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Skoda automobilová, Mladá Boleslav: a Czech-German joint venture in the automotive industry

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SKODA AUTOMOBILOVÁ, MLADÁ BOLESLAV
A CZECH-GERMAN JOINT VENTURE
IN THE AUTOMOTIVE INDUSTRY

by
Birgit Sander

August 1994



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Preface

Joint Ventures (JVs) between western and eastern partners have mushroomed in recent years. Not all of them have a chance to become successful. Trial and error is a basic principle of the western-style market economy. A mixed blessing of success and failure appears to be the rule. Given the manifold imponderabilities in eastern countries it is not difficult to predict that many JVs will fail. A JV is like a marriage: not all of them will run into a happy future, though at the start hopes are running high.

Highflying expectations, in a marriage as well as in a JV, are the main cause for failure and dissatisfaction. In the beginning, partners tend to expect too much from each other. Later on they compare their present situation not with that of the past but with their initial expectations - which were often unrealistically optimistic. Thus, a relatively negative assessment does not need to be an expression of bad experiences but rather a reaction towards outcomes remaining behind expectations.

As in a marriage the partners of a JV are not permanently honeymooning. They have to cope with the worse, too. While a marriage should have much to do with love and affection, a JV must be strictly based on economy efficiency to be successful. Furthermore, many western JV-partners are polygamous, i.e., they are large multinational holding companies with manifold participations in different countries. To be successful they have to reconcile the diverging interests of their partner companies. This requires a long-term and comprehensive strategy.

The following paper on the JV between the Volkswagen AG and Skoda Automobilová a.s. describes how close JV partners are tied to each other - and that they have to share the burden of a setback occurring to anyone of them. The trouble with SEAT has clearly pointed out the importance of well tailored investments and led VW to size down the ambitious investment program initially designed for Skoda. This caused a lot of irritations between the two partners and, moreover, aroused resentments of the Czech population towards foreign investment in general. In a first comment the Czech Minister of Industry and Trade, Vladimír Dlouhý, expressed his deep dissatisfaction: the son-in-law proved to be far less potent than initially expected.

Mostly, however, public perception of such crises in JVs does not reliably reflect actual changes in real conditions. As only bad news is good news the media focus on the negative issues and do their best to keep them at the center of public attention. The paper demonstrates clearly that the JV between VW and Skoda has developed far better than it has been realized by the general public.

The paper was written as a contribution to the project No. 92-0123-R of the PHARE-ACE-program of the EC "Joint Ventures in the Context of Investment Strategies of their Partners". An earlier draft was presented at a workshop in Budapest from June 10th to 12th, 1994. The workshop yielded two other papers dealing with the topic, one adopting a Czech, the other a Spanish point of view.* Copies are available from the authors on request.

Klaus-Dieter Schmidt

* Jana Sereghyová, "Recent Developments and the Perspectives of A.A.S. Skoda, the Joint Venture established by the Volkswagen Concern and the Automotive Concern Skoda Mladá Boleslav CSFR" and Maria Teresa Virgili, Benjamin Bastida, "Development and Perspectives of the SEAT S.A. after the Acquisition by the Volkswagen Concern".

- Multinational companies are global players on international markets and locational choice is an important strategic variable for them: they are present in all countries whose markets are relevant either to produce or to sell their products. Transformation of the former socialist countries in eastern Europe has opened new playing fields both in terms of attractive locations for production and in terms of huge unexplored sales markets. In general, foreign markets can be served by either exporting, licencing or foreign direct investment (FDI). The transforming economies of eastern and central Europe are mostly very much interested in receiving the inflow of foreign investments. Key element to make these undertakings profitable is to combine host country national resources - acquired by the foreign investor - with resources transferred from his headquarters, namely capital, production technology and further intangible assets like management know-how, corporate identity and entrepreneurship. Easterners expect foreign investors to substantially contribute to restructure and modernize their country's economic potential.
- In the long term, interests of national governments and foreign investors are converging: they both want the investments to be profitable as this makes the country benefit, too. Nevertheless, in the short and medium term there is considerable leeway for dissent on how this goal can be reached. Employment, wages and investment targets are highly sensitive issues. Disputes about them may arise easily and erode the confidence between governments and investors. This will be especially intricate if the enterprise under consideration is not entirely foreign-owned but if national government bodies themselves hold part of its equity.

I Skoda in the Context of the VW Corporate Strategy

- The Volkswagen Group (VW) is one of the biggest multinational global players and its companies are operating in 19 countries of the world. VW displays high interest in developing activities in the transforming socialist countries. It has taken considerable commitments there since the beginning of the 90s (Table 1).
- Skoda is the world's third oldest car maker and the most traditional one in eastern Europe. It was founded in 1905 by two Czech engineers, Vaclav Laurin and Vaclav Klement. In 1925 it was taken over by the machine building enterprise Skoda, Pilsen, and adopted its name. In 1945 Skoda was nationalized; in 1950 it was transformed into a stockholding company.

Table 1 - VW Production Sites in Socialist and Former Socialist Countries 1993

Company(a)	Date of Beginning	Country/City	Total Equity(b)	Equity Share of VW Group	Equity Share of Further Owners
Shanghai-Volkswagen Automotive Company Ltd.	October 1984	China/Shanghai	1,200 mill. CNY	50 p.c. VW AG	25 p.c. Shanghai Automotive Industry Comp. 15 p.c. Bank of China 10 p.c. China National Automotive Ind. Corp.
Sächsische Automobilbau GmbH	December 1990	Germany (Saxonia)/ Mosel	10 mill. DM	100 p.c. VW AG	-
FAW-Volkswagen Automotive Company Ltd.	February 1991	China/Changun	1,680 mill. CNY	40 p.c. VW AG	80 p.c. First Automotive Works
SKODA automobilová a.s.	April 1991	Czech Republic/ Mladá Boleslav	9,642 mill. CZK	31 p.c. VW AG	69 p.c. Funds of National Property
Volkswagen Bratislava spol. s.r.o.	May 1991	Slovak Republic/ Bratislava	1,055 mill. SKK	80 p.c. VW AG	20 p.c. Bratislavské Automobilové Zavody a.s.
Motorenwerke Chemnitz GmbH	June 1991	Germany (Saxonia)/ Chemnitz	5 mill. DM	100 p.c. VW Sachsen GmbH	-
Volkswagen Sachsen GmbH	September 1991	Germany (Saxonia)/ Mosel	10 mill. DM	100 p.c. VW AG	-
Volkswagen Poznań Sp. zo. o.	November 1992	Poland/Poznań	40,2 mill. DM	25.4 p.c. VW AG	74.6 p.c. FSR Polmo
Audi Hungaria Motor Kft.	February 1993	Hungary/Győr	2 mill. DM	100 p.c. Audi AG	-

(a) Name and legal form. - (b) National currency.

Source: Volkswagen AG (1993).

- The Czech car industry was the most advanced in the former COMECON. It did not only produce the largest volume of cars but was also one of the most successful eastern exporters. 35 percent of Czech passenger cars were sold abroad and more than two thirds of all exports went to western European countries. The largest buyer was Great Britain absorbing nearly one third of Czech cars sold to western Europe. The early orientation towards western markets and the probably best equipped car plant in eastern Europe made Skoda an attractive partner to western car producers. The more so as it offers low labour costs, well qualified staff and is placed at a favourable location.
- The Skoda - VW joint venture was established in April 1991. It comprises several individual corporations: the production site Skoda Automobilová (Skoda a.a.s.) in Mladá Boleslav and three selling companies, one in each France (Paris), Italy (Verona) and Germany (Weiterstadt). Skoda a.a.s. in Mladá Boleslav is one out of the 15 most important production sites in 12 countries which are run under the roof of the VW group. It comprises the main plant in Mladá Boleslav itself and two nearby plants in Vrchlabí and Kvasiny. The three Skoda selling companies are part of the 14 major selling companies in eight countries which belong to the VW group. This set of firms is complemented by SkoFIN s.r.o., Prague, one out of the group's nine larger financial companies. At the end of 1993 total employment within the VW group was about 253 000 persons, of which Skoda employed about 17 000 persons (6.7 p.c.). Over the past two years, Skoda was one of the most successfully developing group members. It was not only able to consolidate but also to noticeably expand its role with the group (Table 2).

Table 2 - Development of Skoda within the VW Group (a) 1992-1993

	1992	1993
Production	5.7	7.3
Sales to retailers	5.8	7.7
Turnover	1.7	2.3
Purchasing volume	2.2	3.4
Investment volume	7.0	3.9
Employment	6.3	6.7

(a) Percentage share of group total.

Source: Volkswagen AG (1993).

- Skoda a.a.s. is VW's largest commitment in eastern Europe and virtually the largest of all western corporate commitments in the former Soviet bloc. Skoda represents an important part of the Czech economy as it accounts for 3.5 percent of total employment and 5 percent of total exports. As one of the most traditional Czech enterprises it forms part of the national "family silver" and is considered to be highly important for national economic self-esteem. Therefore, VW's activities in Mladá Boleslav are highly exposed to public

interest. In its entrepreneurial decisions VW has to take proper account of this. Political interference in running the company is to be expected as the Czech Fund of National Property still holds 69 percent of the equity. The texture of interwoven property rights has been reinforced as in April 1994 two high ranking Czech officials took seat on Skoda a.a.s.'s supervisory board. The minister of finance became board member and the minister of trade and industry was even appointed vice chairman of the board.

- Entering the joint venture, Skoda a.a.s. has been integrated into the VW multinational group and its global networks of supply, production and sales. The individual companies of large multinationals like the VW group are linked with each other first, by the amount and the quality of internationally mobile resources the group disposes of and second, by the extent to which individual companies may be disposing of parallel capacities, i.e. capacities which are - to a certain extent - substitutional to each other as they are usable to serve overlapping or neighbouring market segments. A common pool of resources and substitutional capacities are tying the group of formerly individual, independent companies up to form a larger unit which has to operate under common constraints. With respect to resources the group will be constrained by the extent to which it disposes of internationally mobile resources, namely capital - or creditworthiness -, advanced production know-how and management know-how. Richness in common resources tends to make the group prosper while scarcity imposes a burden which - however distributed - has to be shared.
- With respect to capacity the group will be constrained as it has to ensure a fairly even utilization of the potentially substitutional capacities it may have at different places. It cannot allow for idle capacities at one place - threatened by closing down - and release bottlenecks at other places by means of expanding facilities there. The group faces an inherent conflict between the concern of full or at least even employment of all existing capacities - especially local labour - and the concern to shift production to those places where productivity is highest. This conflict remains under cover as long as market developments are favourable but it comes into the open if markets are declining and parts of total capacity are becoming redundant. By capacity links market fluctuations are usually spread more evenly among group members than among independent enterprises. Furthermore, group members are less vulnerable to market fluctuations as group membership gives them easier access to international markets and thus opens up larger sales potentials. On the whole and in the long term both resource links and capacity links can be assumed to reduce market risks and to contribute to a more stable development of the multi-company enterprise.

- In order to ensure that the strategic plans are properly implemented VW Wolfsburg delegates managers from the headquarters, so-called expatriates, to each group company. Managerial manpower at present times is urgently needed at many places due to pressing general and regional problems. In recent years the car industry has suffered from recession and in 1993 VW's most important sales markets, the western European markets, contracted by about 14 percent. In this setting VW is highly exposed to fierce international competition and - being a high cost producer compared with other global players - it is forced to realize substantial cost cuts in order to regain competitiveness. As a specific problem, staggering Seat burdens the group with huge losses. This tightens financial restraints all over the group. Skoda, too, appears to be tangibly struck as investment volumes have been cut substantially.
- The management know-how by which the group and its members are directed materializes both in the design of strategic devices and in the man power occupied with implementing the strategy. The VW group strategy is designed in the Wolfsburg headquarters. It outlines a federal organizational structure and lays down common basic rules within which each member company operates independently, namely develops and keeps its own brand label and tends its own market. This shall make sure that group members are not entering into competition with each other on the same markets but rather that the group as a whole is successful in reaching a larger share of the world's car markets.
- Skoda is to be fully integrated into the group's efforts to improve productivity and product quality. In order to become more competitive VW itself felt the need for comprehensive restructuring. It substantially revised its strategic orientation and production concepts. In this respect, VW had learned a lot from its Japanese co-operation partners. Ever since it became involved in its projects with Nissan for producing the Santana in Japan, and with Toyota for producing pick-up trucks in Germany, VW has been learning and adopting advanced Japanese techniques.¹ The core element of improvement is to efficiently manage the flow of materials through the plants. This is achieved mainly by Just-In-Time (JIT) deliveries which require both to adapt internal structures and to establish close partnership with suppliers which on their part, too, have to commit to new concepts of production and co-operation.

¹ Hartley (1992).

- Introducing JIT deliveries is embedded in a comprehensive approach of "lean production". New plant structures² have to be implemented (interlinked production systems, employee-oriented work procedures, JIT-suited logistics) as well as new lean managerial structures. As innovation processes are developing dynamics of their own VW has labelled them CIP, Continuous Improvement Process, later even CIP², Continuous Improvement Process squared, in order to express outstanding commitment and fortified effort. The CIP²-concept comprises all the elements elsewhere known as TQM, total quality management.
- Starting out from production processes by CIP its principles are also applied to improve all further stages of the value creation process, including model range, R&D and co-operation with external suppliers. The model range policy follows a new approach which intends to reduce the number of platforms used throughout the group. Henceforth within each category of cars all model lines shall be built on the same platform (floor, engine, gear, axles) and then will get their individual body shell. The "lean approach" to R&D is based on the principles of SE, simultaneous engineering. Henceforth, all departments involved in product planning, product development and market operations are allowed to work jointly and parallelly in time - i.e. simultaneously rather than sequentially as in the past - on launching a new car.
- Throughout all departments, staff people are involved in the CIP processes. Building up team orientation is considered to be crucially important. CIP workshops - of which more than 1 000 were held in 1993 - are generating a "snowball effect" by which improvements are put into practice at considerable speed. These efforts are extended in order to integrate external suppliers as equal partners into the value creation process. The overall target of CIP is to establish an integrated system of production and procurement throughout the whole group while at the same time preserving its "federal" structure, namely the individual brands which shall retain their distinctive identity.
- There are some striking similarities between the Czech and the Spanish car industry and the role VW plays in each environment.³ Both by production and by sales VW is one of the major players in either country. Furthermore, both Skoda and Seat produce small, cheap cars and serve neighbouring market segments. In this setting Czechs feel some rivalry with their Spanish sister company and suspect to come off badly - or even to be

² Famous example for the "factory of the future" already at work has been VW's Hall 54 at Wolfsburg. The next generation of modern production facilities has been put into operation in Matorell, Spain, and in Mosel near Zwickau in Germany.

³ For a detailed analysis of VW's Spanish subsidiary Seat see Virgili, Bastida (1994).

exploited in favour of Seat - when financial funds are (re)allocated. From an outsider's perspective it may appear to be merely coincidence that Seat experienced huge losses while Skoda was able to pass the break-even point and even succeeded to return a profit. Some Czech observers, though, anxious about Skoda's development are sure to perceive a causal relationship between the actual increase of funds allocated to Seat and the recently curtailed investment programs for Skoda. Evidently, both companies draw on the group's financial resources - although to a considerably different degree. While Seat fell into acute crisis and virtually called for a rescue operation, Skoda is a basically healthy company in need of restructuring in order to become internationally competitive. As a rule, if funds are to yield highest returns they have to be allocated to where they are most urgently needed. And as a matter of fact, at a certain point of time the urgency to refloat Seat was evidently exceeding the needs of restructuring Skoda. It is of no surprise that in this setting the group's overall allocation scheme has been modified such that Seat received a greater weight and more funds than otherwise. A similar shift of resources towards Seat occurred with respect to management know-how. Detlev Schmidt, for instance, said to be VW's top sales manager, first was in charge of selling Skoda cars and realized a remarkable success for the Czech company. Then he went to Spain helping troubled Seat to recover. Reportedly, he reached outstanding results there, too.

II Negotiations and Acquisition Agreements

- Already as early as 1987 VW established first contacts with Skoda. This was done on an informal basis by exchanging letters of understanding and intended to provide operational support. The activities of VW in Mladá Boleslav are inspired by strategic considerations: VW intends to preempt its competitors by developing the potential Skoda offers with respect to the eastern European markets. This holds in terms of production capacity and in terms of relatively cheap, qualified labour as well as in terms of sales opportunities on eastern markets. In addition, certain segments of western markets shall be served from VW's Czech production base.
- In 1991 VW won the public tender - organized by Price Waterhouse, an international investment house - by which Skoda was privatized. The main reason why VW had gained an edge on Renault, its strongest competitor in the bidding process, was that VW other than Renault promised to continue the operation of Skoda as an independent brand. This feature of the privatization process was important for political and psychological reasons as the Czechs give high priority to continuing their engineering tradition. Evidently, it fits well into the VW corporate strategy where each brand is supposed to cultivate its own image and to serve its own market.

- In equity arrangements VW usually goes for majority participations of at least 50.5 percent. In the case of Skoda though, political and psychological considerations were impeding this and VW accepted to acquire a minority stake of only 31 percent (620 mill. DM) in the company's equity. Nevertheless, VW has full say in running the company. In addition, the acquisition contract included an option to raise VW's share up to 50.5 percent in 1994 and up to 70 percent in 1995. This would require further capital injections of 580 mill. DM and turn the Czech company from a joint venture into a fully fledged VW subsidiary. However, the option to raise VW's equity share up to 70 percent temporarily appeared to be endangered as the Czech government suspected that with revising the Skoda investment program the once defined development targets would have been renounced, too.
- The acquisition agreement included a two-year tax holiday which expired at the end of 1993. Since then Skoda has been subject to corporate tax at a rate of about 45 percent. The effective tax rate, though, is expected to be only minimal, thanks to depreciation allowances on capital expenditures and a five-year tax loss carry forward ("Verlustvortrag") allowed under the new Czech tax code. Furthermore, the government released Skoda from around 5.5 bill. CZK of old debts and took responsibility for cleaning up environmental pollution. The Czech government also granted trade protection to Skoda a.s.: first, components needed for production were allowed to be imported duty-free as long as the volume of imported components would not exceed the volume of those which were exported. Second, the Czech government agreed to levy an import duty of 19 percent ad valorem on newly produced foreign cars. The rate shall be reduced over time and the tariff is scheduled to expire in 2001. Tariffs which are levied on imported second-hand cars are varying according to the car's age. Thus, on the domestic market Skoda enjoys a certain, though decreasing degree of trade protection. On export markets basically GATT rules are applied.
- The mainstays for Skoda's future development have been an integral part of the negotiation process but only became an informal part of the acquisition agreement. VW committed itself to effect an 8.2 bill. DM investment program for Skoda over the next 10 years including the modernization of existing facilities, building a new car plant, doubling production capacity up to around 400 000 cars a year by the end of the decade, developing new models to extend the Skoda model range and expanding the Skoda dealer network throughout Europe. Apart from VW's 1.4 bill. DM initial injection of new capital - including its payment for shares - the Skoda investment program was scheduled to be financed by Skoda's own cash flow and by bank borrowings on behalf of Skoda. Borrowings were negotiated with the European Bank for Reconstruction and Development, the International Finance Corporation and some private banks.

III The Joint Venture Set-up and Its Development

Model Range Policy

- In its joint venture with Skoda VW intends to develop Skoda into a fully fledged fourth nameplate next to the established VW, Audi and Seat trademarks. Skoda shall represent the Central European counterpart to the Mediterranean character of Seat. While Seat is considered to embody "southern vitality and joy of life" and to cultivate an emotional image, Skoda is supposed to represent "rationality", namely to offer an "intelligent, mature technology" at an attractive relation of price and quality.⁴ Since 1991 Skoda has been producing three models: the Favorit, a hatchback model, the Favorit pick-up and the Forman, a five-door combi variant of the Favorit. This model range is assumed to be marketable on both national and international markets. It shall be enlarged by a new model in the lower middle range until 1995.

Production and Sales

- Skoda's production and sales strategy is based on the assumption that there will be demand for around 3 mill. cars in central and eastern Europe - excluding the former Soviet Union - in the second half of the 1990s. The aim is to sell one third of production jointly to the Czech Republic and Slovakia, one third to other central European countries, and one third to western Europe. These goals appear to be quite ambitious, especially as recession is hitting all target markets. In 1991, Skoda's sales fell by 8 percent from 187 000 cars in 1990 to 172 000 cars, though they recovered in 1992, rising by 16 percent to 200 000 cars. This was achieved despite declining Czechoslovakian industrial production of 30 percent and 10 percent in 1991 and 1992 respectively. Sales in 1993 grew by about 10 percent against previous year while industrial production in the Czech Republic was stagnating. These results are remarkable, especially if contrasted to group performance: in 1993 world-wide sales of the VW group diminished by around 11 percent against the previous year with sales of Volkswagen, Audi and Seat declining by 10 percent, 25 percent and 15 percent respectively.
- In 1990, two thirds of Skoda's production was sold on its home market. In 1991, domestic sales fell sharply as the government opened the market to foreign imports by the re-

⁴ The image of VW cars has ever since been coined by confidence and reliability and was supposed to appeal to consumers of all social strata. Cars of the Audi brand are targeting the upper segments of the market. They are made to satisfy demanding consumers, offering advanced technology and a specific design.

removal of a 15-20 percent import tax. A flood of privately imported second-hand cars and the illegal export of Skoda cars initially distributed to local were cutting domestic sales by around 27 000 cars. But a high volume of exports to Yugoslavia and Poland compensated for declining domestic sales. In 1992, the war in Yugoslavia and Poland's imposition of tariffs on car imports (35 percent ad valorem) hit exports badly. This drawback, though, could be overcompensated by successfully entering new markets in Turkey and Israel. In 1993, the year of political divorce, sales to the Czech Republic and to Slovakia slightly exceeded the volume of 1992. Sales to Germany decreased considerably by 70 percent, reflecting mainly that the unification driven demand boost was exhausted. The performance on other western markets (mainly in France, Norway, Greece, Portugal and the Netherlands) improved markedly while - due to trade barriers (Table 3), lack of purchasing power and the war in former Yugoslavia - sales to central and eastern European countries were below the level of 1992. Again, this decrease could be compensated by entering new markets, that year in Asia (South Korea e.g.).

Table 3 - Trade Barriers to Imports from the Czech Republic in Selected Eastern European Countries 1994

Country	Import Tariffs	Basic Rate (Percent ad valorem)	Preferential Rate (Percent ad valorem)	Date of Expiration
Poland		35 (a) + 6 (b)	35 (a) + 6 (b)	1988
Hungary		18 13 (c)	18 13 (c)	1988
Slovak Republic		19	0	-
Romania		50	30	-
Slovenia		25	23	1988
CIS		20 - 80	-	-
Bulgaria		15	0	-

(a) Tariff rate applied to car imports. - (b) General import duty. - (c) For cars equipped with catalyst.

Source: Volkswagen AG, compiled from official sources.

- Skoda's sales operations have been completely restructured and now rely largely on a network of exclusive Skoda sales organizations created on all the company's relevant markets. In France, Italy and Germany they have been newly established for this purpose. Skoda Automobile Deutschland GmbH, e.g., was founded in September 1991 and handles imports and sales of Skoda cars in Germany. Two thirds of its equity are held by Skoda a.s., the rest is held by Georg Urban GmbH, Kiel, whose owner was formerly in charge of distributing Yugoslavian cars. Until the end of 1991, Skoda Automobile Deutschland GmbH co-operated with the old Skoda dealer, Sanex Metall und Maschinen GmbH who was a subsidiary of Motokov, the former Czechoslovakian state exporter.

Since 1992 Skoda Automobile Deutschland GmbH has been the exclusive importer and dealer of Skoda cars to the German market. Its main task is to establish a dealer network covering the whole German market (Table 4). The target has been to establish a network of around 600 dealers in 1993 and to enlarge it up to 1 000 in the following years. Skoda's new dealers are mainly recruited out of its traditional distributors, partly out of qualified independent workshops. Additionally, some VW-dealers are ready to set up sales rooms and workshops exclusive to handle Skoda cars. In 1992 Skoda sold around 26 000 cars in Germany and had a share of 0.6 percent in the German market, rising up to 1.0 percent in 1993. With Urban as the partner of Skoda Automobile Deutschland GmbH, Skoda won an agent knowing how to sell eastern cars on western markets. Urban reckons that Skoda's restructuring will proceed quickly and tangibly, probably even faster than that of Seat when it was taken over by VW some 10 years ago.

Table 4 - The Skoda Sales Network

	1992	1993
Number of dealers	1 800	2 250
of which		
in the Czech and Slovak Republics	250	280
in western Europe	1 300	1 650
of which		
in Germany	410	600

Source: Frankfurter Allgemeine Zeitung (1991); Volkswagen AG (1992, 1993); Börsenzeitung (1993).

- With becoming a member of the Volkswagen Group Skoda also took charge of importing VW, Audi and Seat vehicles into the Czech Republic and the Slovak Republic. In 1993 Skoda sold a total of around 4 800 VW, 380 Audi and 2 700 Seat cars to Czech and Slovak dealers.

Employment and Wages

- With VW acquiring part of Skoda's equity and assuming full management responsibility Skoda's staff has been completely taken over and has even been raised slightly from about 16 400 to about 17 000 employees in the main plant and its two subsidiaries. Finding new workers is not a problem with the average monthly pay of skilled workers (6 000 CZK plus 36 percent non-wage labour costs) about 20 percent higher than in other local industries. Low labour costs broaden Skoda's profit margins, particularly compared with car manufacturers in Germany, one of the world's most expensive places to make cars. Cost per worker at Mladá Boleslav is about 5 to 7 DM per hour, thus only a tenth of the costs of a German worker (50 to 55 DM per hour). And Czech workers put in

1.5 hours for every hour worked by their German colleagues. Skoda's Czech staff is joined by some 100 expatriates from Germany whose main task is to introduce the VW corporate identity and to make sure that new production concepts and technologies are properly implemented.

Productivity and Product Quality

- While investment policy is hotly debated, projects under way are progressing well: in-plant logistics have been completely overhauled, a new paint shop has been built and a new assembly line is under construction. Together with numerous smaller improvements - of which around 700 have been introduced since April 1991 - these investments contributed to enhance both productivity and product quality. Labour productivity rose by 7 percent annually during the first two years of the joint venture's operations and by further 10 percent in 1993 (measured in terms of daily production per employee). Similarly, product quality began to improve. On a scale ranging from 6.0 to 1.0 (best mark) Skoda started out at the level of 4.8 and meanwhile has reached 4.2. Its medium term target has been defined at 2.6, while the VW Group standard is actually set at 1.8. It is noteworthy that within the Volkswagen Group it is Skoda who proudly reports the largest quality improvements over the past two years.

Research and Development

- R&D is an important element in restructuring as Skoda has the chance to take full advantage of employing highly qualified research people at comparatively low wages. The R&D team has been enlarged and now employs about 900 people. Parallel to enhancing the team's size, its qualification profile is subject to considerable change. Its share of technical draughtsmen is to decrease while its share of highly qualified engineers is to increase. The team is supposed to develop a new Skoda model until 1995.

Suppliers

- Throughout the whole Volkswagen Group component suppliers are comprehensively integrated into the processes of improving product development and production. Thus, Skoda's traditional suppliers and their restructuring became an integral part of VW's development plan for Skoda. The new supplier concept aims to integrate suppliers as equal partners in working through the value creation process and promoting them to become efficient system suppliers. As improving production processes as well as product development strongly rely on implementing just-in-time deliveries and on standardizing car

components, close co-operation is indispensable. VW's approach of suppliers' integrated development is considered to be one of the most advanced concepts of production and organization in the world's car industry and tends to make VW's commitment to Skoda beneficial to the Czech and the Slovak car industry as a whole.

- Skoda's competitiveness crucially depends on a sound purchasing policy, namely on cheap supplies. Presently, Skoda purchases around 80 percent of its supplies in the Czech and in the Slovak Republic; about 70 percent of its suppliers are located there (Table 5). The purchasing volume of supplies accounts for nearly two thirds of Skoda's turnover on car sales. Skoda realises its purchasing policy in close co-operation with its domestic - both Czech and Slovak - suppliers. They, too, receive VW's assistance in order to restructure simultaneously with Skoda for its part and to meet Skoda's increasing demands, especially to keep pace with rising quality standards. Creating an efficient national supplier industry which shall be fully integrated into the Volkswagen Group is meant to secure long-term competitive advantages for Skoda and, above this, to gradually develop into low-cost high-quality sources of supply for all members of the Volkswagen Group. VW, Audi and Seat have already decided to purchase materials worth 2.3 mill. CZK from Czech suppliers.

Table 5 - Structure of Skoda's Supply Relations 1993

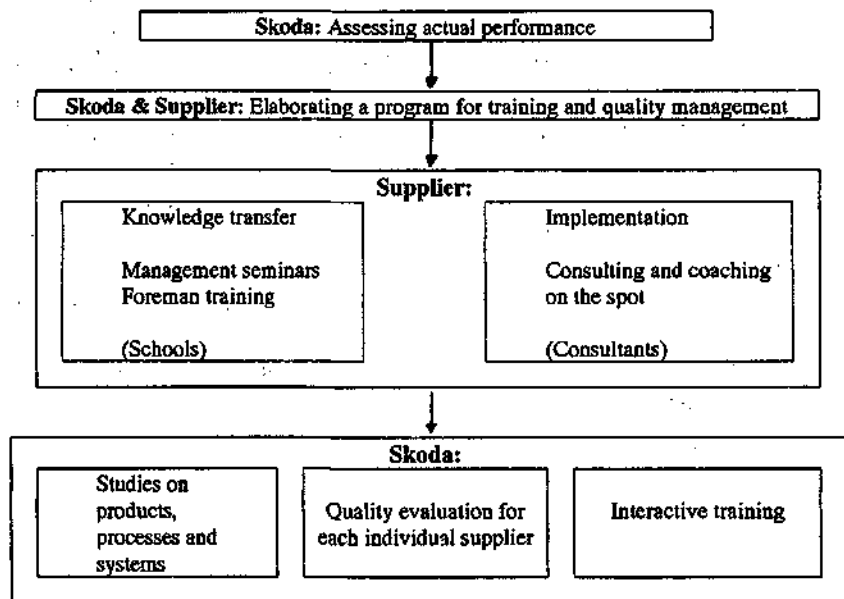
	Number of suppliers	Volume of turnover (bill. CZK)
Czech suppliers	210	14
Slovak suppliers	25	3
Others	105	4
Total	340	21

Source: Volkswagen AG, unpublished data.

- The pivotal strategic device for fully integrating national supplier companies into the group networks is to provide them with spots for production at Skoda's newly built factory. Suppliers will equip these places with their own technical facilities and will then set out to build car components according to Skoda's requirements. By this, transport of bulky parts and complex components is minimized as they are produced on the spot. Suppliers only have to be presupplied with simple materials such as steel and tubes. Beyond cost reductions for transport and handling this approach of close logistic interlinking allows for optimal information flows and a more efficient quality auditing.
- To participate in this development is a quite demanding task for Skoda's traditional suppliers as it requires the companies' readiness to relocate as well as to substantially push up product quality and production efficiency. In order to promote comprehensive restructuring throughout the entire value creation process and to facilitate efficient pro-

curement Skoda's suppliers are involved in sophisticated qualification programs which include training, seminars and workshops with western partners as well as tough quality auditing (Chart 1). Although the Volkswagen Group's quality targets are very ambitious, considerable improvements have already been made.

Chart 1 - Supplier Qualification Program



Source: Volkswagen AG, unpublished material.

- Besides locating suppliers under the very roof of the new Skoda factory a further element in restructuring supply networks is to invite national suppliers to joint venture enterprises in which foreign investors provide the local partner with both capital and know-how - those very inputs which local companies did not receive by means of coupon privatization. Volkswagen's commitment to Skoda has set the scene for many other western investors to follow. So far, leading European and American suppliers have set up 26 joint ventures with local companies and have initiated 12 greenfield investments.

Environmental Protection

- Environmental protection is a further element in VW's development plan for Skoda. The overall group strategy, beyond the concerns of productivity and competitiveness, attaches high importance to environmental protection. Against this background and confronted

with considerable pollution problems at the Czech production site VW and Skoda are setting up a system of waste disposal management at Mladá Boleslav. A concept has been elaborated which in a first stage specifies all types of waste which are occurring, the places where they are liable to be produced, the location of waste collection containers as well as the necessary in-plant logistics to be implemented in the new paint shop, press shop and body shell shop which are under construction in Mladá Boleslav. In a further stage the entire waste infrastructure shall be reviewed. The ultimate goal is to develop a waste-disposal structure which allows to achieve the optimal recycling rate for each material.

Investment Policy

- When Skoda and VW were negotiating the establishment of their joint venture, future investments have been an issue of crucial importance. VW presented a 10-year financial projection totalling a volume of 8.2 bill. DM in order to effect product and technology investments meant to underpin Skoda's competitiveness in the long term. The program included the modernization of existing production facilities as well as the building of a new car plant, doubling production capacity to 400 000 cars a year by the end of the decade, developing a new Skoda model and expanding the Skoda dealer network throughout Europe.
- Apart from VW's 1.4 bill. DM initial injection of new capital - including its payment for shares -, the Skoda investment program was to be financed by bank borrowings on behalf of Skoda and from Skoda's own cash flow. Bank borrowings were negotiated with the International Finance Corporation (IFC), a World Bank subsidiary, the European Bank for Reconstruction and Development (ERBD) and a group of private banks. These deals had been nearly completed when VW announced that Skoda's investments would be curtailed to such an extent that the already negotiated credits were not needed. This astounding announcement caused a lot of rumour in the general public and serious irritations between the Czech and German partners. VW argued that the initially agreed targets of restructuring, capacity growth and technology development could be realized with a substantially smaller volume of funds.
- Revising the investment program comprised both a major reduction of its financial volume and a minor reduction with respect to the envisaged projects. According to VW, reducing the financial volume became possible, first, as Skoda made good progress in improving its productivity - mainly by rationalizing throughout the whole enterprise, by adopting a platform strategy of production and by benefiting from being incorporated in the group supply networks, second, as the close integration of Skoda suppliers into the

production process led to an utmost lean structure of the supply system and, third, because, due to recession, capital goods could be purchased at a 20-30 percent discount. Against this background the financial volume of investments had to be downsized in order to ensure an efficient use of funds so as to realize restructuring targets in a lean and profitable way.

- With respect to envisaged projects only plans concerning engine construction at Mladá Boleslav will not be realized to the extent that has been initially intended. As future demand for engines is expected to decrease and as capacities at German production sites are under-utilised, engine construction in the Czech Republic will be established with a lower degree of vertical integration than previously outlined. Still, Czech suppliers are supposed to produce the largest part of the engines' components. These components will then be assembled automatically in German plants while final assembly, which cannot be fully automatized but needs a lot of handiwork, will be carried out at the Skoda plant. All in all the decision to curtail the ambitious program seems both to reflect the concern of investment efficiency as such and to correct an expansionary development course which is not - or no longer - in accordance with expected market developments. Apparently, this decision has been taken in the very last moment. But presumably it will save Skoda the costly experience of getting oversized.

Restructuring Record

- Over the past three years joint restructuring efforts of Skoda and VW have definitely yielded positive results for the Czech car manufacturer (Table 6). All key indicators reveal a considerable extent of improvement and prove that Skoda is on its way to managing the crucial turnaround. Production increased by around 10 percent last year and production per day rose by more than 8 percent each year. Similarly, turnover and sales grew by 18 and 15 percent last year. Employment grew slightly over the past two years and the break-even point has been passed already in the second year of the joint venture's operations. Although not all initial plans have been realized at full degree it is evident that such results as Skoda is able to report are the exception rather than the rule in enterprise restructuring - irrespectively if the task is to restructure an ailing western enterprise or if it is to restructure a former socialist enterprise.

Table 6 - Development of Skoda 1991-1993

	1991(a)	1992	1993
Employment (persons) (b)	16 360	17 110	17 050
Investment (mill. DM)	61	198	252
Production (units)			
- per year	109 690	200 060	219 610
- per day	756	812	889
Sales to dealers (units)	110 800 (a) 172 200 (c)	198 660	229 450
Turnover (mill. DM)	800	1 680	1 980
Profits (mill. DM)	-40	233 (d) 70 (e)	-246 (d) 8 (e)

(a) For short business year since April 16th, 1991. - (b) End of the year. - (c) Whole year. - (d) According to Czech accounting rules. - (e) According to group consolidated accounts.

Source: Volkswagen AG (1992, 1993); Börsenzeitung (1993); Handelsblatt (1994).

IV Summary and Conclusions

- Companies which establish a joint venture are becoming bound up with each other and are entering a joint future which offers new perspectives to each of them. On the one hand, partner companies can benefit from each other by combining their strengths - this is why joint ventures are set up. On the other hand - which is a potential burden -, they are also tied together when a setback may occur to anyone of them. And what is even more, benefits and burdens are not only to be shared by the partners directly involved in the respective joint venture but also by further enterprises which may be associated to anyone of them. Furthermore, even enterprises which are linked to associated companies by means of the value creation process, namely suppliers and distributors, are concerned by the joint venture set-up. In the case of Skoda and VW it has even been explicitly stated that both supply relations and sales operations are to be fully integrated into the Skoda development plan.
- Establishing a joint venture draws up a new framework within which the partner companies have to take their entrepreneurial decisions. Decision making is effected on several levels: strategic orientation, resource allocation and capacity utilization, including market penetration. On the level of strategic considerations, partners have to agree upon their long-term targets - in particular which markets to serve - and to attune their decisions. In the case of Skoda and VW the basic strategic device is to keep four fully fledged independent nameplates and to build up a federal organizational structure. In this setting Volkswagen as the mother company sets out the targets and principles - similar to consti-

tutional rules - according to which the group is operated while each group member is largely independent in his day-to-day operations.

- On the level of resource endowment, partners have to operate under a joint resource constraint. This constraint is defined by the extent to which the group as a whole disposes of internationally mobile resources, namely financial funds and advanced know-how of production, management and marketing. In a joint venture the major partner is usually expected both to provide investment capital and to delegate some top executives while the minor partner is supposed to contribute in terms of specific, locally based advantages. In the case of Skoda, VW takes the role of the major partner acquiring part of Skoda's equity and drawing up a comprehensive investment program in order to promote Skoda's restructuring. Skoda on its part offers VW to be developed into an attractive high-quality low-cost production site. Since the joint venture was established in 1991, the group's financial restraints have tightened considerably due to an overall decline on the world's car market on the one hand and due to the severe troubles of the Spanish group member on the other hand. Increased importance of investment efficiency led to a major reduction of the financial volume of Skoda's investment program.
- On the level of capacity utilization the group will have to make sure that - as far as parallel capacities are concerned, i.e. capacities which are substitutional to each other - the rate of utilization tends to be fairly even at the individual places throughout the group. Enlargement of capacity at one place will not be promoted as long as there are idle parallel capacities at another place. In the case of Skoda such considerations led to only slightly revised investment plans. With respect to market penetration group membership facilitates Skoda's access to international markets while Skoda on its part acts as the group's bridgehead to the eastern European markets.
- So far, Skoda has shown a remarkable performance in the partnership with VW, even under difficult market conditions. On the whole, the Skoda-VW joint venture substantially pushes restructuring of the Czech car industry and considerably contributes to transforming the Czech economy. Within the joint venture national resources are used more efficiently than before due to their incorporation into a world-wide corporate network. For Skoda and the Czech economy the combination of cheap, well qualified national labour with advanced know-how and fresh capital opens new perspectives for growth and development. For VW the commitment to and co-operation with Skoda allows to strengthen its position on the world's car markets.

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