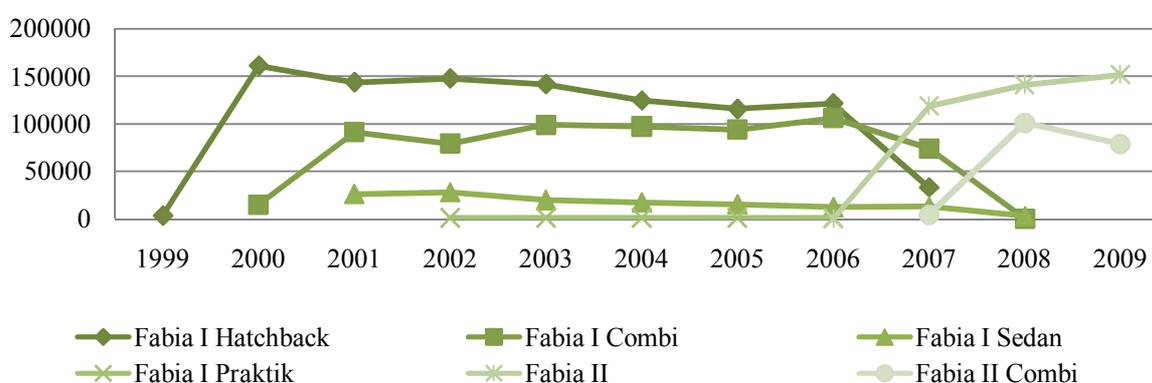
7.3.4. Škoda Fabia

Introduced in September 1999 at the IAA Frankfurt motor-show, the Fabia was the second car produced by Škoda that benefited from the concern-wide platform and component sharing within the VW Group.⁷⁵ It was the first car to use the A04 platform, together with Volkswagen Polo Mk IV and SEAT Ibiza and was to replace the Felicia as an entry-level Škoda.

Just as Octavia, Fabia, which took over the production and quality standards of its larger colleague, was an instant success, due to its high quality and low selling price. In terms of quality, it benefited significantly from the concern wide sharing of components, a lot of which were developed by or in conjuncture with VW, and from sophisticated production techniques, yet its price was set considerably low when compared to its rivals within the VW Group.

Thanks to its qualities, Fabia was awarded numerous prizes around the world, thus it further enhanced the Škoda brand image (e.g. Car of the Year – COTY 2000, “Golden Steering-wheel” by Axel Springer committee, car of the year in British magazines Chat and AutoExpress, etc. (Pavlůsek and Pavlůsek 198)). Fabia Mk2 replaced the Fabia Mk1 in 2007, after eight years of production. In terms of production, it did not and does not lag behind its predecessor, as described in the graph below.⁷⁶ In addition, Fabia and Octavia both succeeded remarkably well in solidifying and enhancing Škoda’s position in European markets⁷⁷, as well as in improving Škoda’s brand image and quality perception, as was intended.

7.3.4 (a) Škoda Fabia I and II Generation Production 1999-2009



⁷⁵ Pavlůsek, Alois, and Pavlůsek Ondřej. Škoda. Prague: Computer Press, 2004.

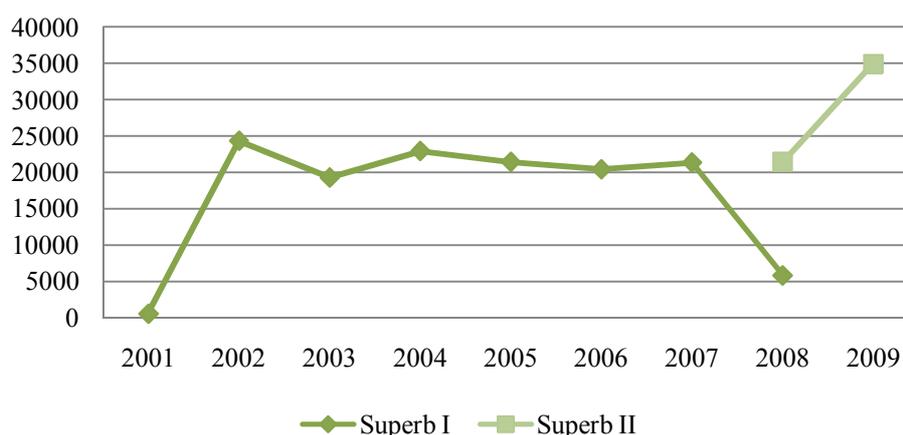
⁷⁶ “Annual Reports”. Škoda Auto. 8 Sept 2010 <<http://new.skoda-auto.com/com/about/investors/annual/Pages/Annualreports.aspx>>.

⁷⁷ Ciferri, Luca. “New flagship model will complete Skoda rebirth”. Automotive News Europe. 7 Sept 2010 <<http://www.autonews.com/apps/pbcs.dll/article?AID=/20010702/ANE/107020793>>.

7.3.5. Škoda Superb

For the first in Škoda's post-JV history, the company set out to tackle the upper-mid car market with its Superb, a basically cunningly rebadged derivation of VW Passat, which positioned itself a class below the Superb. Based on Volkswagen Group B5 PL45+ platform originally intended for Chinese-sold Passat Long Wheel Base (LWB), it had 10cm longer wheelbase than regular VW Passat, thus placing itself amongst entry-level BMW, Mercedes and Audi luxury cars.⁷⁸ Although it was considered to be one of the best cars in its class in terms of value-for-money, Superb did and does not reach the prestige of its class competitors, due to its brand, that has an image of mass market producer of low-cost entry-level cars. The production figures of Škoda Superb and its successor are as follows:⁷⁹

**7.3.5 (a) Škoda Superb I and II Generation
Production 2001-2009**



7.4. Image Building

As is well established in every modern free market economy, a brand is an immensely valuable intangible asset of every company operating under market-oriented, customer-focused principles. It is a relation between the conscious and subconscious of the customer, connecting a brand to an idea of quality, awareness, etc. The ability to differentiate a product is a key-element to success in ever growing market competitiveness. Just the right brand image gives the company the loyalty of its customers, their inclination towards it and their recurrence. Furthermore, a good brand is an essential part of company-supplier relationship

⁷⁸ "Volkswagen Group B platform". Academic Dictionaries and Encyclopedias. 8 Sept 2010 <<http://en.academic.ru/dic.nsf/enwiki/1061028>>.

⁷⁹ "Annual Reports". Škoda Auto. 8 Sept 2010 <<http://new.skoda-auto.com/com/about/investors/annual/Pages/Annualreports.aspx>>.

due to its image in the market. As a result, a good, strong and well established brand is a key to success not only in the car market, but in every other market as well.⁸⁰

7.4.1. Brand Management Prior to JV

Although Škoda had, despite the inferior quality of its products, significantly loyal customers prior to the 1990s (due to its monopolistic position in the domestic market), yet the image of the brand Škoda was considerably damaged all over Western Europe. The domestic customers, who were accustomed to not having the possibility to choose, were somehow adapted and resistant to the miserable products of the communist era, thus had a strong affiliation towards Škoda brand. Truth be told, Škoda's image westwards was somewhat different.

Serious quality and reliability issues of Škoda's products meant that the company was compared to car companies such as Trabant or Lada/VAZ and in minds of its potential customers in Western Europe, Škoda occupied the same rotten space as the companies mentioned. The previously mentioned reliability issues created an image of inferiority and unreliability and the Škoda cars were subject to many jokes. Furthermore, according to the 1990s research by Millward Brown agency, over 60% of the potential customers would not even consider a Škoda when choosing a new car.⁸¹

Although Škoda's engineers had argued that the company was successful in exporting and selling its products abroad, despite the immense difficulties of State Socialism and all the problems connected to it, a lot more than arguments and quality improvement was required in order to improve the company's brand image.⁸²

Furthermore, Škoda's marketing focus had to shift from a long established central planning point of view towards free market economy and market-oriented, customer-focused principles. Prior to the collapse of communist government and establishment of Škoda-VW JV, the company had never encountered a customer who "had a choice" before and had to adapt, thus to persuade its potential customers that its products are up to Western standards.

⁸⁰ Hesková, Marie. Brand Management - značka jako nehmotné aktivum firmy. Mladá Boleslav: Škoda Auto University, 2008

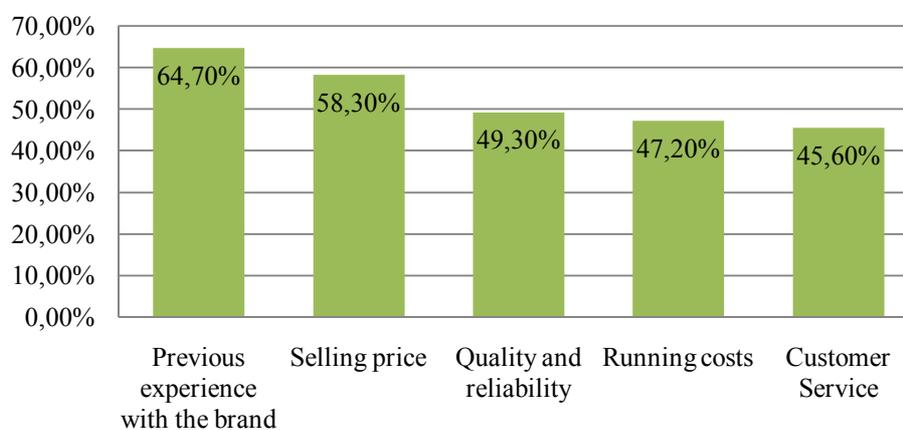
⁸¹ "Skoda's image gets clearer". The Independent, London. 7 Sept 2010 <<http://www.independent.co.uk/life-style/motoring/features/skodas-image-gets-clearer-530247.html>>.

⁸² Mudd, Tom. "The Last Laugh". Industry Week. 01 Sept 2010 <<http://www.industryweek.com/CurrentArticles/asp/articles.asp?ArticleID=898>>.

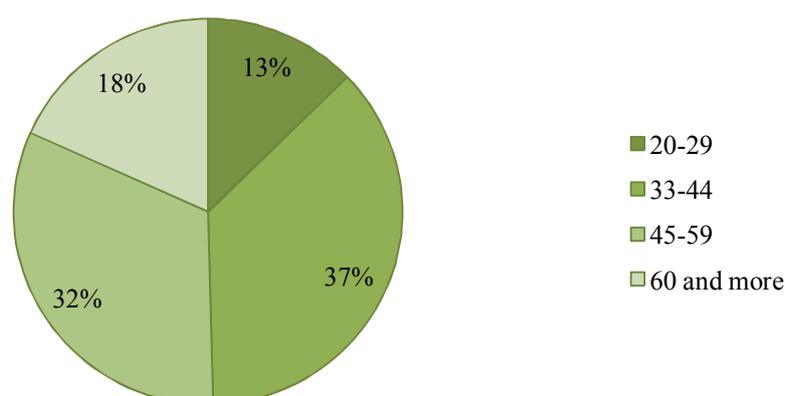
Moreover, Škoda had already 3 million customers estimated who did not have a good experience with the brand.⁸³

The areas where Škoda had to promote its products were therefore quite simple to determine, due to its position in a lower-end, entry-level market. Amongst many others, the most significant preferences of the customers when choosing a Škoda car were and still are experience with the brand, low selling price and quality combined with reliability, as was proved by a survey conducted in October-December 2008. The most significant findings are as followed:⁸⁴

7.4.1 (a) Most Important Reasons for Buying Škoda Car 2008



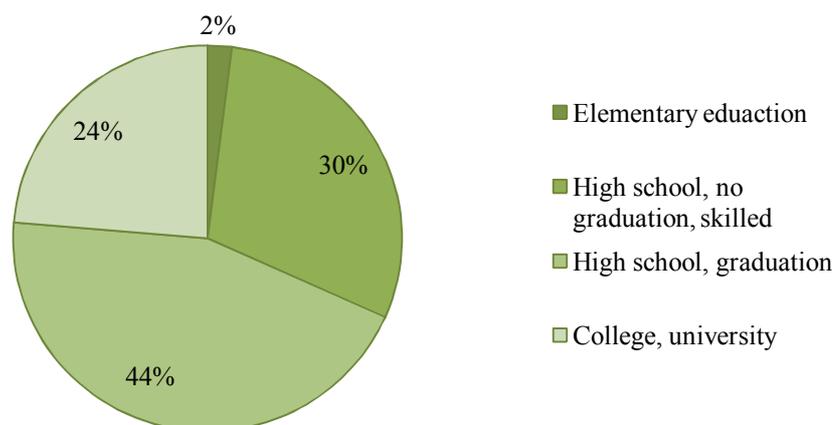
7.4.1 (b) Customers Age Structure



⁸³ "In a Czech Plant, VW Shows How to Succeed in the East". The New York Times. 7 Sept 2010 <<http://www.nytimes.com/1993/06/22/business/in-a-czech-plant-vw-shows-how-to-succeed-in-the-east.html?pagewanted=2>>.

⁸⁴ Štrach, Pavel. Marketing v automobilovém průmyslu - Sborník příspěvků. Mladá Boleslav: Škoda Auto University, 2009.

7.4.1 (c) Customers Education Structure



7.4.2. Image Building through Promotion

As the mere improvement of products' quality was insufficient in order to improve brand image, Škoda's advertising agency, Fallon, decided that the best decision to tackle the issue was to confront the prejudices in 1999-2000. The previous, ordinary advertising campaign applied from 1991 promoting the Škoda's roots, history and heritage proved ineffective and the company still had an image of cheap-cars manufacturer, despite the quality products it offered. What the company needed was to shift the image towards the value-for-money manufacturer.

The company subsequently brought out a series self-ridiculing, bantering advertising campaign, each based on a different slogan that pictured Škoda's products as being superior to the people's expectations:⁸⁵

- "It's a Skoda. Honest"
- "Škoda. It might earn you more respect than you think"
- "It's a Skoda. Which for some is still a problem"

Aside from the commercials, various other methods of promotion, PR, celebrity endorsement and direct marketing campaigns were employed. The campaigns gave the impression that the company is displaying a willingness to poke fun at itself, thus show Škoda in a positive light.

⁸⁵ "It's a Skoda campaign - honest". Guardian UK. 7 Sept 2010
<<http://www.guardian.co.uk/media/2001/dec/13/advertising3>>.

As a result of the extensive and relentless advertising and promotion introduced in 1999-2000, according to a post-campaign research in 2001 by Millward Brown, 79% of consumers believed that Škodas were better than they used to be.⁸⁶ Škoda thus made a successful effort to shift its brand image from cheap car maker towards value-for-money car maker. Apparently, Škoda's target customers began to view Škoda cars as cut-price VWs, equal in both quality and reliability. Furthermore, worldwide sales and exports of Škodas improved significantly, as demonstrated by the following chart:⁸⁷

7.4.2 (a) Škoda Exports Comparison		
Year	1991	2000
Worldwide sales	172.000	385.000
Exports	26%	82%
Number of countries exported to	30	72

Next to statistic proofs of the successful transformation of Škoda's brand image, Škoda's improving quality has been backed up by two car magazines reviews, Germany's *Autobild* and Britain's *What Car?* even named the Fabia their car of the year for 2000. Then Škoda has been placed at or near the top of the prestigious J.D. Power & Associates customer satisfaction survey in each of the consecutive three years.⁸⁸ Furthermore, the prestigious and world-wide known BBC *Top Gear* magazine said that the Fabia feels like it is in a class above the rest.⁸⁹ PR like this has even enhanced Škoda's successful transformation of its brand image and by the late 1990s, Škoda was established as a mass-market car brand in Europe and the Central Europe's largest car manufacturer, producing decent quality value-for-money cars that one should not be ashamed of having.

8. Expansion of Škoda

In order to succeed, every larger company should expand to other markets to keep up with ferocious competition worldwide. Even though Škoda was a well known car company in its domestic market and in central Europe, the prosperous future of the newly reborn Škoda

⁸⁶ "Skoda's image gets clearer". The Independent, London. 7 Sept 2010 <<http://www.independent.co.uk/life-style/motoring/features/skodas-image-gets-clearer-530247.html>>.

⁸⁷ Ciferri, Luca. "New flagship model will complete Skoda rebirth". Automotive News Europe. 7 Sept 2010 <<http://www.autonews.com/apps/pbcs.dll/article?AID=/20010702/ANE/107020793>>.

⁸⁸ "Slav Motown". The Economist. 7 Sept 2010 <<http://www.economist.com/node/464948>>.

⁸⁹ Mudd, Tom. "The Last Laugh". Industry Week. 01 Sept 2010 <<http://www.industryweek.com/CurrentArticles/asp/articles.asp?ArticleID=898>>.

required much more – an expansion. Yet, any expansion Škoda meant to execute had to be carried out precisely within the Group's policy and restriction and that made the task challenging. Nevertheless, the following chapter will analyze the success with which Škoda penetrated the new markets and expanded its field of activity. It is an expansion essential for Škoda's future success.

As was already mentioned several times in previous sections of this paper, Škoda's expansion to other markets is severely limited. On one hand, company's expansion is restricted and limited by the VW Group in context of Škoda's position within VW Group division segmentation. On the other, there are forces within the markets that make expansion even more demanding.

In accordance with original intentions prior to the formation of Škoda-VW JV, Škoda is to be the entry-level brand of VW, appealing to the lowest levels of the car market. Additionally, Škoda's sales and profits are not supposed to rise at the expense of other VW Group brands. In 2006, 80% of Škoda's exports took place within the EU, and only 5% was exported beyond Europe itself (Pavlínek 109). By virtue of other Western European car market issues, such as growing customers' exigencies, severe competition across the market and slowly rising demand for new cars added to restrictions from the side of VW Group, Škoda's potential expansion in Western European markets seem unattainable. In consequence, such factors made it imperative to expand company's markets to Eastern European markets and beyond, yet choice of the target region did not come easily.

First of all, penetration of North American market (USA, Canada) would be excessively demanding due to inevitable high costs of penetrative promotion, competitiveness of local market and customer habits, that change ever so slowly, yet make penetration considerably difficult. Furthermore, penetration of South American market seems unwise, due to low buying potential and dense presence of other car manufacturers and finally, penetration of African market seems redundant and unprofitable, due to low or virtually non-existing car mass market.

Due to such issues, Škoda's management recognized that significant potential lies in CEE and Asian markets, due to sky-rocketing demand of local emerging car markets. Other potential markets to expand to were deemed unsuitable. To avoid possible trade barriers between the countries in form of duties and customs on imported cars, Škoda adopted the solution to produce and assemble its cars abroad from SKD (Semi-knocked-down), MKD (Multi-

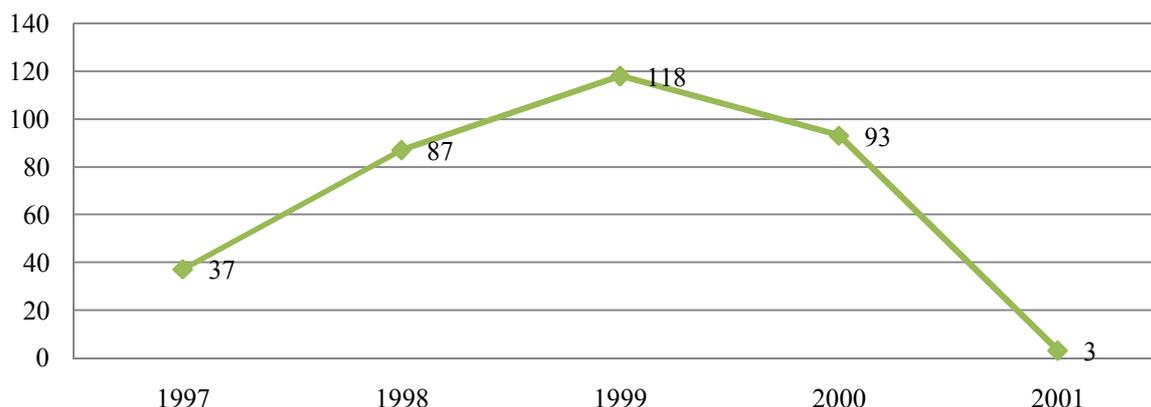
knocked-down) and CKD (Completely-knocked-down) components, thus avoiding the high costs of importing assembled cars in the first place. Additionally, such assembly was to only take place in small-number production (Pavlínek 109-117).

8.1. Poland

Initially, the first country Škoda ventured to in order to assemble its cars abroad was Poland in 1994. From the immediate neighbors of Czech Republic, it was the country where Škoda cars were not exported to due to 41% import duty imposed on imported cars. The country concealed enormous potential, because its car market is almost four times larger than the one of Czech Republic. As was intended, Škoda overcame the import duty problem and set out to assemble its cars in Poznań, in VW' commercial vehicle factory that was part of Tarpan-VW JV since 1993 to be specific.⁹⁰

Initially, SKD and MKD assembly of Favorits was established, gradually broadened by assembly of Felicias, Octavias and Fabias. The production of Poznań plant reached its peak at 1999, when 40.000 units were produced (Pavlínek 117). After import duties were abolished in 2002, assembly of Škoda cars seemed redundant and the production was therefore stopped. Needless to say that from then on Škoda imported its cars to Polish car market with ease. To briefly describe production trends in Poznań, refer to the following graph.⁹¹

**8.1 (a) Poznań
Average Daily Production 1997-2001**



⁹⁰ "Press Releases." Volkswagen Poznan. 09 Sept. 2010. <http://www.volkswagen-poznan.pl/informacja_en?ph_main_content_start=show&ph_main_content_cmn_id=1168>.

⁹¹ "Annual Reports". Škoda Auto. 8 Sept 2010 <<http://new.skoda-auto.com/com/about/investors/annual/Pages/Annualreports.aspx>>.

8.2. Russia

To establish assembly of its cars in Russian market proved much more difficult than Škoda anticipated. Five attempts to establish the assembly in Russia were made, four of them unsuccessful (Pavlínek 118-120).

In 1996, Škoda set out to bargain its first deal to form JV with a company called Avantgard that would result in Avtorossija JV and produce Felicias at first. Although the deal seemed promising and negotiations were finished, the production never started and Avantgard backed out from the deal.

Two years later, in 1998 set out to make an agreement with Agromaš factory in Minsk and although 8 pilot Felicias were produced, the cooperation crashed, reportedly due to administrative and political reasons.

The next year in 1999, Czech and Russian government agreed on intention to produce Felicias under JV with Izhmash-Avto in Izhevsk, forming venture called Skoda Auto Udmurtia, 75% of which was supposed to be owned by Škoda, 25% by Izhmash-Avto. The assembly was planned to initialize with SKD and MKD assembly that would gradually transform into fully independent local production, utilizing local suppliers, although economic problems negatively affected the deal and caused delays. Consequently, the parties disagreed on property and legal issues and the endeavor crashed in 2001.⁹²

Škoda eventually attempted to approach the issue differently and ventured to build a brand new factory in cooperation with VW in 2002, either near Moscow or Leningrad. The supposed deal of 50/50 production of both Škoda and VW cars eventually crashed as well, yet a new deal with VW was reached in 2006, resulting in newly constructed the Kaluga factory, 188 km southwest from Moscow.

Both Škoda Octavia and VW Passat are built in the Kaluga factory and planned production is to peak 160.000 units annually.⁹³ The successful establishment could very well have a

⁹² "Russia's Izhmash May Get Japanese Loan for Auto Paint Shop." Global Automotive Industry News. 09 Sept. 2010. <http://www.just-auto.com/news/russias-izhmash-may-get-japanese-loan-for-auto-paint-shop_id76261.aspx>.

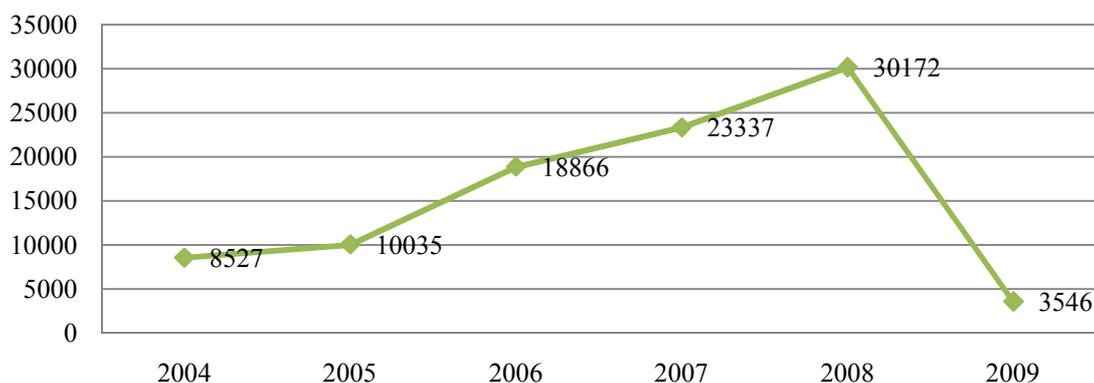
⁹³ "VW Start Production in Kaluga Plant Russia." INAUTONEWS Cars News. 09 Sept. 2010. <<http://www.inautonews.com/vw-start-production-in-kaluga-russia>>.

succession in the near future as VW plans to build yet another factory in Russia in cooperation with Škoda.⁹⁴

8.3. Ukraine

In 2001, Škoda made an agreement with Evrocar Ukraine to initiate production of Octavias and Fabias under license in Solomonovo plant (Pavlinek 120). Škoda aimed to lower its risks to a minimum by not forming JV with Evrocar. VW products are assembled in parallel with Škoda cars via SKD and CKD assembly procedures. The annual assembly figures of Solomonovo plant are as follows (the severe decline in production in 2009 was caused by dramatic drop in demand, parallel with the outset of the global economic crisis):⁹⁵

**8.3 (a) Solomonovo
Annual Production 2004-2009**



8.4. Kazakhstan

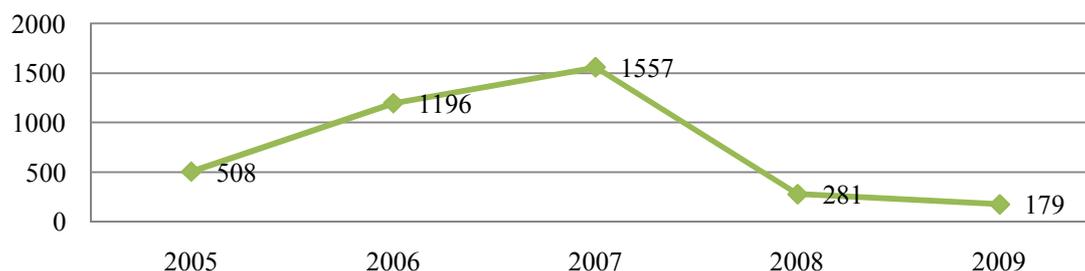
In Kazakhstan, low-volume production of Octavia model set out in August 2005 in a plant located in Ust-Kamenogorsk. Although the production started well, in 2008 and 2009, Škoda assembly in Kazakhstan, as well as in Ukraine, suffered severe decrease, due to unfavorable economic conditions, described by following graph:⁹⁶

⁹⁴ "Volkswagen Přemýšlí O Další Továrně v Rusku, Hledá Ji Škoda." IDNES.cz. 09 Sept. 2010. <http://ekonomika.idnes.cz/volkswagen-premysli-o-dalsi-tovarne-v-rusku-hleda-ji-skoda-pag-/eko-zahranicni.asp?c=A100622_1405979_eko-zahranicni_vem>.

⁹⁵ "Annual Reports". Škoda Auto. 8 Sept 2010 <<http://new.skoda-auto.com/com/about/investors/annual/Pages/Annualreports.aspx>>.

⁹⁶ "Annual Reports". Škoda Auto. 8 Sept 2010 <<http://new.skoda-auto.com/com/about/investors/annual/Pages/Annualreports.aspx>>.

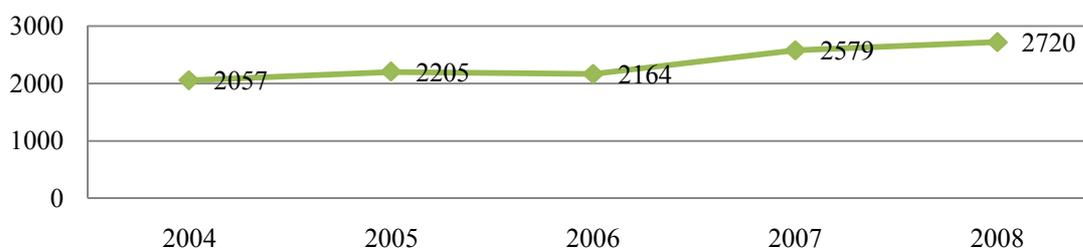
8.4 (a) Ust-Kamenogorsk Annual Production 2005-2009



8.5. Bosnia-Herzegovina

The SKD assembly of Felicias initiated on August 31, 1998 in Vogošča near Sarajev. The assembly plant is a part of Volkswagen-Slovenian Prevent JV, where 58% of shares were in hands of VW and 42% in hands of its partner (Pavlínek 121). The deal turned out to be very convenient for Škoda, as it not made a single investment in the plant. The company also counted on further exporting Vogošča produced cars to the east, although the plan shut down by the end of 2008, due to cancellation of import duties.⁹⁷ The annual production numbers of Vogošča plant were as follows:⁹⁸

8.5 (a) Vogošča Annual Production 2004-2008



8.6. India

The first attempt to establish Škoda Felicia assembly, parallel with Audi A6 assembly, in India took place in 1994 between Škoda and Audi and two years later, in 1996, it was decided that assembly would begin in the city of Bangalore. This initial attempt crashed and Eicher

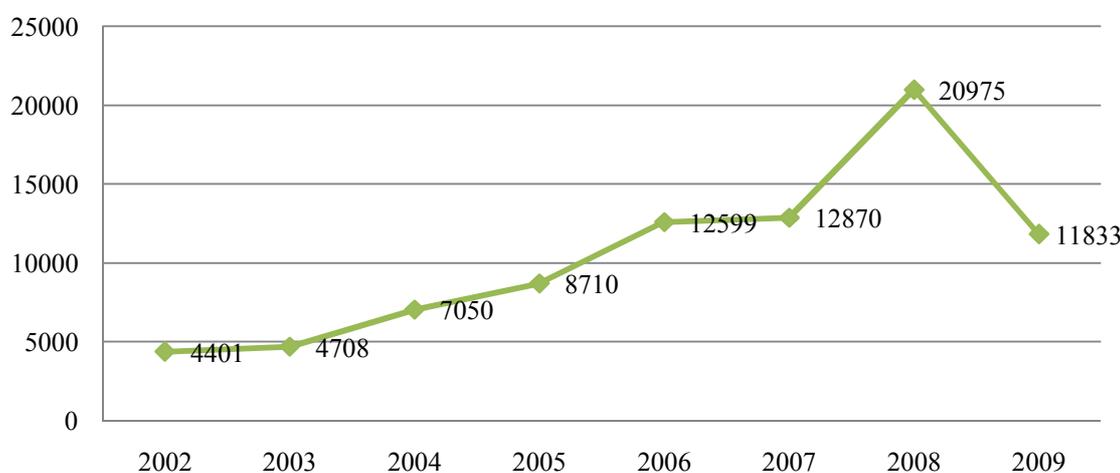
⁹⁷ "Volkswagen and Skoda Assembly Lines in Vogošča Shutting down This Year." Limun.hr. 09 Sept. 2010. <<http://limun.hr/en/main.aspx?id=293192>>.

⁹⁸ "Annual Reports". Škoda Auto. 8 Sept 2010 <<http://new.skoda-auto.com/com/about/investors/annual/Pages/Annualreports.aspx>>.

Group withdrew from the deal in 1997. In the same year, another attempt was made but it did not materialized due to unattainable demands of the Indian government (Pavlínek 123).

Eventually, the Indian government backed out from its demands and in 1999, Škoda Auto India Private subsidiary was formed in Aurangabad. The production took place in a rented Shendra plant on the outskirts of the city.⁹⁹ To boost the production for a very devouring market, a new plant was built in 2004.¹⁰⁰ Further expansion to south-east Asia is anxiously anticipated. The annual assembly figures rose steadily throughout the plants' operations, as described below:¹⁰¹

8.6 (a) Aurangabad Annual Production 2002-2009



8.7. China

Up until 2005, Škoda's expansion to the massive Chinese market was rendered impossible due to the strong presence of VW and Audi and imposed severely strict import quotas (Pavlínek 124). Eventually Shanghai Volkswagen Automotive was established and began producing Škoda models under license.¹⁰² Even though the enterprise took off relatively recently, it already shows significant promise, due to enormous potential of China's emerging

⁹⁹ "Skoda Auto India Pvt Ltd | Company Profile and Company Information." All about Companies. 09 Sept. 2010. <<http://www.provigator.com/skoda-auto-india-pvt-ltd>>.

¹⁰⁰ "New Skoda Factory to Begin Operations in January Next." ACCESSmyLIBRARY. 9 Sept. 2010. <http://www.accessmylibrary.com/coms2/summary_0286-831300_ITM>.

¹⁰¹ "Annual Reports". Škoda Auto. 8 Sept 2010 <<http://new.skoda-auto.com/com/about/investors/annual/Pages/Annualreports.aspx>>.

¹⁰² "Skoda to Play 'Key Role' for VW." English.China.com.. 09 Sept. 2010. <http://english.china.com/zh_cn/business/auto/11021615/20060926/13651520.html>.

car market, capable of swallowing enormous amounts of sales and imports, as backed up by the following chart:¹⁰³

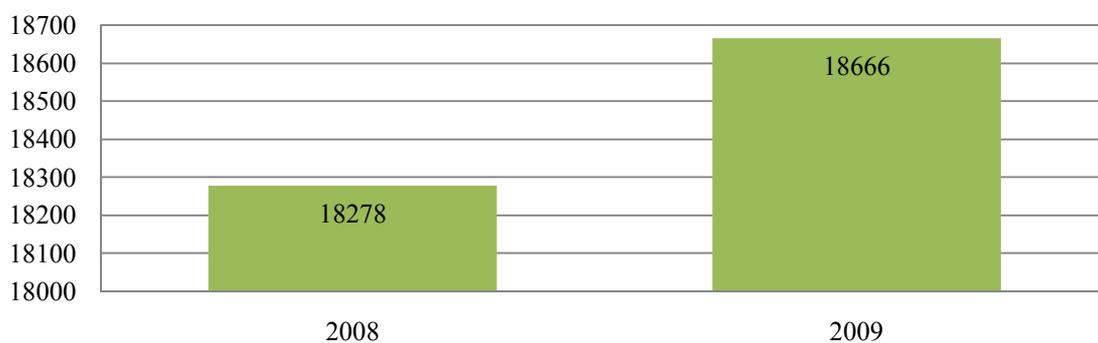
8.7 (a) Shanghai Annual Production 2007-2009



8.8. Slovakia

In Czech Republic's traditional neighbor, Škoda set out to produce its models in Volkswagen plant in Bratislava in 2008. The company called Volkswagen Bratislava a. s. currently employs approx. 6 600 workers and parallel with Škoda Octavias, it also assembles Audi and VW models and gearboxes for Porsche Cayenne.¹⁰⁴ The initial production numbers are as follows:¹⁰⁵

8.8 (a) Bratislava Annual Production 2008-2009



¹⁰³ "Annual Reports". Škoda Auto. 8 Sept 2010 <<http://new.skoda-auto.com/com/about/investors/annual/Pages/Annualreports.aspx>>.

¹⁰⁴ "Volkswagen Group - Production Plants." Volkswagen Konzern - Startseite.. 09 Sept. 2010. <http://www.volkswagenag.com/vwag/vwcorp/content/en/the_group/production_plants.html>.

¹⁰⁵ "Annual Reports". Škoda Auto. 8 Sept 2010 <<http://new.skoda-auto.com/com/about/investors/annual/Pages/Annualreports.aspx>>.

9. Conclusion

When taking the development of Škoda Auto into consideration, an obvious question comes into mind: Was it a successful move? To answer this question, we should consider where Škoda started from and where it ended up.

Before making any condemnatory conclusion, we have to realize that although Škoda was a well established brand all over the world by early 1990s, idleness would not prevent it from eventual decline and bankruptcy. It is disturbing to think that one of the oldest car manufacturers in the world, that was considerably successful on global scale prior to its nationalization, gradually stagnated and lagged behind its western competitors to such an extent, that when the markets opened up again in early 1990s, without appropriate remedy, it would have not only been crippled, but sentenced to extinguishment.

On a local scale however, everything seemed under control. Incapable and stiffed socialistic management only little realized the threats that lay beyond the company's monopolistic position in the domestic market. For the time being, the centrally-planned, yet incomprehensible production quotas formed and shaped the demand and the desperate target customer was willing to accept any new product, as long as it had four wheels and an engine. Any other wishes and demands were more or less perceived as irrelevant.

The entire Czechoslovak car market was relying on the manufacturer, whose workers had to walk the length of the factory just to get the appropriate tools to sloppily put components in place, when the rest of the western car market was racing to streamline its production, seeking radical production principles and state-of-the-art technology to help.

I am in no way saying however, that Škoda was a poor manufacturer during its socialistic era. On one hand, the fact that we have to bear in mind is that despite the tough conditions that the company had to operate under, it had lasted relatively well and managed to sell its products abroad. What is more, thanks to partially loosening of its socialistic chains, it has managed to develop a product (i.e. Favorit) that was able to successfully compete with other products on highly competitive European markets. On the other hand, it was simply not enough.

When Volkswagen stepped in the equation, many concerns were brought about, as it would just do harm to Škoda and that Škoda would lose its distinct and unique identity. It was quite simply feared that the VW would march in and ruthlessly take over Škoda, no matter the pride

and boast of the country behind it. Previous experience with the German subjects suggested it indeed. Such concerns were of course understandable, yet premature.

Eventually, when it turned out that hegemony would not take place and that, at first, the Germans and the Czech were simply joining hands, the common man was able to sit back and watch how the poverty-stricken company got back on its feet. Joining German scrupulosity and Czech ingenuity proved to be a brilliant combination and relatively swiftly, yet not easily, Škoda, backed-up by VW Group considerable capital, managed to direct itself in the way it was supposed to.

However, under VW supervision, the company set out to be a Czech success story, unfortunately, all was soon happening on Volkswagen's expense. The same was of course with Spanish Seat, which was an entry-level brand too, just as VW Group intended. When Volkswagen realized the threat the two rookies imposed, the act of objection was inevitable. Škoda got its wings trimmed and VW management briskly took charge of the cheerful, Czech-managed company.

Although the reasons behind such a move were clearly stated and understandably valid, one can never underestimate the significance of the element of power and control. If some said that the moment, when Škoda lost its identity, was in 1991 when JV with Volkswagen was established, I say the most serious impact on the company's identity struck down when the VW-appointed man took charge of high-management. Simply put, to see a German name as a CEO of Czech company with such heritage and tradition just seems inappropriate.

Fortunately, as the luck, or rather careful calculation, has it, the restructuring process was a success and Škoda, along with the entire VW Group, launched its way to the top of their respective field, a way for which the company paid considerably high price, however. But it is a way to the top nevertheless.

However, I maintain that it was a price worth paying. When Volkswagen stepped in in 1991, it was fairly foolish to think that for all the capital they invested in helping Škoda get back on its feet, they would not want anything in return. We have to remember, that without Volkswagen, the company as we know it would possibly not exist anymore. It would either diminish under Renault or under the bitter burden of indebtedness. Alternatively, if it would have somehow earn its way and survive, it would struggle on the verge of bankruptcy.

So where does Škoda as a company stand nowadays? Well, one thing is certain, Volkswagen does not sponge on the company as Renault intended, and with no amplification, it can be stated that Škoda is a valuable partner and an equal. Furthermore, Škoda's long-term survival rests with success and failure of the entire Volkswagen Group and as the VW Group launches itself at the top of global automotive industry with all self-esteem, I believe, that Škoda will do just fine. So to answer the question, was it a successful move to join hands with Volkswagen? I honestly believe so.

10. Summary

Škoda Auto je v současné době jeden z největších zaměstnavatelů v České Republice, ať už přímo ve firemních prostorách v Mladé Boleslavi, Kvasínách a Vrchlabí, nebo nepřímo v domácí síti dodavatelů. Bohatá a rozmanitá historie společnosti a její důležitost na domácím trhu zapříčinila, že značka Škoda je hluboko zakořeněna v povědomí spotřebitelů jak na domácích trzích, tak i na evropských trzích. V současnosti se firma velice rychle rozvíjí v oblasti její působnosti na mezinárodním měřítku i v oblasti rozvoji výrobního portfolia. Jako taková se Škoda postupně stává klíčovým hráčem v evropském automobilovém průmyslu v oblasti prodeje, výroby i vývoje, a těší se stále rostoucí oblíbenosti doma i v zahraničí. Úspěch značky Škoda Auto se však rozvíjí na pozadí rozsáhlých transformačních procesů, které byly provedeny v průběhu devadesátých let, když Škodu Auto převzal koncern Volkswagen Group.

Tato práce, psaná formou případové studie, se tedy v podstatě zabývá problematikou akvizičních procesů v automobilovém průmyslu, konkrétně pak samotným procesem privatizace Škodovky. Práce dále analyzuje vývoj pozice Škody Auto v rámci koncernu Volkswagen Group a blíže se zabývá na transformační procesy v rámci firmy, které pomohly umístit společnost Škoda Auto mezi přední hráče automobilového průmyslu.

Bereme-li akviziční procesy v automobilovém průmyslu obecně, jedná se o procesy, které jsou a vždycky byly přirozenou součástí této oblasti průmyslu. V současné době rapidně se měnících a relativně nestabilních trhů je stabilita firmy kriticky závislá na jejím neustálém rozvoji a růstu. Spolupráce automobilových firem ve formě joint-venture partnerství je pak velmi efektivní a účinná metoda, jak společnost či koncern stabilně rozvíjet a zajistit její/jeho trvalý růst.

V minulosti, kdy byl automobilový průmysl roztržštěn do mnoha nezávislých frakcí, byly takovéto procesy na každodenním pořádku, avšak v dnešní době globalizovaných trhů, které jsou výsledkem krystalizace a shlukování těchto frakcí, je potencionální prostor pro růst a rozvoj působnosti firmy na trhu velmi omezený. Procesy akvizic a JV se proto postupně stává neefektivnějším řešením problému růstu.

Automobilka Škoda, jejíž historii lze datovat až do roku 1895, byla po mnohá léta minulého století symbolem síly a prosperity. Období stagnace a úpadku, které následovalo její znárodnění, však dostalo Škodu do kritické situace. Uzavřenost domácích trhů od okolního světa, která trvala více než 40 let, měla na svědomí to, že se Škoda přestala inovativně rozvíjet. Ačkoli její monopolistická pozice v rámci domácího trhu jí zajišťovala v podstatě stabilní pozici i poptávku po jejích produktech, vývoj automobilového průmyslu za hranicemi železné opony se řítit raketovým tempem kupředu a nechal Škodovku daleko za sebou.

Poptávka po zastaralých produktech Škodovky prudce klesala a ta čím dál více pociťovala potřebu rozvoje vývoje a výroby, aby vůbec dokázala přežít. Na konci osmdesátých let rozhodnutí pustit se takřka nezávisle do vývoje nového produktu, který by byl schopen obstát v evropské konkurenci, dovedlo Škodovku do silného zadlužení a dramatických problémů. Když se náhle evropské trhy po změnách v roce 1989 otevřely, Škoda byla paralyzována a ochromena na hranici bankrotu. Jakýkoli nezávislý rozvoj, který by zajistil dlouhodobé přežití společnosti, byl v podstatě neuskutečnitelný a vyhledání JV partnerství se silným zahraničním partnerem se proto zdálo být jediným východiskem z problému.

Potenciál, který ve Škodovce ležel, pak po vyhlášení záměru škodovku privatizovat přilákal značné množství zájemců z celého světa, ti se vzájemně předháněli v tom, kdo nejlépe vyhoví požadavkům československé vlády. Do užšího kruhu zájemců byl vybrán Renault a Volkswagen. Renault postupně předložil dva návrhy, které však byly nedostačující a příliš bezohledné vůči značce Škoda. Na druhé straně, Volkswagen svou nabídku zformuloval během blízké spolupráce se zástupci ze všech oblastí Škodovky a dostatečně naplňoval požadavky vlády

Když během námluv eventuálně Volkswagen předběhl Renault a byl vybrán za partnera Škodovce, stál před ním nelehký úkol: najít způsob, jak silně zadluženou společnost, s prkennou organizační strukturou a drasticky zastaralým portfoliem přetvořit tak, aby byla konkurenceschopná a schopná stabilního rozvoje v rámci evropských i globálních automobilových trhů. Kromě investování značného množství kapitálu bylo třeba také

dramaticky a důkladně reformovat management společnosti, její image, lidské zdroje a kvalitu i rozsah výrobního portfolia.

Asi největší výzvou představovala transformace řízení lidských zdrojů společnosti. Organizace společnosti do té doby byla strukturalizována tak, aby vyhovovala monopolistickému postavení výrobce na domácím trhu, tudíž byla neflexibilní a neschopna rozvoje. Poté, co se firmě ve spolupráci s jejími německými kolegy podařilo během tzv. „kick-off“ workshopu v listopadu roku 1990 úspěšně identifikovat všechny kritické problémy, které bylo potřeba vyřešit, byly nasazeny tzv. „tandemové“ týmy k řešení každého individuálního problému. Spolupráce Čechů s Němci na úrovni managementu se prokázala jako velmi účinné a zevrubné řešení.

Z oblastí, které bylo potřeba přetvořit, můžeme zmínit např. problematiku získávání nových pracovníků, tvorbu platového systému, rozvoj managementu na všech úrovních, reorganizace managementu na nejnižší úrovni apod. Výsledkem těchto transformačních procesů mezi lety 1990 až 1994 bylo, že organizace v rámci Škody vyhovovala požadavkům flexibility a přizpůsobivosti západních trhů a nově se objevila oddanost pracovníků k firmě a identifikace se značkou. Zaměstnanci byli motivováni k inovativním návrhům a zlepšením, což byla záležitost dříve spíše potlačována. Všechny tyto změny „v morku kostí“ společnosti Škoda napomohly jejímu rapidnímu rozvoji.

Transformovat řízení lidských zdrojů však nebylo to jediné, co bylo třeba udělat pro zajištění růstu a rozvoje společnosti. Pro cílového zákazníka jakékoli společnosti jsou spíše než vnitřní organizace, kultura či etika společnosti rozhodující finální produkty, které si spotřebitel kupuje. Do začátku devadesátých let měla Škodovka velmi špatnou reputaci co se kvality a spolehlivosti jejích výrobků týkalo. Škodovky byly proto cílem mnoha vtipů a ve společnosti technicky vyspělejších produktů západních trhů neměly šanci na jakoukoli konkurenceschopnost. Pro upevnění značky Škoda na trhu a zlepšení její image v očích zákazníků bylo proto nutné dramaticky zvýšit kvalitu a racionalizaci výrobního procesu, komponentů a v neposlední řadě přijít na trh s produkty, které by Škodu zbavily její nezáviděníhodné image.

Efektivita výroby prošla drastickými změnami. Do výroby byly zavedeny principy a procesy známé z prostředí japonských, vysoce produktivních firem, jako například fraktální organizace výroby či princip konceptu zaměstnanecké páteře továrny. Dále byly začleněny moderní a velmi efektivní způsoby výroby, mezi které patří například CAD-CAM návrhy,

SKD, MKD či CKD principy montáže či just-in-time organizace zásobování. Tyto změny zajistily vysokou produktivitu a snížení nákladů.

Pro cílového zákazníka však bylo zlepšení kvality výrobků klíčové. Toho bylo částečně dosaženo díky zavedení moderních výrobních postupů uvnitř firmy, daleko kritičtější však bylo adresovat problematiku kvality komponentů dodávaných dodavatelskou sítí společnosti. Od kvality komponentů se odvíjí celková kvalita produktů. Průzkum dodavatelské sítě, kde byli jednotliví dodavatelé hodnoceni známkami kvality, odhalil, že kvalita z 99% případů nevyhovuje. Dodavatelé pak byli následně nuceni zlepšit kvalitu dodávaných komponentů, aby byli schopni dále si zachovat své smluvní partnerství se Škodou. Integrace dodavatelské sítě se sítěmi v rámci VW pak zajistila trvalý přísun kvalitních komponent bez nárůstu nákladů.

Po zlepšení výrobních procesů a zajištění kvalitních komponent přišel na řadu vývoj nových produktů, které by byly schopné naplnit i překonat požadavky zákazníků. První vlaštkou pak byl model Felicie. Ačkoli byla založena na předešlém modelu Škodovky, Favoritu a byla stále technicky pozadu od svých konkurentů, stala se prodejním hitem jak na domácích tak na zahraničních trzích, díky své nízké ceně a vysoké užitné hodnotě. Dalším modelem nové generace se stala Škoda Octavia, při jejíž výrobě se naplno využilo moderních výrobních principů a vysoce kvalitních komponent. Byl to také první model vyráběn s přispěním unifikovaných dílů Volkswagen Group. Její kvalita a příznivá cena první Octavii zajistila vysokou popularitu 14 let trvající výrobu. Na úspěch Octavie pak navázal modela Škoda Fabia, která se také stala hitem jak doma, tak v zahraničí. Škoda si poté troufla na vyšší oblasti trhu se svým modelem Superb. Modely nástupnických generací se pak těší stejné oblibě, jako jejich předchůdci, ne-li větší.

Samotné uvedení více kvalitních produktů na trh však nebylo to jediné, co pomohlo zlepšit image Škodovky. Konvenční marketingové techniky se neprokázaly jako účinné a Škoda se proto rozhodla adoptovat netradiční způsoby propagace svých výrobků, směřované spíše směrem k sebekritice. Vtipné a širokou veřejností přijaté reklamy ještě posílily prodeje produktů Škoda, a to hlavně v zahraničí.

Výsledkem integrace vyšší kvality a útok na evropské trhy s modely, které více jak splňovaly požadavky zákazníků, spojený se vtipným a ve výsledku velmi účinným marketingovým mixem pomohly Škodě nejenom zvýšit prodeje a odbyt svých výrobků, ale také získat image výrobce, který vyrábí produkty na špičce jednotlivých tříd.

Škodovka následně na své rostoucí úspěchy v devadesátých letech navázala programem expanze na ostatní trhy. Snaha o expanzi v rámci Evropy nebyla možná anebo byla zhodnocená jako velmi obtížná. Svůj vliv na tento fakt měla jak pozice Škody Auto v rámci koncernu Volkswagen Group, tak i silná a neúprosná konkurence v rámci evropských trhů. Škoda se proto následně rozhodla o expanzi na velmi potentní východoevropské a asijské trhy, kde je poptávka stále rostoucí a potenciál místních trhů na absorpci nových produktů velmi značný.

V rámci svého programu expanze Škoda rozšířila své výrobní kapacity do zemí jako je Polsko, Ukrajina, Rusko, Indie nebo Čína, a i přes problémy, které sebou přinesla globální ekonomická krize, svou pozici na těchto trzích stále více upevňuje. Dále také Škoda značně rozšířila své exportní kapacity v celosvětovém měřítku.

Škoda byla v rámci koncernu Volkswagen Group původně zařazena jako značka, vyrábějící produkty pro nejnižší, tzv. „vstupní“ úroveň automobilového trhu, společně se značkou Seat. Přestože Volkswagen považoval svou strategii dvou značek atakující stejný trh za pozitivní tím, že z konkurence na nejnižší úrovni by hlavně těžil cílový zákazník, dopady této struktury byly poněkud odlišné.

Rostoucí úspěchy značky Škoda, stejně jako rostoucí úspěchy její bratrské koncernové značky Seat však způsobovaly problémy v rámci koncernu Volkswagen. Úspěchy jedné značky se tvořily na úkor jiné značky a vedení koncernu tuto problematiku brzy adresovalo tím, že restrukturalizovalo Volkswagen Group jako takový v roce 2001. V rámci koncernu byly vytvořeny dvě divize, Audi a VW, záměrem pak bylo minimalizovat vzájemnou kanibalizaci a více diferencovat portfolio. Škoda byla nově zařazena do divize VW jako vstupní značka. Od té doby již není předsedou správní rady Čech, ale Němec a celková samostatnost značky Škoda, stejně jako každé jiné značky koncernu, byla vážně omezena.

Zda lze ztrátu samostatnosti považovat za dobrý či špatný krok je pouze subjektivní. Faktem ale zůstává, že nová struktura koncernu Volkswagen Group splnila očekávání ze strany vedení a koncern jako celek stabilně roste, atakující první příčku mezi světovými výrobci. Jak je v rámci koncernů pravidlem, úspěšnost jedné značky jde ruku v ruce s úspěchem koncernu. Toto pravidlo také platí pro společnost Škoda Auto.

11. Abstract

Cílem této bakalářské práce je seznámit čtenáře s tím, jak koncern Volkswagen získal Škodu Auto a jak se mu podařilo přetvořit ji ze společnosti pokulhávající na pokraji bankrotu na úspěšnou společnost v rámci světových trhů, která se těší čím dál víc z přízně a zájmu zákazníků. Předtím, než se čtenář ponoří do problematiky joint-venture Škoda-Volkswagen, je seznámen s obecnými principy, které stojí za spoluprací světových automobilových firem, doprovázené názornými příklady. Následně je čtenář seznámen s pozadím a historií obou zmíněných společností a i s tím, co je vedlo k tomu uzavřít partnerství Škoda-VW. Následně je představen proces privatizace Škody Auto, kde jsou vysvětleny okolnosti, které vedly českou vládu k výběru Volkswagenu za partnera Škodovky. Dále probíranou problematikou je následná transformace společnosti Škoda Auto pod vedením VW, zahrnující přetvoření produkce, kvality, řízení lidských zdrojů a managementu značky společnosti. Dále je vysvětlena pozice Škody Auto v rámci koncernu Volkswagen a vývoj nových produktů, které dovolili Škodě upevnit si svou pozici na trhu. Nakonec se práce zabývá expanzí společnosti Škoda, která šla ruku v ruce s jejím úspěchem díky její úspěšné transformaci.

The aim of this bachelor thesis is to give the reader general ideas about how Volkswagen Group acquired Škoda Auto and managed to transform it from an enterprise limping on the verge of bankruptcy into a successful mass market car company that more and more enjoys acceptance and interest of its customers. Before dealing with Škoda-Volkswagen JV, the reader is introduced to general principles behind automotive JVs, supplied with examples. Consequently, the background and history of both companies involved, Škoda and Volkswagen, is introduced, explaining events that piloted them towards JV. The process of Škoda's privatization is introduced afterwards, interpreting circumstances leading the Czech government to choose VW to accompany Škoda in its future endeavors. Post-JV transformation of Škoda is the issue developed afterwards, describing transformation of production, quality, HR management and brand management of the company. Furthermore, general position and role of Škoda within VW Group is described, along with the development of new products which helped Škoda to consolidate its position in the market. Eventually, the thesis concerns with the expansion of the company, brought about by its success, consequent to the successful its transformation.

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