****

9B17M104

success tastes bitter: POLMOS LUBLIN (b)

Krzysztof Obloj and Tomasz Obloj wrote this case solely to provide material for class discussion. The authors do not intend to illustrate either effective or ineffective handling of a managerial situation. The authors may have disguised certain names and other identifying information to protect confidentiality.

*This publication may not be transmitted, photocopied, digitized, or otherwise reproduced in any form or by any means without the permission of the copyright holder. Reproduction of this material is not covered under authorization by any reproduction rights organization. To order copies or request permission to reproduce materials, contact Ivey Publishing, Ivey Business School, Western University, London, Ontario, Canada, N6G 0N1; (t) 519.661.3208; (e)* [*cases@ivey.ca*](mailto:cases@ivey.ca)*;* [*www.iveycases.com*](http://www.iveycases.com)*.*

Copyright © 2017, Richard Ivey School of Business Foundation Version: 2017-07-07

Following the successful initial public offering (IPO) in February 2005, Polmos Lublin’s board of directors approved a major investment plan, including new production and bottling lines. Polmos Lublin was a mid-size liquor company in Poland. The board also launched Polmos Lublin on the path to internationalization. Initial results were not very promising; incumbents in all targeted international markets retaliated and the regulatory environments imposed limitations that slowed the pace of entry. As expected, the company also suffered from the “liability of foreignness.” While Poland was recognized as a source of high-quality pure vodka, it had no advantage in the flavoured vodka segment. Revenues from international operations stagnated at 1 per cent of total revenues despite significant investments.

Another major project was leveraging brand equity by creating “flankers”—offerings of Polmos Lublin’s primary brand, *Bitter* (Żołądkowa Gorzka), in different tastes (e.g., with mint or honey). The flankers were priced similarly to the original product, and were a successful product innovation, especially Bitter with mint.

Two additional projects were related to existing offerings. The company raised the profiles of existing but only weakly supported brands of pure vodka in the portfolio (1906 and Bison). Polmos Lublin also diversified its offering in flavoured vodkas with a new line of lighter, liqueur-style vodkas with lower alcohol content, branded as *Nalewki Kresowe* (Nalewki, the traditional Polish name for homemade fruit-based vodkas). The expectation for this new line was that lack of competition would justify higher prices, and the decreased spirit content would result in less excise tax, thus allowing for high margins. However, Nalewki did not sell very well, and it was bought mainly for gifts.

In parallel, the executive board prepared to acquire Polmos Bialystok, the last remaining state-owned major producer, and made their intention to bid public knowledge. This announcement triggered strong competitive reaction. Central European Distribution Corporation (CEDC), which had become the largest distributor of liquors in Poland (it held 30 per cent of the total market, and was responsible for the distribution of 35 per cent of Polmos Lublin’s products), decided to integrate production with distribution. It acquired Bols’ vodka operations in Poland and decided to participate in the acquisition bid for Polmos Bialystok. Several days later, CEDC cancelled all orders from Polmos Lublin due to “high level of inventory.” Several others also announced their intention to buy Polmos Bialystok.

To make things even worse, Polmos Lublin’s core product came under threat. Unnerved by the dominant position of Bitterand drawn by the fast growth of the flavoured vodkas segment, the Belvedere (renamed after its leading vodka brand in Poland as Sobieski) decided to promote its traditional honey vodka brand, Krupnik. Sobieski also launched a new flavoured vodka, Balsam Pomorski(Balsam). Balsam looked like Bitter and tasted similar (see Exhibit 1). Sobieski priced their new vodka below Bitter, benefiting from an advantage of economies of scale and control over the distribution network.

Polmos Lublin’s executive board initially trivialized the threat, assuming that a lower quality and lower priced product would not pose a competitive challenge. Indeed, in the beginning, the impact of Balsam on Polmos Lublin was rather mild; while Balsam took market share away from Bitter, it also contributed to overall growth in the flavoured vodka market. However, with time, Balsambecame a substitute for Bitterand its market share grew rapidly from 0.5 per cent in 2004 to 3.1 per cent of the total vodka market volume in 2005.

In contrast, Bitter’s total market share dropped from 6.4 per cent to 5.8 per cent in January 2005, and further dropped to 5 per cent in May 2005 (see Exhibit 2). The company’s financial results deteriorated rapidly as a result. Investors noticed Polmos Lublin’s difficult situation; the company’s share value tanked from zł50[[1]](#footnote-1) at the time of the IPO to zł30 in July 2005 (see Exhibit 3). Polmos Lublin’s competitive position and financial results did not seem as invincible as in former years (see Exhibit 4). Compounding the problem with decreasing demand, new machinery that allowed doubled production capacity was about to arrive.

A factor contributing to these problems was management’s redirected attention; they had been focusing their time and attention on the complex preparation to bid for Polmos Bialystok. Yet, despite spending over €1 million on the bidding process, the company lost to CEDC. The country’s largest distributor also became the country’s largest vodka producer. CEDC paid almost zł1.06 billion (€250 million) for 61 per cent ownership of Polmos Bialystok—a price judged as excessive by most analysts. However, the new competitive landscape gave CEDC a market lead with 32 per cent of the total market and the two leading pure vodka brands, Absolwent and Bols. Their flavoured vodka, Żubrówka, moved into second place, just behind Bitter. Sobieski now controlled 31 per cent of the market, followed by Polmos Zielona Gora with 7.5 per cent. Polmos Lublin’s market share shrank to 5 per cent of the national market by volume.

By July 2005, the supervisory board had had enough. Neither the internationalization nor acquisition plans were working. Almost all members of the executive board were replaced. Marek Malinowski became the new chief executive officer, tasked with a simple mandate: develop a strategy to save the company. Malinowski had been vice-president of Polmos Lublin from 2001 until 2004. He had managed the initial successful turnaround of the company along with Polmos Lublin’s initial investor, Janusz Palikot, and was primarily responsible for the growth of sales and strengthening of the Bitter brand. However, this time, the situation in the marketplace was much more complicated. Nonetheless, Malinowski was mildly optimistic (as usual) in his evaluation:

The situation was not tragic. We lost market share and our main brand was threatened. But this is a normal business situation. Our former success was a result of the Bitter brand development and we have to focus on restoring our place in the flavoured vodka segment. We have to work harder and react with both efficiency and market moves. But we cannot expect wonders as flavoured vodkas are about seven times smaller than pure vodkas in terms of volume and five time smaller in terms of value.

He still had a daunting task of coming up with a long-term strategy to save the sinking company and the Supervisory Board demanded a detailed plan of action.

Exhibit 1: Similar looks—Bitter (Żołądkowa Gorzka), left, and Balsam Pomorski, right

|  |  |
| --- | --- |
| Macintosh HD:Users:kobloj:Desktop:IMG_2572.jpg | Macintosh HD:Users:kobloj:Desktop:IMG_2574.jpg |

Source: Case authors’ photographs.

Exhibit 2: Major brands in the Flavoured vodkas segment

(% of total vodka market by volume)

|  |  |  |  |
| --- | --- | --- | --- |
| **Producer** | **Brand** | **May 2004** | **May 2005** |
| Polmos Lublin | Bitter (Żołądkowa Gorzka) | 6.4 | 5.0 |
| Polmos Białystok | Żubrówka | 3.6 | 3.3 |
| Sobieski Company | Balsam Pomorski | 0.5 | 3.1 |
| Sobieski Company | Krupnik | 0.6 | 0.6 |

Source: Company documents and internal analysis.

Exhibit 3: Polmos Lublin share prices, February–July 2005 (in zł)



Note: zł = PLN = Polish Zloty; IPO = initial public offering; TMT = top management team; CEDC = Central European Distribution Corporation.

Source: Created by the case authors based on Warsaw Stock Exchange data.

Exhibit 4: Polmos Lublin, Financial data

(in zł ‘000, except Number of Shares and profit per share)

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | **2001** | **2002** | **2003** | **2004** | **2005 (June 30)** |
| Revenues | 172,460 | 231,642 | 304,775 | 337,728 | 132,133 |
| Operating income | 2,744 | 9,342 | 10,854 | 26,309 | 1563 |
| Net income after interests | (1,103) | 8,719 | 8,727 | 23,434 | 3451 |
| Net income after interests and taxes | (1,128) | 4,795 | 6,416 | 17,705 | (4052) |
| [Amortization](http://www.bankier.pl/gielda/notowania/akcje/charts?isin=PLPLMSL00015&period=Y&cons=f&wersja=s&page=1&typ=std&row=4) | 1,652 | 1,486 | 1,994 | 2,971 | 1809 |
| [EBIDTA](http://www.bankier.pl/gielda/notowania/akcje/charts?isin=PLPLMSL00015&period=Y&cons=f&wersja=s&page=1&typ=std&row=5) | 4,396 | 12,828 | 12,848 | 29,280 | 3472 |
| [Assets (including intangible assets)](http://www.bankier.pl/gielda/notowania/akcje/charts?isin=PLPLMSL00015&period=Y&cons=f&wersja=s&page=1&typ=std&row=6) | 54,809 | 106,280 | 95,306 | 175,995 | 203,507 |
| Equity | 22,790 | 28,585 | 37,002 | 66,149 | 128,421 |
| Number of shares | 2,700,000 | 2,700,000 | 3,030,400 | 3,030,400 | 4,140,897 |
| Profit per share (zł) | 0.418 | 1.775 | 2.117 | 5.842 | (0.98) |

Note: zł = PLN = Polish Zloty; € = euro; €1 = zł3.67 in 2001, zł3.83 in 2002, zł4.39 in 2003, zł4.50 in 2004, and zł4.02 in 2005; EBIDTA = earnings before interest, taxes, depreciation, and amortization.

Source: Company financial reports, 2002, 2003, 2004, 2005, 2006; mBank S.A. (formerly BRE Bank S.A.) report, August 22, 2005.

1. zł = PLN = Polish zloty; € = euro; €1 = zł4.07 on July 31, 2005. [↑](#footnote-ref-1)