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U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

REFERENCE CONTRACT NO. EUR-0014-C-00-1058-00

ENTERPRISE RESTRUCTURING AND PRIVATIZATION

QUARTERLY PROGRESS REPORT

JANUARY 31, 1994

Coopers &Lybrand

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January 31, 1994

Agency for International Development
ENE/RME/ED
Room 6923 NS
320 21st Street, N.W.
Washington, D.C.

Attn: Mark Karns

Reference: Contract No. EUR-0014-C-00-1058

Dear Mr. Karns:

In compliance with the terms of our referenced contract with AID, we are submitting this report on work completed by Coopers & Lybrand during the first quarter of fiscal year 1994, from October to Dectmber, 1993. The report contains three sections:

I. Status of Current Activities - which covers all work on delivery orders awarded during the quarter.

II. First Quarter Financial Report - which covers the financial status of the delivery orders.

III. Proposals/Concepts Submitted - which summarizes all work currently under consideration by AID for funding under this IQC.

We welcome any comments or questions that you or other AID staff might have on the report. Please contact me at (703) 908-1650, or Sue-Jean Lee at (703) 908-1664.

Sincerely,

Robert J. Rourke

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I. STATUS OF CURRENT ACTIVITIES

Five delivery orders were active during the first quarter of fiscal year 1994, from October to December, 1993. They are as follows:

- **D.O. #11, Chemko Phase II** - was awarded in the third quarter of FY 1993. Work will begin next quarter, upon verification of a new scope of work.

- **D.O. #12, IMPACT** - was awarded in the third quarter of FY 1993.

- **D.O. #13, Brasov POF** - was awarded in the third quarter of FY 1993.

- **D.O. #14, Latvia Selected Enterprise Privatization** - was awarded in the third quarter of FY 1993.

- **D.O. #15, Corporate Finance and Investment Banking Support for PBK Bank** - was awarded in the third quarter of FY 1993.

The chart on page I-2 summarizes the status of all active delivery orders. This is followed by more detailed profiles on the new projects that include information on the scope of work, status, products and deliverables, activities this quarter, activities for next quarter, and actions pending. A financial report on all delivery orders awarded to date is included in the next section.

Progress of Active Delivery Orders

Chemko Phase II (D.O. #11) implements the work plan formulated in Delivery Order #8. The work includes privatization technical assistance for the Chemko State Enterprise. Due to ongoing changes in the Scope of Work, there has been no significant progress on the project.

IMPACT - Improving Methodologies of Privatization to Accelerate the Closing of Transactions (D.O. #12) continues work begun in Delivery Order #10, COMPASS. The project team began work on October 1, and is progressing on schedule.

D.O. #13 is a project to develop a long-term strategic plan to allow the **Brasov POF** to achieve its mandate in becoming an effective mutual fund for its shareholders in Romania. Work was begun on this project on October 1, and is continuing as scheduled.

Latvia Selected Enterprise Privatization (D.O. #14) will provide assistance to the Government of Latvia to privatize up to 25 enterprises through sale transactions for hard or local currency, partial sale or lease-to-own arrangements. This project team also began on October 1, and is progressing in accordance with the work plan.

Corporate Finance and Investment Banking Support for PBK Bank (D.O. #15) will provide advisory services to assist the Powszechny Bank Kredytowy S.A. of Warsaw in strengthening portfolio management and the establishment of investment banking capabilities. The team began to arrive in Warsaw on October 1, and is working on schedule.

Delivery Order Status

Delivery Order Number	Project Name	Country of Performance	Budget	Progress
11	Chemko II	Slovak Republic	$246,506	D.O. was signed on September 13. Work has not begun, as Scope of Work is undergoing modifications.
12	IMPACT	Hungary	$864,553	D.O. was signed on September 29. Work began October 1, and is progressing on schedule.
13	Brasov POF	Romania	$1,140,028	D.O. was signed on September 30. Work began October 1, and is progressing on schedule.
14	Latvia – Selected Enterprise Privatization	Latvia	$904,036	D.O. was signed on September 30. Work began October 1, and is progressing on schedule.
15	PBK Bank	Poland	$3,933,145	D.O. was signed on September 30. Work began October 1, and is progressing on schedule.

Delivery Order No. 11

Chemko State Enterprise Privatization
Phase II

Country of Performance	:	Slovak Republic
Budget	:	$246,506
Team Members & Level of Effort Utilized	:	Woodward, Financial Planner Klein, Financial Planner Cromack, Financial Planner Good, Financial Planner Friday, Industrial Engineer Kovacs, Industrial Engineer Beck, Mkt/Export Promotion Lewandowski, Mkt/Export Promotion Ory, PDQA Specialist Sims, Accountant/Auditor Kadvan, Senior Local National Sottova, Senior Local National Durinakova, Junior Local National

Total 0 days

Scope:

Privatization Technical Assistance for the Chemko State Enterprise, as outlined in the work plan formulated in Delivery Order # 8, Chemko State Enterprise.

Status:

The Scope of Work is currently being redefined for this Delivery Order. No significant work on the project has begun.

Delivery Order No. 12

Improving Methodologies of Privatization to Accelerate the Closing of Transactions (IMPACT)

Country of Performance	:	Hungary	
Budget	:	$864,553	
Team Members & Level of Effort Utilized	:	Itil Asmon, Financial Planner	51 days
		Vincent Morabito, Financial Planner	51 days
		Scott Canfield, Financial Planner	13 days
		Andre Iha, Management/Labor Relations Spec.	13 days
		John Hoffmire, Mgmt/Labor Relations Spec.	16 days
		Stephen Martin, Capital Mkt. Specialist	55 days
		Steven Mark, Capital Mkt. Specialist	42 days
		Jeffrey Gates, Attorney	16 days
		Ferenc Simon, Local National Junior Staff	31 days
		Total	272 days

Scope:

The IMPACT Delivery Order is designed to provide technical assistance to the Department of Economics and Transaction Methodologies (DETM) of the State Property Agency (SPA) for accelerating privatization through the development of new methodologies and implementation of methodologies developed under predecessor project COMPASS. This project will result in practical programs ready for implementation and will ensure that USAID's TA has an immediate impact on the acceleration of privatization in Hungary.

Status:

In October, a series of discussions was undertaken with Department of Economics and Transaction Methodologies (DETM) personnel to define the work plan of the technical assistance team, and to integrate the work of IMPACT into the other priorities of the SPA.

During November the SPA Board of Directors focused much of its energy on issues relating to the bank restructuring plan currently under consideration. Since many of the troubled credits of the Hungarian banks are to companies in the SPA portfolio, the Board proposed various schemes regarding the optimum restructuring plan and the role the SPA should play.

The majority of the companies remaining in the SPA portfolio are losing money or facing bankruptcy, and the SPA is hesitant to sell companies in a distressed condition. Accordingly, Ms. Elizabeth Hagen has held numerous discussions with the team regarding how to tailor the development of methodologies to financially troubled companies.

By the end of the quarter, the following progress had been made on the Delivery Order:

- privatization leasing and revenue sharing are nearly complete
- ESOP legal amendments and ESOP training materials are 75% complete
- ESOP accounting systems are about half complete
- materials for SPA training and work on distressed companies are about 30% complete
- asset management are about 25% complete
- MBOs are about 20% complete

It may be concluded that of implementation of the IMPACT DO is on schedule. In addition, IMPACT has made to date some significant over-deliveries, particularly in the field of ESOPs. It should be noted that the achievements listed above were achieved even though the macro-environment has been difficult for the following reasons:

- The SPA board was occupied during this period mostly with the debate regarding company debt restructuring, rather than with new privatization methodologies;

- The uncertainty concerning SPA's future absorbed much of the staff's attention;

- The prolonged sickness of Prime Minister Josef Antall, culminating in his death on 12/12/93 and the process of his replacement delayed many policy decisions.

However, by late December the outlines of SPA policy for 1994 have considerably clarified:

- Mr Pougracz, SPA chairman, announced that the SPA may be merged soon with the State Asset Holding Company (AVRt.). The implications of such a merger have not yet been worked out.

- The government policy regarding debt restructuring was established by mid-December.

- The installment payments methodology became a high-priority topic for the SPA.

- Perhaps most important, it has become increasingly clear that during 1994 the high-priority privatization methodologies for SPA are likely to be ESOPs, MBOs and instalment payments. All three subjects are receiving TA through the IMPACT DO. This signifies that the TA activities have the potential of being timely and useful to SPA in 1994.

Activities This Quarter:

The IMPACT team undertook the following activities:

1. Proposed criteria for selection of companies to participate in asset management and debt consolidation program.

   As an illustrative exercise for asset management contracts, analyzed the financial crisis at the Hungarian Roller Bearing Works (MGM Rt.) and recommended principles for the design of an asset management contract for MGM Rt.

   Also, translated and Analyzed the Ministry of Finance proposal for asset management and debt consolidation project.

2. Developed criteria for financial restructuring of debtor companies, developed a discussion paper, and held discussions with relevant SPA staff regarding the formulation of model reorganization plans, the role of SPA as owner, principles of debt consolidation, and asset management contracts as a way to implement company reorganization. The team completed the present phase of technical assistance by delivering a paper regarding the methodology which the SPA could use to evaluate reorganization plans submitted by debtor companies.

   The team was asked to contribute to the debate regarding financial restructuring of SPA companies in the framework of the government's debt consolidation program. The team delivered to Dr. Lajtai an action document on "management of the Debt Restructuring Process from SPA's Point of View." This document was utilized by Dr. Lajtai at the SPA board and the Inter-Ministerial Committee on Debt Restructuring.

3. Leasing and installment sales: A series of meetings was held with SPA personnel and outside firms involved in privatization leasing to identify weaknesses in the current approach and offer recommendations and programs for improvement. The team has practically completed work on privatization leasing contracts according to the scope of work. The conclusions were discussed and accepted on 12/20/93 by Dr. Lajtai, who intends to bring them to the SPA board. The work will be finalized and submitted in January.

   The IMPACT team is undertaking a case study of one firm which has been privatized through lizing. In addition, the team is conducting a survey of managers on the constraints to using privatization lizing. A survey questionnaire is being developed. Final recommendations will be delivered for the implementation of the standardized, transparent leasing methodology.

4. The team completed the first stage of its work on installing in ESOP companies computerized administration/accounting systems for ESOP shares. The work includes:

analyzing the ESOP laws of Hungary to determine reporting requirements, reviewing existing administration systems, and most importantly, implementing an actual computer administration/accounting system in two ESOP companies, "Aranygaller" and "Kozepuletepito."

In order to implement ESOP administration/accounting systems in these companies, the TA team analyzed the company ESOP bylaws and their current operations and requirements and began building the employee data base which is a necessary requirement for a fully functional administration/accounting system.

The team will provide the Hungarian Share Participation Foundation with the software for an ESOP administration/accounting system for use in Hungarian companies. This fully integrated system will be customized for Hungarian conditions. To facilitate the usefulness of this software, a users' manual for the system is being prepared in Hungarian. This work is proceeding on schedule and the second phase - system installation will start in January.

5. The Second Annual Hungarian ESOP Conference was successfully held on December 3 and 4. The conference was keynoted by Mr. Tamas Szabo, Minister for Privatization, and Lajos Csepi, Executive Director of the SPA. David Cowles, USAID/Budapest Representative, delivered one of the opening speeches, stressing the United States' commitment to privatization and democracy including support for ESOPs in Hungary.

   In addition to other work, the team contributed to the organization and preparations for the conference. Four members of the TA team were speakers at the conference:

   - Itil Asmon spoke on the financial performance of ESOP companies.
   - Jeffrey Gates spoke on the importance of ESOPs for economic justice and the ESOP law in Hungary.
   - John Hoffmire spoke on how to improve the performance of ESOP companies through Total Quality Management and other methods of employee participation.
   - Andre Iha discussed the administrative and reporting requirements for ESOPs in Hungary and the optimal system design for ESOP companies.

   The TA team continues to work closely with the Hungarian Share Participation Foundation.

6. The TA team drafted a preliminary paper on the potential of revenue-sharing contracts for privatization. This includes the basic legal principles involved, the experiences in other countries, the advantages and disadvantages for Hungary, the commercial and political risks, and the criteria for managing and administering revenue sharing contracts. This is nearly finished and will be presented to SPA in early January.

7. Manager Support for Privatization: The TA team determined that to assist in the implementation of methodologies for privatization which involve managers, their attitudes, motivating, and understanding of privatization must be determined so programs can be designed that reflect their needs. The team has begun the design of a comprehensive survey questionnaire of management attitudes regarding privatization. This questionnaire was finalized and distributed in December, and the results will be collected and analyzed during January/February.

8. ESOP legislation and promotion - The team's US ESOP attorney prepared a set of recommendations for further ESOP legislation.

9. Management Buyouts (MBOs) - At the end of November, the TA team determined that to assist in the implementation of methodologies for privatization which involve managers, their attitudes, motivation, and understanding of privatization must be determined so that the programs can be designed that reflect their needs. This information is not available within the SPA. For this purpose a survey questionnaire for assessment of the demand for MBOs was finalized in December. It will be tested and distributed in January, collected in February and analyzed in March.

10. The IMPACT Scope of Work included delivering training to selected SPA officials. Since the financial restructuring of enterprises will be a major subject of SPA activity in 1994, Dr. Lajtai requested that the training component of the project would give priority to training in financial restructuring.

    The TA team delivered a "Training Plan Outline" which proposed such training to be composed of three parts: (1) basic financial and accounting concepts relevant to enterprise restructuring, (2) in-depth analysis of case studies, and (3) special subjects. Dr. Lajtai accepted the outline, subject to some comments.

11. The contents of work on financial monitoring of companies has been better defined. Dr. Lajtai wants such financial monitoring to concentrate on monitoring how SPA companies undergoing receiving debt relief are complying with their reorganization plans. Work on this deliverable will be ongoing in January-February 1994.

Deliverables Produced:

"Proposal to the Committee for Debt Restructuring Regarding Criteria for Selection among SPA Companies which Apply for Debt Restructuring and Asset Management" October 7, 1993

"Review of the Asset Management Contract Proposal of 18 October 1993 for the Hungarian Roller Bearing Works (MGM Rt.)" October 22, 1993

"Recommendations for the Asset Management Contract Proposal of 18 October 1993 for the Hungarian Roller Bearing Works (MGM Rt.)" October 25, 1993

"Contents of the Reorganization Plan Submitted by Debtor Companies" October 27, 1993

"Methodology for the SPA to Evaluate Reorganization Plans Submitted by Debtor Companies" November 2, 1993

"Economic Performance of ESOPs - Recent Research Results" presented to the Second Annual Hungarian ESOP Conference, December 3-4, 1993

"Employee Ownership as a Competitive Strategy" presented to the Second Annual Hungarian ESOP Conference, December 3-4, 1993

"Proposed Amendments to the ESOP Law"

"Draft Questionnaire - Assessment of Demand for Management Buyouts (MBO) of State-Owned Enterprises"

"Management of the Debt Restructuring Process from SPA's Point of View" December 14, 1993

"Training Plan Outline" December 16, 1993

Delivery Order No. 13

Brasov POF

Country of Performance : Romania
Budget : $1,140,028

Team Members & Level of Effort Utilized :

Long-Term	
Robin Hardie, Financial Planner	57 days
Dan Simionescu, Economist	65 days
Marcela Halmgren-Valdez, Accountant	60 days
Catalin Mocuta, Local National Junior Staff	64 days
Short-Term	
Jean-Pierre Vigroux, Financial Planner	2 days
Robert Rourke, Financial Planner	4 days
Emilian Radu, Local National Senior Staff	28 days
Ion Andrei	3 days
Total	283 days

Scope:

This project is to develop a long-term strategic plan to allow the Brasov POF to achieve its mandate in becoming an effective mutual fund for its shareholders in Romania.

Status:

After a week of introductory meetings in mid October, the team began work. A full work plan for the C&L team for the next 9 months was presented to Mr. Fercala, head of the Brasov POF, in December. The team has received his comments and is finalizing the plan. Mr. Fercala is currently awaiting reconfirmation by the Rumanian government (which he is fully expected to get). Until he is reconfirmed, many projects in the POF are on hold.

Activities This Quarter:

1. Advice on POF Structure - Mr. Fercala asked us to review the current structure of the POF and to come up with our own recommendations, taking into account the structure proposed by Roland Berger. We presented our ideas to him in November, and debate continues in the POF regarding these recommendations.

2. Advice on POF Personnel - Advice was sought from the C&L team by the head of the POF's Personnel Department on its role in the screening and hiring representatives for 1200 companies, as well as on interviewing, training and contracts of POF employees generally. The POF is considering replacing these 700 plus part-time people with 75 full-time employees.

In December, the team was asked to interview a number of POF staff at middle management level to give our opinion on their professional potential. The opinions presented seemed well received and add a further element to our proposal for a new structure for the POF.

3. Advice on Management Contracts - A law was passed in October stating that the present boards of administration of state-owned companies would be replaced by a Shareholders Assembly (SA) with representatives from the POFs and SOF. The managers will sign a contract with their new SA including performance criteria to be negotiated between them. Information can be required quarterly or monthly. This will be a useful training ground both for the managers and for the POF evaluators.

4. Meetings - On November 4th, the team attended a meeting with representatives from the advisers to the other POFs, which were organized by the National Privatization Agency (NAP).

Mike Hicks, the EBRD representative in Romania, came to Brosov on November 17th with local PHARE representatives to present a PHARE study on the agro-industrial sector to the POF. The study covers more than 200 medium companies, many of them in this POF, based on data from fiscal 1991. The study was carried out for the MAF who are very reluctant to use available PHARE funds for privatization.

The team attended a meeting at USAID Bucharest, on November 23rd to meet Dr. Trivedi, a USAID-funded short-term adviser to the Council for Reform. Dr. Trivedi gave a talk on the value of non-financial measurements and their possible use in Romania. The meeting was also meant as an opportunity to familiarize the team with other USAID-funded projects in the economic sector in Romania.

EBRD organized a meeting in Bucharest to discuss the creation of an OTC market for certificates of ownership (COs). All the potential participants are invited, including banks, potential brokers, and investors such as the Rumanian Capital Fund. The team is invited and is urging Fercala to attend for the POF.

In December, the team attended a monthly meeting at USAID Bucharest of the agents working in the economic sector in Romania who are financed by the agency. There is no overlap between our activities, but it was a useful opportunity to liaise on general matters. The team was informed of the availability of funding for short-term training courses in the US for Rumanians working in programs funded or assisted by USAID - thus including POF staff. We discussed this with Mr. Fercala, who has recommended four people from the POF plus Codruta Timariu from our own staff.

Other contacts made during December include the local office of Saatchi & Saatchi, Victorward Ltd. (a US company seeking to take over part of Tractorul, a large tractor manufacturer in Brasov) and the managing director of Shell Romania who expressed interest in involving the POF as a partner in future ventures.

5. Certificates of Ownership (COs) - We were asked for advice on various aspects concerning Certificates of Ownership including their valuation for this quarter.

We presented a proposal to promote the exchange of COs between CO holders of different POFs on a 1:1 basis, pending the emergence of an effective secondary market. The secondary market as is currently only deals in books of five and not in individual POF certificates.

6. Inter POF Meeting-Secondary Market - We were invited by Mr. Fercala to attend the monthly meeting of the POFs, held on December 16-17 in Craiova in southwest Romania. The main topics of the meeting were the valuation of COs and the organization by the POFs of a semi-official secondary market. The Brasov POF may create its own broking subsidiary for this market.

7. Privatization - The sole current privatization of a medium-sized company in the POF - the sale of a local confectionery company to Jacob Suchard active. Jacob Suchard wants to close in February and recently had their first meeting with the POF.

The POF has pre-selected 40 companies in its portfolio as candidates for privatization this year by public offer for 100% of the shares. This would be done by first transferring the SOF's 70% to the POFs. Of these 40 companies, only 8 do not have a legal problem over the ownership of the land they occupy.

8. Seminar on Capital Markets in Romania - The team attended a seminar sponsored by the Know-How Fund and EBRD on the development of a capital market in Romania in Bucharest on December 10th. This was an opportunity to meet representatives from other POFs as well as two of the investment funds who will be players in this market. The first government securities could be issued by Easter - short-term notes with a maturity of 30-90 days. The POFs will be significant institutional investors in Romania after the banks and insurance companies and these notes will be of great interest.

There were also discussions on COs' the current market in them, future trading on an OTC market and even eventual quotation on the stock exchange. It is hoped that the stock exchange will be opened before the end of the year.

9. Company Visits - The C&L team visited Astra Trading, a small company with a turnover this year of US $1.5 million. The company is based in Brasov and has a fleet of tourist busses and foreign trade involvement in the import of food products and the export of spare parts for trucks. The firm has a healthy business but difficulties in obtaining foreign currency, local products and overseas contacts.

Delivery Order No. 14

LATVIA - Privatization of Selected State Enterprises

Country of Performance	:	Latvia	
Budget	:	$904,036	
Team Members & Level of Effort Utilized	:	B. Carrie, Financial Planner	51.5 days
		K. Eisen, Financial Planner	17 days
		N. Melngailis, Financial Planner	10 days
		V. Slaidins, Economist	55 days
		B. Pulins, Accountant	20 days
		F. Klavins, Attorney	2.5 days
		R. Slaidins, Attorney	2 days
		B. Bradley, Industrial Engineer	20 days
		Total	178 days

Scope:

To provide assistance to the Government of Latvia to privatize up to 25 enterprises through sale transactions for hard or local currency, partial sale or lease-to-own arrangements. The amount of assistance provided to each enterprise will vary according to its size, organization, technological specifications, suitability for sale and the agreed privatization method.

Status:

The project commenced on October 1, 1993. At the completion of this quarter, the team is still looking for suitable privatization candidates. Two industries in which the Ministry of Privatization requested and were denied assistance were sugar and grain. As sugar is a politically sensitive commodity, USAID advised the team not to proceed with privatization efforts. The team also will not assist in the grain sector privatization, as the EC assistance plans to cover it.

Activities This Quarter:

By the end of December 1993, the selection criteria for enterprises should have been agreed with the government and a number of enterprises screened against the criteria. The first group of enterprises should have been selected for privatization and work should have commenced on the privatization of them.

The greatest difficulties experienced by the project were with the selection of suitable enterprises. In various published lists and other documents, the Ministry of Agriculture has already selected enterprises for privatization and established priorities. The criteria that the Ministry used in selecting and prioritizing enterprises seemed to political rather than economic. Also, those selecting enterprises and setting priorities were not always fully aware of the circumstances of the enterprises being promoted for privatization. This meant that in a number of cases the enterprises that the Ministry had as its top priorities did not fit within the project's terms of reference or other limitations guiding the project's work. For example, the Ministry regularly requested assistance with the sugar industry and with the grain sector; both areas where it was agreed with USAID that the project would not get involved. In other instances the Ministry was interested in enterprises or sectors that were in need of significant restructuring prior to privatization; for example the flax industry.

Even where a suitable enterprise was agreed on with the Ministry, they often had trouble in defining the exact nature of the assistance required. For example, with the edible oil extraction plant it was not clear whether an open tender was to be conducted or merely a valuation of the enterprise conducted to assist in negotiations with a previously selected investor. This significantly delayed commencing work on that enterprise.

Given the difficulties in selecting enterprises, by the end of the first quarter of the project only six enterprises had been selected for privatization. These consisted of four meat plants, a bakery and the oil extraction plant. Only in the case of the four meat plants had substantial work been completed before Christmas. The delay in commencing work on the other two enterprises was due to uncertainties over the nature of the work to be undertaken in the case of the oil plant, and in the case of the bakery, whether a group of bakeries would be dealt with, or only one plant.

Prior to the commencement of the project, contact had been made in Washington with the Latvian official in charge of privatization of the electronics industry. Electronics was seen as a potentially viable sector outside of agriculture for the project to work on. Following meetings with two officials now in charge of the industry's privatization, a visit to a plant and a meeting with the directors of two plants, it was decided that the electronics industry appeared not to provide suitable enterprises for privatization by the project.

The majority of the technical work in October focused on establishing a list of suitable privatization candidates. The original list of 25 enterprises prepared by the Ministry of Agriculture was resubmitted to the privatization unit within the Ministry. A number of the enterprises on the list have now been sold. However, the flax plants on the list were identified as still being suitable privatization candidates, as well as the Liepaja meat processing plant and the Riga green houses. Other potential candidates identified were the country's three sugar processing plants and the Rezekne bakery.

A meeting was held in October with the Ministry official responsible for the flax industry. He outlined the current status and problems of the industry. It became apparent that the main obstacle to the privatization of the industry is Larelini, the central linen manufacturing plant.

This plant is not the responsibility of the Ministry of Agriculture, so the industry appeared not to be a suitable privatization candidate for the project. However, the Minister of Agriculture indicated that although a crucial part of the industry is covered by a different Ministry, this should not be a problem.

In November, further investigations were made into the flax industry. Financial statements and statistics on the industry were obtained and a meeting held with officials of the Ministry of Economy who oversee the central processing plant. A visit was made to meet the director of one of the primary processing plants in Balvi - the plant is currently not operational as there is virtually no flax being grown in the area. It was concluded that in its current state the industry is not viable and the prospects for privatizing state-owned plants in the industry are limited. The dispersed responsibility for the industry within the government create further difficulties. A recommendation was made to the Ministry that they should conduct a study of the industry from the farmer through to the final production of cloth to determine if the industry could be viable, and what role, if any, the government should play in this industry.

In October, Mark Abramovitz visited Riga and was briefed on progress with the project. AID representatives and project staff met the Minister of Agriculture to discuss the project. The Minister laid out his priorities for assistance. At the top of his list was an edible oil plant in Liepaja, followed by the sugar processing plants. Various other enterprises were also discussed. Follow up meetings were held with the head of the privatization section within the Ministry and his two deputies. A number of issues the Minister had raised were clarified and additional information on the edible oil plant, the Rezekne bakery and the flax industry was obtained.

A visit was made to the director of the Institute of Agrarian Economics to obtain background information on various sectors within agriculture and to elicit suggestions on enterprises and sectors on which the project could focus. A meeting was held with the local EC PHARE representatives to ensure coordination of efforts.

Consideration was given to including enterprises in the forestry sector as privatization candidates. There is considerable foreign interest in the forestry sector and the country would benefit from assistance in maximizing the return from this interest. However, responsibility for forestry privatization is currently in the process of moving from the previous Ministry of Industry to the central privatization agency. Until this move is completed next year, there appear to be no officials within the government willing to take responsibility for involving the project in the privatization process. The situation will be reviewed once the central privatization agency is established.

Project team member Brad Bradley conducted preliminary reviews of other potential privatization candidates. A visit was made to Milgravis, a bottling plant in Riga, and financial statements were obtained. Although the enterprise currently has minimal production and operates at a loss, the plant is in reasonable condition and could be a good candidate for future privatization.

Nils Melngailis attended a meeting of the Meat Privatization Commission in October and arranged for the privatization of four meat processing plants to be handled by the project. The allocation of the four plants to the project was confirmed by the chairman of the commission. Basic information on the four plants was collected and a visit to the closest plant was arranged. On the basis of the information collected it appears that the plants are suitable candidates. Contact was maintained with the Meat Privatization Commission throughout the quarter.

Two meetings were held in November with Ministry to discuss the Ministry's priorities, the status of particular projects, and timetables. The Ministry again requested assistance with privatization in the grain industry. It was explained that the EC would be funding assistance in this area and duplication of effort should be avoided. The situation with bakeries was also discussed. The Ministry suggested that an additional two bakeries could possibly be allocated to the project for privatization. The situation with the edible oil plant, as described below, was discussed but not resolved. On the four meat plants the group delegated responsibility to the chairman of the privatization committee. The Ministry undertook to produce a record of the meeting to act as an agreement between the project and the Ministry, which has yet to be provided.

Several meetings were held with the chairman of the meat privatization committee in October. The status of each of the four plants allocated to the project was discussed together with the proposed timetable for their privatization. The timetable, which provided for technical experts to visit the plants in November and December and the sales process to start in January, was subsequently confirmed.

In November, a preliminary visit was made by the resident project staff to the Valmiera meat processing plant to collect information and assist the management's attitude towards privatization. The plant seems to be a reasonable candidate for privatization, although it may be of limited interest to western investors because of its hygiene standards. Initial visits were made to the other three meat plants and the edible oil plant by the resident staff, the food processing expert and the accountant. None of the three meat plants are up to the standard of Valmiera in terms of hygiene, plant or management, and Balvi has an additional problem that part of the enterprise has already been sold to the employees. One visit will be made to each plant once the valuation expert has arrived.

Investigations into the edible oil plant revealed that CanadianAgra, a Canadian private sector company, had already completed a feasibility study on upgrading the edible oil plant in Liepaja. This was done following a request form the previous Minister of Agriculture for submissions from various foreign corporations. CanadianAgra was subsequently informed by the then acting Minister of Agriculture that they had been selected as the preferred investor for the plant. CanadianAgra has identified sources of funds, including their own equity, to finance the upgrading. All that appears to be needed to conclude a deal is a valuation of the existing plant and a legal agreement between the government and CanadianAgra. Despite the Minister's desire to move quickly with this enterprise, the Ministry is planning to conduct a new tender for the plant's sale. These facts were presented to the Ministry and they undertook to investigate

further. The situation was subsequently discussed with the director of the Ministry, but not resolved.

Two meetings were held with Andris Berzins, the head of the grain authority, to discuss the privatization of bakeries and additional assistance in the grain sector. Mr. Berzins is also the chairman of the bakeries privatization commission. He was of the view that the project should only work on the privatization of the Rezekne bakery and perhaps provide some assistance with Baltmaiznieks. He undertook to confirm that position with the rest of the members of the bakery commission.

On the grain sector, the work planned by the EC and the position of the local C&L office was explained to Mr. Berzins. These discussions fit in with the work that two USAID Washington representatives were going to identify areas in which AID could provide assistance in the grain sector.

Further efforts were made in December to identify suitable candidates for the second batch of privatization. This included Brad Bradley's visit to a greenhouse on the outskirts of Riga. The greenhouse buildings are in reasonable condition but the plant's design was based on the expectation of and inexpensive energy supply. With the recent substantial increases in energy prices, the enterprise has run up considerable debts and is not financially viable in its current form. Following a financial restructuring the enterprise may be a suitable candidate for privatization.

A meeting was held with Invest Riga, the firm that the Government uses to carry out most of the statutory valuation work required for enterprises being privatized. It was hoped that their work, or at least the data they had collected, could be used as a basis for the valuation work being undertaken by the project. However, Invest Riga was reluctant to provide the information and it appeared that the procedures used for valuations are not rigorous.

Team member Bruce Carrie attended the December review meeting which the local AID office held with the US Ambassador, covering the projects currently being funded in Latvia and additional areas where assistance could usefully be provided.

Delivery Order No. 15

Corporate Finance and Investment Banking Support for Powszechny Bank Kredytowy (PBK) of Warsaw

Country of Performance : Poland
Budget : $3,933,145

Team Members & Level of Effort Utilized :

M. Bakal, Financial Planner	25.25 days
W. Gminski, Financial Planner	44 days
D. Finty, Financial Planner	12 days
M. Bayliss, Financial Planner	40 days
M. Ott, Capital Market Specialist	19 days
A. Reczek, Financial Planner	0.5 days
P. Stamp, Financial Planner	6 days
C. Spicer, Financial Planner	5 days
R. Rourke, Financial Planner	4 days
K. Kelly, Capital Market Specialist	10.5 days
Total	166.25 days

EXECUTIVE SUMMARY

- **Familiarization**: To advise the client on deal structuring, the team has had to invest initial time and effort on gaining an understanding of PBK and local capital markets. While the team possesses a strong base of knowledge regarding Central and Eastern Europe, Polish market conditions are distinct and have required research so as to meet PBK's needs more effectively.

- **Logistics**: Because of space constraints at the client's office, the project specialist team used, as an interim measure, work facilities at Coopers & Lybrand. A first priority of the team was to arrange a work area with computer, telephone and fax support. In the face of tight office space conditions in Warsaw, this took some considerable time and effort.

- **Objectives clarification**: The original Terms of Reference (see "Objectives") were quite broad and had to be coordinated with another aid project, specifically PHARE's loan portfolio "work out" assistance. However, the project allowed for some "fine tuning" with more understanding of the client's needs. This is being done in consultation with PBK management and has resulted in a shift in focus within the broad "corporate finance/investment banking"

mandate. The Project Team will be initially concentrating on the equity portfolio and investment banking areas, and has only recently begun to focus upon loan works-outs and privatization activity.

- **Project activity**: For specifics, see the attached "Status Report". To summarize, the Project Team has been involved in approximately 12 separate, identifiable projects. For this "start-up period" at the Project's commencement, much work was on a preliminary "fact finding" basis. At the same time, the Project Team was still able to become well acquainted with the details of several projects and to complete some others. Of particular interest, the Project Team also undertook, at PBK's request, to prepare a policy and procedures manual for evaluating direct equity investments. As well, the Project Team responded to a specific client request to examine PBK's brokerage operations. The Project Team took the first steps on this project by a preliminary review of an operating budget. In the second quarter, this would expand into a full-fledged project. In addition to these specific, identifiable projects discussed herein, the Project Team responded to a variety of PBK informational or assistance queries, as requested.

- **Obstacles**: Working together with bank staff in the investment banking area has had its challenges due to i) competing demands on PBK staff's time; ii) lack of any precedent investment banking activity in Poland to be guided by; and iii) the need for fuller clarity of responsibilities on transaction initiation and follow through. Concerted efforts at overcoming obstacles (such as more open communication channels; appointment of a dedicated bank liaison person and more advance planning) will hopefully remedy matters.

PROJECT OBJECTIVES SUMMARY

Project Background

As part of Poland's transition process to a market economy, financial institutions must achieve a critical goal:

- Soundness (i.e. solvency/liquidity/profitability/independence from the state)

The banking system's progress will largely depend on asset quality which, in turn, is a function of the health of Polish borrowers/investments/capital markets. In particular, this will depend upon the ability of such entities to attract external sources of investment. Absent the resources (both skills and financial) to privatize and restructure themselves, Polish enterprises require initiatives from the banking sector to:

- Play an active role in corporate restructuring through such means as financial concessions on debt instruments and the supply of technical/financial guidance.

- Subject to sound banking principles and in the absence of developed equity capital markets, supply or at least channel domestic or international equity capital into capital-short industries. This entails investment and merchant banking activity as part of the "universal bank" role.

Project Objectives

1) Know-how transfer of investment banking skills to PBK staff via deal-making with companies within PBK's equity and loan portfolio.

2) Create investment banking operational capacity at PBK as possible model for others.

3) Advise on equity conversion/investment components of specific loan workouts.

4) Assist PBK's role in "Polish Enterprise and Banking Sector Restructuring Program".

Scope of Work

A. Portfolio management (of existing assets)

i) portfolio classification to identify viability/potential
ii) prioritizing restructuring candidates by urgency
iii) restructuring weak companies for turnarounds
iv) formulating individual client privatization tactics
v) suggesting divestment strategies or "exit" options for redundant assets or for assets prime for privatization
vi) drafting individual restructuring action plans
vii) developing portfolio monitoring procedures
viii) recommending PBK's role within transactions

Deliverable: Portfolio management program

B. Investment banking capability (for future operations)

i) selection of privatization methods
ii) corporate finance service capacity
iii) identification of attractive candidates for affiliation with PBK
iv) financial innovation
v) market making
vi) financial product development
vii) encourage medium/long term securities

Deliverable: Organizational development of investment banking capabilities within PBK

via 1) knowledge transfer on transactions
2) coaching of staff
3) training courses
4) MIS development

Modifications

De-emphasize:

- Loan portfolio work-outs restructurings which are being dealt with by PHARE
- Privatization activities

Concentrate on:

- Transaction structuring within equity portfolio
- Identification of domestic target companies/industries for investment banking transactions
- Organization of an investment banking department
- Transaction structuring on selected companies within the work-out portfolio specifically brought to the Team's attention by PBK

Activities This Quarter:

1) Gained preliminary understanding of client's organization, needs and objectives

2) Established initial contact and lines of communication with key bank personnel

3) Scanned and networked within Poland-based institutions to develop a better understanding of the capital markets

4) Clarified client needs, constraints and problems, in face of project impediments, and adjusted project objectives for better fit

5) Organized physical facilities and work support for specialist team

6) Initiated starts on 12 projects for follow-up in the 2nd quarter

7) Commenced work on operating manual for investment department

8) Liaised/co-ordinated with PHARE group on associated Work-out project

9) Undertook review of PBK's participation in the EBRD's Stabilization, Restructuring and Privatization Program

10) Evaluated and made recommendations on the Bristol Hotel

11) Reviewed and commented upon the Banque Pallas Stern privatization fund proposal

13) Prepared comments on the bank's "Brokerage Business Plan"

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14) Reviewed and recommended analytical software package to be utilized within PBK's Capital Investment Bureau

15) Developed information requests relating to six projects to be initiated in the second quarter.

Activities Next Quarter:

1) Clarify and finalize client needs on project through preparation of a "Work Plan"

2) Continuing improvement of communications/co-operation with designated bank staff

3) Bank to appoint a qualified individual to act as liaison between the Bank and the Project Team

4) Settle all outstanding confidentiality issues re: client information

5) Introduce new Team Project members to PBK's senior management

6) Open up lines of communication with bank directors to raise the Project's profile

7) Settle sub-contract with Pro-Invest to second C&L staff to PHARE's workout project

8) Advance investment manual project; incorporate bank input/ideas

9) Commence full scale review of brokerage operation's business plan

10) Clear (close/complete) 50% of outstanding deals in progress

11) Continue to monitor all deals in progress

12) Open 20 new files/deals to "in progress" status

13) Commence monthly reporting beginning February 28/94

III. PROPOSALS/CONCEPTS SUBMITTED

The status of concepts/proposals submitted or still outstanding this quarter are shown in the chart on page III-2 and are summarized by country below:

Hungary

- **Redeployment of Financial Assets, Restructuring and Privatization** - Proposal submitted to AID on September 27. C&L was not awarded the project.

Slovak Republic

- **Assistance to the National Credit Bank** - scope of work will involve consulting and training sessions for the National Credit Bank. Will be proposed on a competitive bid basis.

- **Assistance to the Energy Sector of the Slovak Republic** - scope of work will involve privatization assistance to the Energy Sector.

Slovenia

- **Assistance in the Slovenia Bank Rehabilitation Project** - proposal was submitted on December 13, 1993. Awaiting AID Response.

Project Concepts Status

Country of Performance	Project Concept Name	Description	Proposed Budget	Date of Initial Submission	Status
Hungary	Redeployment of Financial Assets Restructuring and Privatization	Set up Methodology Unit in the State Property Agency	$2,000,000	27-Sep-93	Proposal submitted September 27. C&L was awarded the project.
Slovak Republic	National Credit Bank	Consulting and training for the National Credit Bank			Under consideration by AID for possible competitive bid.
	Energy Sector	Assistance to the Energy Sector of the Slovak Republic			Slovak government is deciding priority for this project.
Slovenia	Bank Rehabilitation Project	Assist financial sector reform in Slovenia, with aid to commercial banks and the Bank Rehabilitation Agency.		13-Dec-93	Proposal was submitted on December 13, 1993. Awaiting AID response.