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## **CORPORATE GOVERNANCE and COMPETITIVENESS**

*Sponsored by*

*United States Agency for International Development*

**Prague, Czech Republic  
June 1994**

## *COURSE OVERVIEW*

Welcome to the course on "Corporate Governance and Competitiveness". This course has been designed specifically for individuals who are or will be serving in the boards of privatized companies in the Czech Republic/Slovakia. The workshop has been organized by the Price Waterhouse International Privatization Group (PW-IPG), a U.S.-based company specializing in providing practical assistance in all aspects of privatization. The workshop is being financed by the United States Agency for International Development (USAID). The next pages will provide you with an overview of the course and explain the types of activities planned for the next two days.

### **Background: Why this Course?**

Over the past year, thousands of newly privatized Czech/Slovak firms have had to adapt to an increasingly competitive environment while at the same time dealing with new owners and corporate governance structures. Good corporate governance is a tool for helping companies gain access to capital, expertise, and other inputs critical to becoming competitive domestically and abroad. Good corporate governance requires balancing the rights of the shareholders with effective and responsive decision-making at the board levels. This course will discuss how the benefits of different corporate governance models can be adapted to the unique Czech/Slovak environment. This course will also provide practical suggestions in the area of shareholder relations and the holding of annual general meetings.

The evolution of companies in the Czech/Slovak Republic have a large bearing on the public faith and confidence in the economic reform process. You play a critical role in shaping the newly privatized companies. What types of companies should you be striving to create? A good company is one that year after year puts out excellent products and services, anticipating consumer demand; one that attracts able employees and provides a nurturing environment, ensuring that their full potential is tapped; one that consistently outperforms the competition in terms of the return provided on shareholder equity.

What roles do corporate governance boards play in the process of improving company performance and creating the type of company described above? The boards build the foundation for fostering excellence in companies. It is the responsibility of directors to ensure that the best and most qualified people are recruited for top management positions; that these individuals are adequately motivated; that their actions are monitored; and that the company is fully in compliance with the legal and ethical requirements society places on it. In other words, the boards are expected to provide vision and guidance to company management and employees, and protect the investment of shareholders by monitoring management and corporate performance.

This is an enormous task and covers a far wider range of skills and topics—in financial and human resources management, strategy design, and other areas, than could possibly be covered in a two day workshop. This is why the focus of this workshop is much narrower.

**Focus: The Role of Corporate Governance**

This workshop is focused on a very specific objective -- to enhance the ability of corporate leadership to shape a governance environment that facilitates good corporate decision-making. Accordingly, this workshop consists of five related modules that provide a framework for evaluating and designing corporate governance structures that work for your company. In this context, this workshop begins with a general background on how laws and government regulations affect board operations, member behavior and board relations with management, employees and lenders, and how these factors in turn affect strategy implementation choices. We then turn our attention to the specifics of board decision-making and discuss mechanisms that enhance effective decision-making at the board level. Table 1 provides a summary of the topics covered in the workshop.

TABLE 1 COURSE OUTLINE	
<b>MODULE 1:</b>	<b>CORPORATE GOVERNANCE IN A CHANGING ENVIRONMENT</b>
	Objectives: Discuss the new environment surrounding the newly privatized firm and the differing interests of various stakeholders.
<b>MODULE 2:</b>	<b>CORPORATE STRUCTURE AND DECISION-MAKING MECHANISMS</b>
	Objectives: To discuss (i) the effectiveness of various corporate governance systems; (ii) the structure of Czech/Slovak corporate governance and; (iii) enhancing board operations and decision-making.
<b>MODULE 3:</b>	<b>SHAREHOLDER RELATIONS AND COMMUNICATIONS</b>
	Objectives: To discuss (i) fundamental shareholder rights; (ii) fairness and transparency of voting procedures and; (iii) practical issues relating to the preparation and holding of a general meeting.
<b>MODULE 4:</b>	<b>FINANCIAL REPORTING AND INFORMATION SYSTEMS</b>
	Objectives: To discuss the various disclosure requirements on a public joint-stock company and the development of efficient and cost-effective internal management information systems to monitor performance.
<b>MODULE 5:</b>	<b>BUSINESS STRATEGY AND FINANCING</b>
	Objectives: Enhance participants' ability to (i) evaluate the strategic position and strengths and weaknesses of the firm; (ii) evaluate restructuring options and; (iii) understand the potential sources of capital.

## **The Training Methodology**

Just as important as the content of the workshop, is the methodology for transmitting the information. It has been PW-IPG's guiding philosophy in preparing this course that individuals such as yourselves need more than theory. You also need the opportunity to test the theory by applying it to the types problems and situations you face in your daily work environment. You also need to receive feedback on how you applied the techniques and the new tools obtained from the course. This means that while you can expect some amount of basic lecture time during this workshop, we expect participants to be more than passive listeners.

In this workshop, we will use the case study as a tool for re-inforcing concepts introduced through lectures. A case study focusing on an industrial company, similar to those which you represent, will be used in the course. The case study is based on an actual company and describes the actual tasks faced by a member of the board. The case places you the reader in the role of the problem-solver. The first part of the case will be used in a role play which allows the participants to debate the conflicting interests of different types of shareholders. In the second part of the case, participants will have to evaluate options to raise capital and will address some of the issues Czech/Slovak firms are expected to face in the coming months and years.

## **Conclusion**

This workshop is not designed to make you instant experts on board relations and functions, or on strategy or capital market operations. It does seek to give you useful guidelines and frameworks for structuring information, identifying and analyzing options, and making recommendations on governance structures. In this context this workshop will not solve all your problems, or provide answers to all the technical issues before you. But we hope it will provide some useful guidelines for helping you evaluate the considerable sets of issues that must be weighed when selecting and shaping your governance structures. In this sense, we hope to make your job more manageable and, by improving the soundness and value of the recommendations you and your colleague provide, make the process of economic transformation more effective.

## **Note About the Training Binder**

This binder is meant to be used as a workbook and basic reference guide. All overheads used in class are reproduced in the binder. All case materials and discussion questions are included in the binder as well.

## CORPORATE GOVERNANCE AND COMPETITIVENESS

### **Course Objectives:**

*Over the past year, thousands of Czech/Slovak firms have had to adapt to an increasingly competitive environment while at the same time dealing with new owners and corporate governance structures. This Price Waterhouse-International Privatization Group course, funded by the United States Agency for International Development will discuss how the benefits of different corporate governance models can be adapted to the unique Czech/Slovak environment. Good corporate governance is important in order to balance the rights of shareholders with effective and responsive decision-making at the Board levels. This course will also provide practical suggestions in the area of shareholder relations and the holding of annual general meetings.*

*Since the success of firms depends on strong corporate leadership, this course will also provide directors with tools to help in evaluating business strategy and restructuring plans and present an overview of potential sources of capital.*

*This practical course will use a mix of lectures and case studies. Simultaneous translation will be provided.*

**Length:** 2 days

**Target Audience:** Management and Supervisory Board directors representing management, investment funds or other owners.

## COURSE OUTLINE

### **MODULE 1: Corporate Governance in a changing environment**

*Objectives: Discuss the new environment surrounding the newly privatized firm and the differing interests of various stakeholders. Provide a brief overview of the need for and benefit of good corporate governance.*

#### **Topics**

##### **A. The firm and its environment in market economy**

- (1) Competitive environment
- (2) Regulatory environment

##### **B. Stakeholders: Conflicts and common interests**

- (1) Types of shareholders (Funds, individuals, banks, management, state)
- (2) Issues of control and protection of minority shareholders
- (3) Interest of other stakeholders (Potential investors, public)

##### **C. Role of Corporate Governance**

- (1) Basic principles of good corporate governance
- (2) Advantages of good corporate governance
- (3) Czech/Slovak regulations

### **MODULE 2: Corporate structure and decision-making mechanisms**

*Objectives: To discuss (i) the effectiveness of various corporate governance systems; (ii) the structure of Czech/Slovak corporate governance and (iii) enhancing board operations and decision-making.*

#### **Topics**

##### **A. Models of corporate governance**

- (1) Overview of German, US and other models
- (2) Effectiveness of each model

##### **B. Czech/Slovak corporate governance structure**

- (1) Roles and responsibilities of boards and shareholders

- (2) Regulation
- (3) Articles of association: theory and practice
- (4) Duties of individual board members

#### C. Effective board operations and decision-making

- (1) Use of committees
- (2) Selection and compensation of board members

### **MODULE 3: Shareholder relations and communications**

*Objectives: To discuss (i) fundamental shareholder rights; (ii) fairness and transparency of voting procedures and (iii) practical issues relating to the preparation and holding of a general meeting.*

#### **Topics**

##### **A. Ownership**

- (1) Recognition of ownership and shareholder registry
- (2) Limitations on ownership
- (2) Managing shareholder expectations
- (3) Protection of minority shareholders

##### **B. Voting mechanisms**

- (1) Voting procedures ensuring fairness and transparency
- (2) Proxy process
- (3) Cumulative voting
- (4) Shareholder proposals

##### **C. General Meeting**

- (1) Purpose of the General Meeting
- (2) Shareholder notification
- (3) Logistics
- (4) Agenda

### **MODULE 4: Financial reporting and information systems**

*Objectives: To discuss the various disclosure requirements on a public joint-stock company and the development of efficient and cost-effective internal management information systems to monitor performance.*

## Topics

### A. Public disclosure

- (1) Financial reports
- (2) Annual reports
- (3) Proxy statements
- (4) Prospectus
- (5) Taxation reports

### B. Financial statements

- (1) Basic accounting principles
- (2) Overview of standard financial statements
- (3) Czech/Slovak vs EC/US standards

### C. Management Information Systems

- (1) Additional information required by management/boards for decision making
- (2) Development of an effective and efficient information system

## **MODULE 5: Business strategy and financing**

*Objectives: Enhance participants' ability to (i) evaluate the strategic position and strengths and weaknesses of the firm; (ii) evaluate restructuring options and (iii) understand the potential sources of capital*

## Topics

### A. Business strategy

- (1) Competitive analysis
- (2) Business plan development
- (3) Restructuring and investment decisions

### B. Business financing

- (1) Capital markets (domestic and foreign)
- (2) Debt vs equity capital
- (3) Share issue mechanisms, dividend policy and other financing instruments

## COURSE SCHEDULE

### DAY 1

18:00-19:00 Registration  
19:00-20:30 Reception

### DAY 2

07:30-08:15 Breakfast  
08:30-09:00 Introduction  
09:00-10:00 Module 1: Corporate governance in a changing environment  
10:00-10:15 Break  
10:15-12:00 Module 2: Corporate structure and decision-making mechanisms  
12:00-13:00 Lunch  
13:00-14:30 Module 3: Shareholder relations and communications  
14:30-15:30 Case study: Progress (Part A): Individual reading  
15:30-16:15 Case study: Progress (Part A): Small group discussions  
16:15-17:45 Case study: Progress (Part A): Role play  
18:30-19:30 Dinner  
19:30-20:00 Video: Balance Sheet Barrier

### DAY 3

07:30-08:15 Breakfast  
08:30-10:00 Module 4: Financial reporting and information systems  
10:00-10:15 Break  
10:15-12:00 Module 5: Business strategy and financing  
12:00-13:00 Lunch  
13:00-14:00 Case study: Progress (Part B): Individual reading  
14:00-14:45 Case study: Progress (Part B): Small group discussions  
14:45-16:15 Case study: Progress (Part B): Plenary session  
16:15-16:45 Conclusion, evaluation and certificates

# TRAINERS AND IMPLEMENTING INSTITUTIONS

This course is being undertaken by a group of individuals and institutions which have worked together closely in the development of numerous courses on privatization and restructuring provided in the Czech Republic over the last 24 months, under contract to the International Privatization Group of Price Waterhouse and sponsored largely by the US Agency for International Development.

## **Trainers**

The trainers involved in this course are:

### **Tessie San Martin - Director of Training for Central Europe, Price Waterhouse - International Privatization Group, Washington, D.C.**

Dr. San Martin is responsible for the design of the training programs and the development of course materials for this workshop on Corporate Governance. She also designed and directed the course on Negotiating Privatization Transactions for the Ministry of Industry and Ministry of Privatization in the Czech and Slovak Republic which took place in the first half of 1992. Dr. San Martin has directed similar programs sponsored by the Ministry of Privatization in Poland. She has designed numerous courses in strategic planning, management and operations as well as supervised the development of case studies and faculty training in a wide range of management training institutes around the world, including CADER in the Dominican Republic, ESAN in Peru, the Cyprus International Institute of Management, INAP in Argentina and the Graduate School of Business in Lahore, Pakistan. Dr. San Martin has a PhD. in Political Economy and a Masters in Public Administration from Harvard University.

Price Waterhouse - International Privatization Group  
1801 K Street N.W., Washington, D.C. 20006, USA,  
Tel: 202-296-0800, Fax: 202-467-4405

### **Marc Flynn - Manager, Price Waterhouse, International Privatization Group, Washington, D.C.**

Mr. Flynn is responsible for directing the needs assessment and overseeing quality control for all materials development. He has been involved in training and course development in several countries in Central and Eastern Europe since 1991. Mr. Flynn's previous work experience was in marketing management and strategic planning in the office products manufacturing and computer distribution fields in Canada. He holds an MBA (Western Ontario), BSc. in Economics (Montreal) and a Certificate in Law (Montreal).

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### **Sandy Chen - President, CORUM Business Services, Prague.**

Mr. Chen is responsible for overseeing case study development as well as coordinating the production of all reference and presentation materials for the courses. Mr. Chen is

founder and president of CORUM, a local management consulting and training firm in Prague and has lived there for over 4 years. CORUM has developed and delivered business training programs for local firms and has completed several market research and strategic market entry plans for both foreign and local firms. Prior to coming to Prague, Mr. Chen's worked for the strategy consulting firm of Temple, Barker & Sloan (now a division of Mercer Management Consulting) in Boston. He holds a B.A Magna cum laude (International Business) and a B.A. in Economics from Brown University.

CORUM Business Services Ltd, Legerova 15, Praha 2, 120 00, CR  
Tel/Fax: 29 71 34

## Implementing Institutions

### *Price Waterhouse International Privatization Group*

*Price Waterhouse* (PW), one of the world's leading professional firms of management consultants, accountants and auditors, with a global network of firms practicing in more than 110 countries, has a long tradition of providing timely and practical consulting and training services for public and private sector clients around the world. Our organization has designed and delivered dozens of practical training programs for public and private sector decision-makers in the area of privatization, corporate governance and capital markets. In Central and Eastern Europe and the newly independent states of the former Soviet Union, over 1,000 privatization agency, investment fund and enterprise officials have attended the dozens of *Price Waterhouse International Privatization Group* (PW-IPG) executive management training programs held in the region since 1992. In the Slovak Republic, *PW-IPG* has held training programs in enterprise appraisal and negotiations for Ministry of Industry, Ministry of Economy, Ministry of Privatization and National Property Fund officials since 1992.

The International Privatization Group at Price Waterhouse (PW-IPG) was established in December 1990 with the support of the United States Agency for International Development (USAID). PW-IPG provides privatization related technical advisory services and training to government and private sector practitioners in developing countries throughout the world. IPG also conducts applied research and maintains a comprehensive library and information service on privatization.

PW-IPG training programs are popular with practitioners because they are practical and carefully tailored to their needs. All material was aimed at addressing their particular skills gaps. Case studies prepared specifically for these training programs re-created actual decision-making situations faced by officials in similar positions such as were being occupied by the course participants.

*PW-IPG's* training programs have covered a wide variety of topics related to privatization and capital markets development, corporate, organizational and financial restructuring, enterprise management, negotiations and corporate governance. Participants have been impressed with the non-theoretical and practical nature of these training programs. Our highly regarded training programs distinguish themselves by:

- a. Extensive Experience in Privatization, Restructuring and Capital Market Development. Our training programs are based on years of practical experience providing advice and support to privatization agencies, capital market regulators, financial institutions, enterprise managers, and other key players throughout the NIS, Central and Eastern Europe, Asia, Latin America and Africa.
- b. Collaboration with Local Specialized Institutions. Our network of local offices and our linkages with a specialized training institutions keep our

programs up-to-date and the materials modified to fit constantly changing market conditions.

- c. Careful tailoring of training materials to local needs. For any teaching methodology to be effective, training materials must be tailored to provide maximum relevance to their audiences. *PW-IPG* has created an extensive library of case studies and other training materials specifically for decision-makers in emerging market environments.
- d. The use of interactive training methodologies. Our training programs rely on a wide variety of training methodologies, including case studies, computer simulations, role plays, site visits, internships and exchanges.

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## **CZECH REPUBLIC**

### *Anglo-American Business Institute, Inc.*

The Institute, established in mid-1992, with the assistance of the Prague University of Economics, is a private firm involved in the following activities:

- . Privatization and Corporate Governance Training Program (PW-IPG/USAID): Logistical support, primary contact with Ministries and local trainers and material development.
- . Privatization of Municipal Services Seminar (PW-IPG/USAID): Conducted surveys of municipalities in Czech Republic and Slovak Republic and coordinated all logistics and translations.
- . Small business development
- . Investment promotion of large-scale projects with foreign capital participation
- . Trade promotion assistance
- . Logistics support for foreign organizations operating in Czechoslovakia.

The President and Chief Executive Officer of the Institute is Dr. Ladislav Venyš. Dr. Venys is also the Director of the Centre for Democracy and Free Enterprise (CDFE). The Centre is a non-profit Czech foundation involved in various activities with several international institutions on educational and training programs in the CSFR including:

- . Development of a Legal Resource Center in Prague, funded by the Ford Foundation
- . Placement in Czech and Slovak firms of US business school graduates in cooperation with the MBA Enterprise Corps
- . Book distribution program (Sabre Foundation)
- . Seminars for Czech and Slovak Parliamentarians (East-West Parliamentary Project)

Anglo-American Business Institute, Štěpánská 18, Praha 1, 110 00, CR

Tel/Fax: 42-2-2422-6720 or 2422-6447

## SLOVAKIA

### *The Entrepreneurship Center*

The Entrepreneurship Center is one of the most successful small business consulting programs in Slovaia and the Czech Republic and provides complementary activities designed to address the diverse needs of entrepreneurs. The mission of the Entrepreneur Center is to encourage the rapid growth of entrepreneurship in the Czech Republic and Slovakia.

The Entrepreneurship Center accomplishes its mission in two ways:

- Aiding entrepreneurs directly in one-on-one consultations that often stretch over a period of months. Entrepreneurs are aided with formulating, evaluating, and developing their ideas and ventures. When appropriate, assistance is given in obtaining financing to launch or expand enterprises.
- Aid is provided to entrepreneurs indirectly by helping to improve the overall business environment through educational and training activities.

The Entrepreneurship Center, Vysoka 20, Bratislava, 811 06, SR, Tel/Fax: 07-325-010

# Corporate Governance and Competitiveness

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## Workshop for Czech Directors



# Corporate Governance and Competitiveness

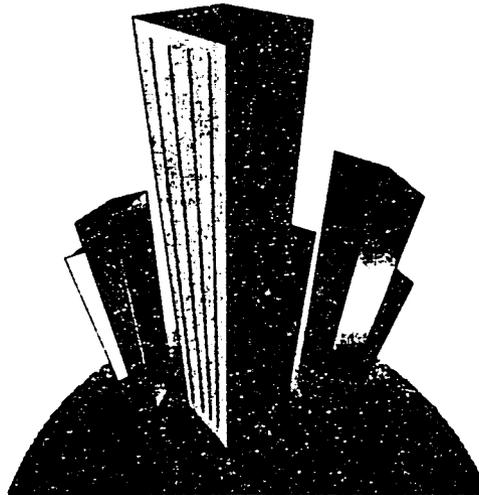
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- Module 1: Corporate Governance in a Changing Environment
- Module 2: Corporate Structure and Decision Making Mechanisms
- Module 3: Shareholder Relations and Communications
- Module 4: Financial Reporting and Information Systems
- Module 5: Business Strategy and Financing

# Corporate Governance in a Changing Environment

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## Module 1



# Module 1: Agenda

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- The firm and its environment in a market economy
  - Competitive environment
  - Regulatory environment
- Stakeholders: Conflicts and common interests
- Role of corporate governance

# The Firm as an Entity

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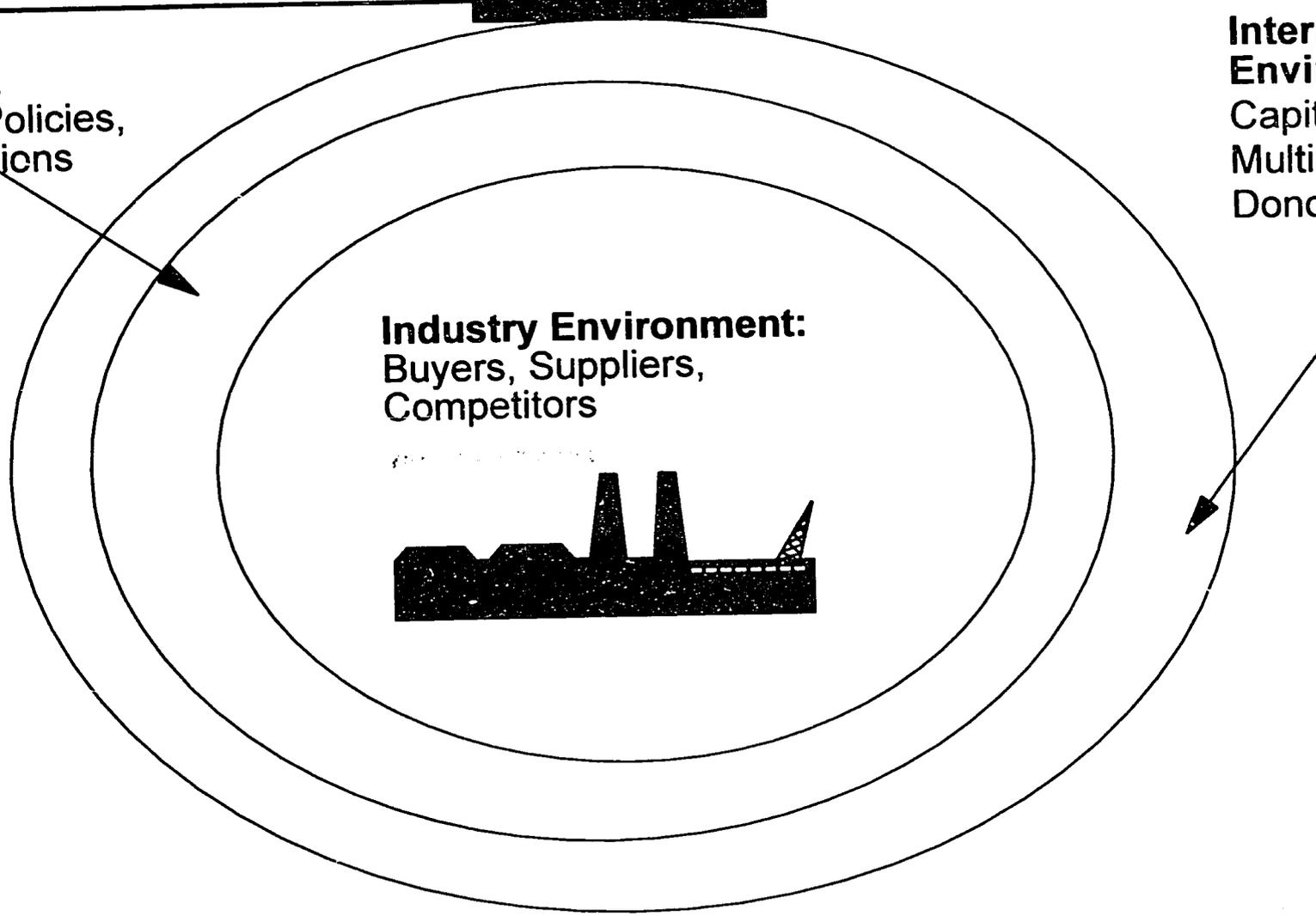
- A firm is an independent legal person with rights and obligations
- A firm is composed of
  - Management
  - Employees
  - Intangible assets
  - Physical assets
- A firm's value to shareholders derives from how well all assets are employed to generate cash and profits
- Shareholders own the firm and are represented by the Supervisory and Management Board
- Directors are legally accountable to all shareholders

# The Firm's Environment

**Domestic Environment:**  
Government Policies,  
Laws, Regulations

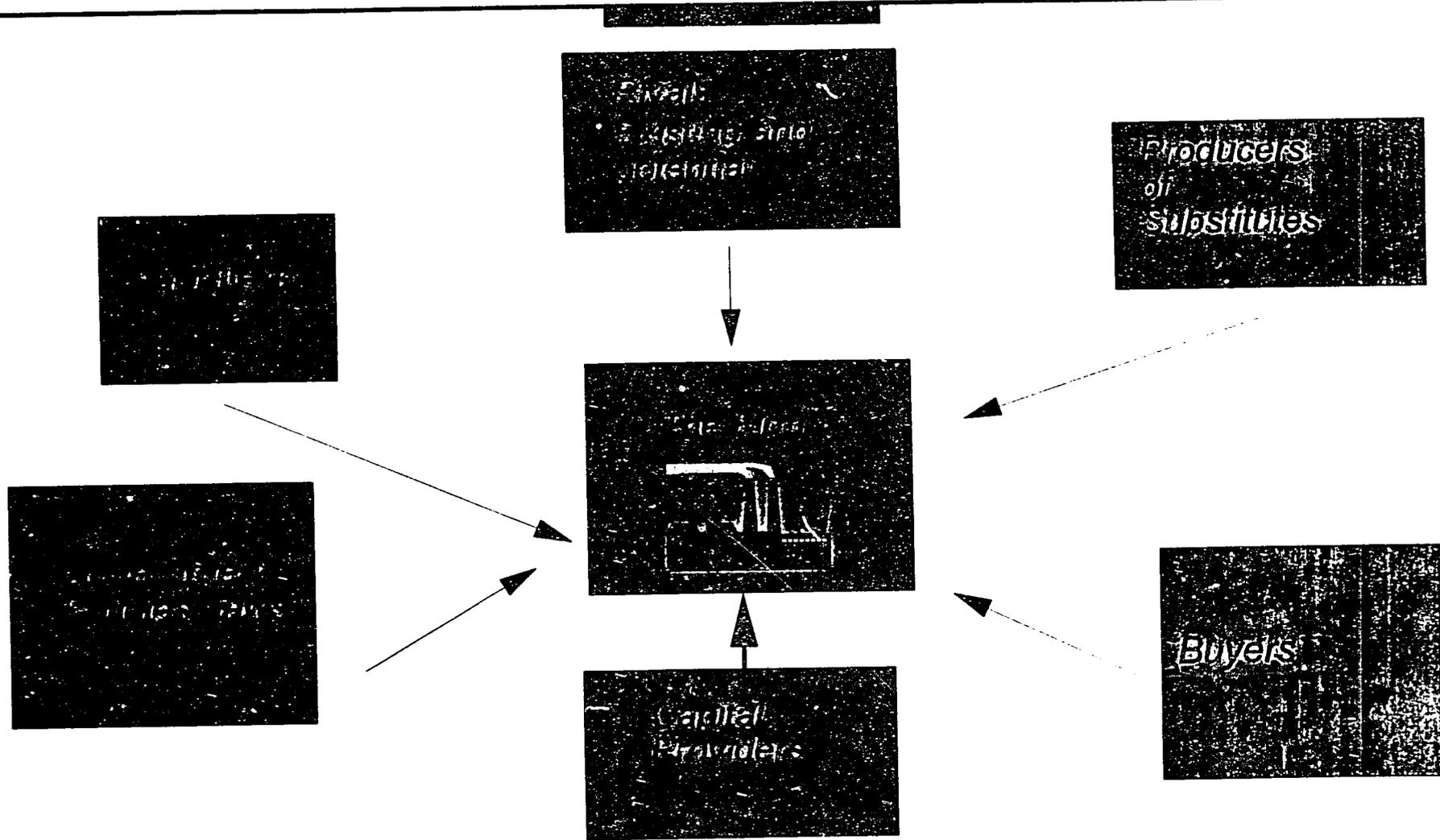
**International Environment:**  
Capital Markets  
Multinationals,  
Donors

**Industry Environment:**  
Buyers, Suppliers,  
Competitors



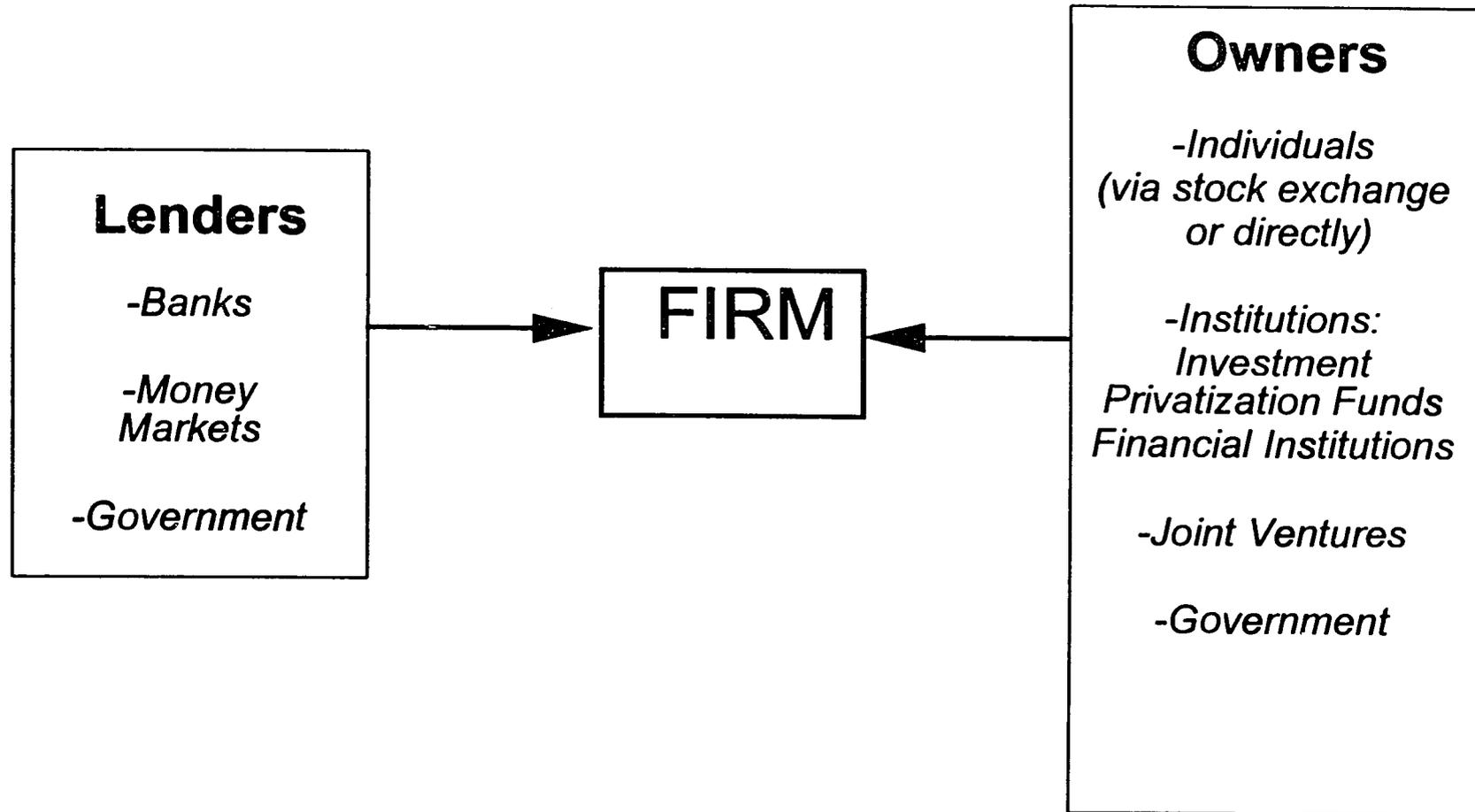
# New Competitive Environment

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# Capital Providers

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# Czech Regulatory Environment

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- **New legal and regulatory structures affect relationships between the firm and actors in the environment:**
- Commercial Code
  - affects the competitive relationship between the firm, competitors, suppliers and buyers
  - affects relationship between owners and the firm
- Bankruptcy Act
  - affects relationship between capital providers and the firm
- Securities Law/Investment Fund Laws
  - affects transactions between capital providers
- Taxation Laws
  - affects financing options and cash flow

# Czech Regulatory Bodies

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- Ministry of Finance
  - Ensures that securities are issued and traded in a fair, orderly and efficient manner
  - Monitors market participants (including Investment Privatization Funds) and enforces securities laws
  - Administers corporate taxation

# Types of Stakeholders

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- Includes shareholders, who own the firm and other stakeholders who are affected by actions of the firm
- Shareholders
  - Investment Privatization Funds
  - Individuals
  - Management
  - National Property Fund
  - Strategic Investors
- Other stakeholders
  - Employees
  - Community
  - Potential investors
  - Buyers/Suppliers

# Management

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- Priorities:
  - job security and remuneration
  - increase reputation and size of firm
  - new technology
  - responsibility towards employees/community
  - financial performance of firm
  - dividends

# Investment Privatization Funds & Outside Investors

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- Investment Privatization Funds
  - Priorities:
    - Increase share value
    - dividends (cash flow for operations)
    - influence on the firm to make required changes
- Individual investors
  - Priorities:
    - dividends
    - increase share value

# Government

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- Employment
- Stability
- Social benefits
- Taxes
- Environmental issues

# Shareholder Objectives: Common Objectives and Possible Conflicts

## Priorities

	Salaries	Social Benefits	Dividend	Long-term	Control
<b>Managers</b>	Med	Med	Med	High	High
<b>IPFs</b>	Low	Low	High	Med	High
<b>Other Outside</b>	Low	Low	High	Med	Low
<b>Government</b>	Med	Med	Low	High	Low

# Common Frustrations

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- New environment
- Uncertainty of future
- Changing laws and regulations
- Lack of information to make decisions
- Lack of experience
  - competitive market
  - procedures of corporate governance

# Common Goals

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- Viable long-term enterprise resulting in profits, employment
- Increase in share value and dividends
- Access to outside capital and technology
- All shareholders are sources of additional capital for firm
- Reduction of corporate taxes

# Achievement of Common Goals through:

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- Communication between shareholders and management
- Accountability of management
- Transparency of process
- Manage shareholder expectations
- Provide information

# Corporate Governance - Why ?

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A tool for achievement of common objectives

- Adoption of sound corporate governance practices helps ensure efficient running of an enterprise and enhances value to shareholders while protecting rights of all stakeholders

# Corporate Governance - What ?

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- Defines:
  - Rights of shareholders on the firm
  - Relationship between shareholders and their representatives (Supervisory and Management Boards)
  - Roles and responsibilities of Board members and management (as Boards and individually)
  - Structure of the organization
  - Responsibility of the firm towards other stakeholders
  - Procedures and guidelines

# Principles of Good Corporate Governance

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- Transparency
- Disclosure
- Loyalty
- Accountability
- Legality

# Advantage of Good Corporate Governance

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- Access to capital (debt and equity)
- Access to domestic and foreign investment
- Protects directors/managers from legal action
- Increases efficiency of decision-making
- Increases public faith and trust in reform

# The Czech Corporate Governance Model

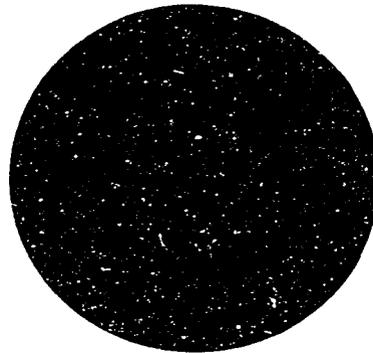
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- Based on the Commercial Code
- Includes:
  - Articles of Incorporation
  - General Meeting of Shareholders
  - Supervisory Board
  - Management Board

# Different Approaches to Corporate Governance around the World

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- But all companies in a market economy share basic characteristics:
  - General Meeting--a mechanism for guaranteeing shareholder participation in corporate decision-making
  - Management structure responsible to General Meeting
  - Shareholder right to sue or seek redress



# Different Approaches to Corporate Governance around the World

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- Globalization of trade and capital are leading to convergence of governance practices:
  - Increased disclosure
  - Increased protection of minority shareholder rights (voting mechanisms)
  - Increased transparency



# Corporate Governance: Summary

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- Corporate governance is a process which enhances the competitiveness of the firm while balancing the needs of the shareholders with those of other stakeholders.

# Decision-Making Mechanisms in the Company

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## Module 2



# Module 2: Agenda

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- Models of Corporate Governance
  - Overview of German and US models
  - Effectiveness of each model
- Czech Corporate Governance structure
  - Roles and responsibilities of shareholders and boards
  - Duties of individual Board members
- Effective board operations and decision-making

# International Corporate Governance Models - An Overview

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- Why ?:
  - Czech laws and regulations are adapted from these models
  - Adapt lessons-learned from other systems to Czech reality
  - Foreign investors expect Czech firms to follow internationally accepted corporate governance principles

# Shareholders - Common International Standards

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- Ultimate authority in the firm
- Economic interest is realized through dividends and/or increase in share value
- Exercise authority through voting at General Meeting, electing representatives to the Boards, and voting on major issues



# Generally Accepted Shareholder Rights

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- Right to vote at shareholder meetings
- Right to sell or transfer shares without approval or unreasonable costs/procedures
- Right to dividends
- Right to information concerning enterprise
- Right to fair and equal treatment of shares of same class (1 share= 1 vote)
- Right to enforce loyalty and adherence to Articles of Incorporation by their representatives (directors and managers)
- Liability limited to initial investment

# Shareholders: What they Should Not Do

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- Due to lack of information and knowledge it is preferable that they do not get involved in:
  - day-to-day operations
  - specifics of long term business plans
  - selection of management
  - buying and selling of assets in normal course of business

# Structure of Corporate Governance in Market Economies

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- A modern corporation requires that two very distinct functions be fulfilled:

**Managing and Directing**

# Roles of Management and Directors

	<b>Directors</b>	<b>Management</b>
<b>Responsible for:</b>	<p>Approving long-term strategy</p> <p>Approving financing</p> <p>Approving Major investments</p> <p>Ensuring that management is operating within:</p> <p><i>the Articles of Incorporation</i></p> <p><i>Goals set out by General Meeting of Shareholders</i></p> <p><i>Legal framework</i></p> <p>Ensuring accuracy of the financial statements</p>	<p>Developing long-term strategy</p> <p>Planning financial requirements</p> <p>Managing firm operations on a day-to-day basis</p> <p>Ensuring accuracy of the financial statements</p>

# Role of Directors/Managers

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- The role of Directors should be dynamic.
  - As the environment changes, and as the firm acts to change its environment, corporate survival and growth will depend on the extent to which the firm can use the special talents and skills from management and its directors.
- But the one unchanging and basic goal and function of Directors/Managers is to ***Enhance Shareholder Value***

# Corporate Governance: A Product of National Development

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- Differences of corporate governance are a product of :
  - Political histories
  - Laws and regulations
  - Cultures
  - Paths of economic development

# Determinants of Corporate Governance

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Attitudes & Politics



Financial Organizations  
& Markets



Corporate Ownership Structure

# German System - Characteristics

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- Concentrated ownership
  - Emphasis on debt rather than equity financing
  - Smaller stock market
- Close relations between financial institutions and industry
- Reliance on informal contracts
- Disclosure requirements less stringent than US
- Hostile takeovers infrequent
- Two-tier board system
- Employees have considerable influence

# Shareholders in Germany

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- Concentrated shareholder ownership and power
  - Significant interlocking ownership between firms
  - Individuals shareholders invest through banks, transferring voting rights to banks via proxy
  - Banks effectively control 50% of shares
- In recent years, several large firms have sought to raise capital in international markets. They are facing demands for greater disclosure and voice by new investors.

# German Board Structure

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- Supervisory Board (Aufsichtsrat)
  - One-third to one half elected by employees, others by shareholders
  - Members cannot be on the Management Board
  - Banks often control Supervisory Board
- Management Board (Vorstand)
  - Elected by Supervisory Board
  - Consists of internal management only
  - Manage operations and represents firm
  - More involved in decisions than US boards

# German Model - Lessons learned

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- Pros:
  - Longer-term outlook and investment planning
  - Stability
  - Strong information handling and decision-making systems
- Cons:
  - Discourages new ideas and limits entrepreneurial leadership
  - Slower adaptation to changing competitive environment
  - Risks of conflict of interest (banks as lenders and representative of shareholders)

# US System - Characteristics

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- Diverse ownership
  - Strong anti-monopoly regulations
  - Large and liquid stock markets
  - Strong legal backing of shareholder rights
- Strict disclosure requirements
- Separation of financial institutions and industry
- Reliance on explicit contracts enforced by court system
- De-facto control of proxy process by management
- No statutory role for employees

# Shareholders in US

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- Traditionally shareholders have had limited involvement in firm due to:
  - Ease of exit in liquid market (selling shares rather than voting for change)
  - Dispersed ownership
- Recently shareholders have increased involvement
  - Cost of exit for institutional investors has increased due to large block of shares
  - Hostile takeovers used as a tool to replace management

# US Board Structure

---

- Board of Directors
  - Elected by shareholders
  - Main role is to represent shareholders
  - Appoints CEO and other top managers who manage and represent the firm
  - Monitor and oversee strategic and financial direction of the firm
  - Includes inside (management) and outside directors. Recent trend is toward including a majority of outside directors

# US Board Structure - Outside vs. Inside Directors

---

- Good corporate governance suggests that a majority of Board members should be "independent" outside directors so that Board may objectively oversee performance of management
- Additional advantage of outside directors is to acquire expertise and increase contacts
- Recent trend is moving towards a majority of outside directors on the Board
- Recent debate on the "independence" of outside directors. For example, the nomination of the firm's consultants and lawyers to the Boards

# US Model - Lessons Learned

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- Pros:
  - Ease of exit, if shareholder unsatisfied with performance
  - Able to adapt quickly
  - Threat of takeover has accelerated needed restructuring
- Cons:
  - Directors/Management tend to be short-term oriented (influenced by stock market and short-term contracts with firm)
  - Removal of management in under-performing firms has been slow due to management dominated boards

# Checks and Balances on Management Performance: Role of Financial Markets

---

- Markets discount share value of poorly managed and poorly performing companies
  - Markets judge company performance together with industry performance and overall economy
- Opportunity cost and risk
  - Global competition and ease of capital flows discipline inefficient management
  - Institutional and strategic investors have many more options today

# Relevance of Other Corporate Governance Models to Your Environment

---

- Depends on many factors:
  - Structure of capital markets
  - Liquidity and ease of exit from market
  - Structure of shareholdings
  - Human resources available
  - Government regulations
  - Political clout of other shareholders

# The Czech Corporate Governance Model

---

- Based on the Commercial Code
- Includes:
  - Articles of Incorporation
  - General Meeting of Shareholders
  - Supervisory Board
  - Management Board

# Articles of Incorporation

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- Includes
  - Definition of general scope of business activities
  - Authority of and procedures for holding General Meetings
  - Supervisory and Management Boards: Number of members, definition of powers, and decision-making mechanisms
  - Principles of distribution of profits
  - Procedure for modifying capital stock
  - Procedure for amending Articles of Incorporation

# Exclusive Role of Shareholders

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- Through the General Meeting they can:
  - Elect and dismiss members of Supervisory Board (except employee representatives)
  - Elect and dismiss Management Board members (unless Articles of Incorporation states that Supervisory Board elects them)
  - Approve financial statements
  - Decide on dividend payouts
  - Decide on increase or decrease of capital stock
  - Amend Articles of Incorporation

# Supervisory Board: Composition

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- One half to two thirds of members elected by the General Meeting, one third to one half by employees
- Members elected for up to 5 years
- Members cannot also be on Management Board
- Voting: Majority rules

# Role of Supervisory Board

---

- Power depends on whether it appoints members of Management Board
- Represents interest of shareholders and the public
- Ensures company and Management Board acts in accordance to Articles of Incorporation, the provisions of the General Meeting, and the law
- Ensures that financial statements are a fair representation of reality
- Represents company in court litigation against members of Management Board
- Tends to be reactive rather than proactive

# Management Board - Composition

---

- Appointed by at General Meeting or by Supervisory Board
- Minimum of 3 members is specified by regulations and should be an odd number
- Members elected for a maximum terms of 5 years, but can be replaced at anytime by shareholders, at a General Meeting
- Members elect the Chairman
- Majority rules, unless stipulated otherwise in the Articles of Incorporation

# Role of the Management Board

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- Manages activities of company and acts on its behalf, as stipulated in Articles of Incorporation
- Decision-Making and negotiation authority between shareholder meetings
- Appoints and dismisses Senior Management
- Determines compensation of Senior Management
- Oversee activities of management
- Convenes General Meeting

# Management Role

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- Senior managers (whether on Boards or not) have critical role in success of firm:
  - Manage day-to-day operations
  - Execute decisions made by Boards/General Meeting
  - Develop short and long term strategies
  - Plan financial requirements and financial monitoring systems
  - Understand changing market environment
  - Communicate and motivate employees

# Legal Responsibility of Directors

---

- **Fiduciary role:** People in whom others place a special trust and confidence, and are therefore subject to duties of care and loyalty. Directors represent all shareholders.
- **Care:** Involves concern, attention, and diligence that directors are expected to exercise in discharging their duties. "In good faith": in a manner one believes is in the best interest of the firm
- **Loyalty:** Director's obligation to subordinate self-interest to the interest of the firm, when the two conflict

# Role of the Boards -Issues for Czech Directors

---

- Supervisory does not nominate Management Board members, therefore reducing its power
- Management Boards includes management and representatives of shareholders.
  - Are Board members representing rights of all shareholders. Power concentrated between management and few large shareholders
- Efficiency of frequent meetings with outside directors. Board should direct and oversee management. Should not be involved in day-to-day operations

# Role of the Boards - Issues (Con't)

---

- Ensure transparency
  - Minutes of the Board meetings available to shareholders
  - Clear voting procedures and disclosure
  - Recruitment of truly independent Board members
- Increase efficiency of Board operations
  - Use of committees
- Monitor performance
  - Set-up appropriate information system.
- Manage shareholder expectations

# Board Operations: Use of Committees

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- Advantages of Committees:
  - Focus attention on areas critical to firm success
  - Harness expertise of individual directors to benefit of company and management
  - Help management monitor a rapidly changing environment (early warning system)
  - Help manage relations with external environment



# Types of Committees

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- Committees should specialize in specific critical areas:
  - Audit committee
  - Executive (strategy) committee
  - Compensation committee
  - Nominating committee (nominating new board members)



# The Audit Committee: Contributions to Corporate Performance

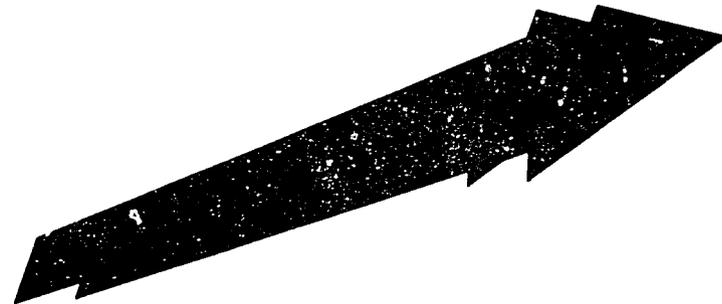
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- Should do more than perfunctory consent to accounting policies and procedures
- Should periodically review "high exposure areas:"
  - procedures under stress because of changes in the external business environment: e.g. adequacy of reserves for future losses as result of special promotions and credit practices

# Executive (Strategy) Committee

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- Can help management by outlining key strategic issues which need to address
- Can help management by "selling" strategy to general meeting, and key actors such as suppliers, creditors



# Nominating Committee

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- Management Board and Supervisory Board must work in unison to identify and recruit top talent, but the committee can make job easier by:
  - formulate selection criteria that include professional expertise, availability, age, etc.
  - identify and compile information on candidates
- Important to find members who will constructively examine important/strategic issues

# Benefits of Outside Directors

---

- Outside directors can bring many potential benefits to the firm
  - Attract capital by:
    - facilitating contacts
    - increasing credibility of the firm
  - Facilitate access to markets, suppliers, technologies, know-how
  - Provide objectivity
  - Provide strategic guidance through
    - their knowledge of the industry
    - their contacts in the industry (domestic and foreign)

# Compensation Committee

---

- Ensure incentives for management congruent with company needs and external challenges
- Should evaluate
  - how much to salary to pay;
  - the proportion of total remuneration represented by salary;
  - The balance between short and long-term performance incentives.
- Evaluate management succession plans
- Organize annual management performance review
- Committee should be made up of non-management members

# Module 2: Summary

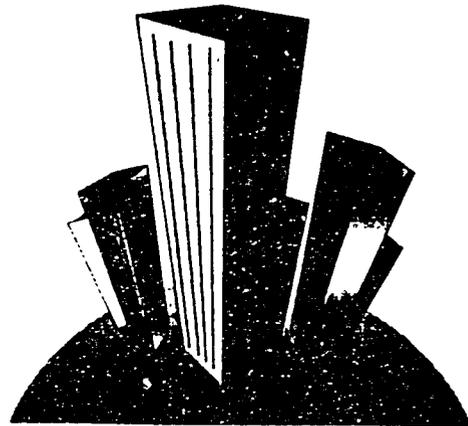
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- All systems of corporate governance continuously evolve and adapt to changing environment
- Constant evolution requires transparency and information to all stakeholders
- No system of governance is perfect

# Shareholder Communications and Relations

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## Module 3



# Module 3: Agenda

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- Ownership
  - Recognition
  - Protection of minority shareholders
- Voting mechanisms
  - Voting procedures
  - Proxy process
  - Cumulative voting
  - Shareholder proposals
- General Meeting
  - Agenda
  - Logistics

# Recognition of Ownership

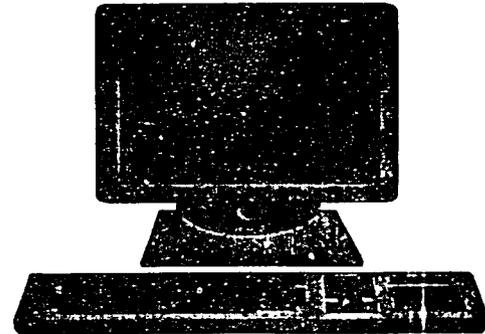
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- Recognition of ownership is essential in order for shareholders to exercise their rights: to dividends, to voting at General Meetings, and to selling their shares
- Methods
  - Stock certificates (Named or bearer)
  - De-materialized shares
  - Shareholder registry
  - Beneficial vs. nominal owner

# Shareholders' Registry

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- What is it?
  - A reference of all transactions and the identities of shareholders.
  - Should include:
    - shareholder's name and place of residence
    - number and class of shares
    - date of acquisition



# Shareholders' Registry

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- Increases transparency, improves shareholder & investor relations
- Official record of share ownership; without being registered, shareholders cannot vote or receive dividends
- Role of Center for Securities
  - Maintain accurate records and register transactions on a timely manner
- Responsibility of Management
- Access to registry and confidentiality

# Protection of Minority Shareholders

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- Main principles include:
- Directors have a fiduciary responsibility to all shareholders
- Concept of one share, one vote
- Preemptive rights on new share issues (Offer new issues proportionally to existing owners)
- Ultimate protection is the increased efficiency of secondary market (ease of exit)

# Establishing Voting Procedures

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- To make the voting process proceed smoothly, and to ensure transparency, firms must adopt policies with regard to
  - Board nominations
  - Shareholder proposals
  - Recognition of ownership and setting a record date
  - Recognition of power of attorneys/proxys
  - Confidentiality of voting
  - Neutrality of voting inspectors

# Voting Procedures: Protection of Minority Shareholders

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- Super majority voting on key issues (66%)
  - Amendments to Articles of Incorporation
  - Increase or reduction of capital stock
- Quorum requirement
  - 30 % of shares outstanding, if not achieved
  - No quorum for second meeting
- Cumulative voting
  - Provides proportional representation on Board of Directors



# Proxy Process - US Experience

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*Goal: Firm must facilitate the voting process in order to give shareholders their voice in corporate governance and attain a quorum*

The firm includes with the Notification of the General Meeting:

- Proxy Statement, including
  - Board Proposals
  - Shareholder Proposals
- Proxy Card
  - allowing the shareholder, who cannot attend General Meeting, to vote or transfer voting power on one or all issues to a designee

# Elements of a Proxy Statement - US Example

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- Explanation of voting procedures, both for proxy and in-person
- Information on board nominees, including
  - Background, professional affiliations
  - Compensation and share holdings
- Information on other Board initiatives
- Shareholders' Proposals
  - Shareholders' statement of support
  - Board's response

# Proxy Card - US Example

---

- Based on information in the proxy statement, shareholders can vote on specific issues or empower a designee to vote on their behalf
- The designee is empowered to vote on the shareholder's behalf only on that particular occasion
- Shareholders can limit their proxy's voting power to particular issues
- Shareholders can cancel a proxy at any time

# Qualifying Shareholder Proposals - US Experience

---

- Not all shareholder proposals should be included in a proxy statement and be voted on at a General Meeting. Examples of common criteria include the following:
  - The proposal can be initiated by a shareholder controlling a significant number of shares (Czech: 10%)
  - The proposal must be concerned with matters of corporate policy, not operational matters
  - The proposal must not interfere with the board's discretionary authority previously granted by the shareholders
  - Proposal must be sent to Board in advance (45-90 days) of the mailing of notification of the General Meeting

# Proxy Process - Czech/Slovakia

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- Requires notarized power of attorney
  - Entails cost and time
- Legality and practicality of US-type proxy system

# General Meeting

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- Required by Commercial Code and must be held once a year
- Shareholder's primary vehicle for exercising their rights
- Board must ensure transparency, clear procedures and equal treatment of shareholders
- General Meeting requires substantial planning

# Purpose of the General Meeting From Shareholders' Perspective

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- Vote for directors and other major issues
- Make first-hand judgments about quality of directors/management
- Voice concerns about major issues and ask for additional information during Q&A
  - Corporate governance issues
  - Major strategic decisions
  - Firm policies
  - Financial performance
- Formally suggest a course of action to management via a shareholder proposal

# Purpose of the General Meeting From Management's Perspective

---

- Get required shareholder approval for board-recommended actions
  - amending the Articles of Incorporation
  - electing members to the boards
  - approving issuance of dividends
  - approving issuance of new shares
- Strengthen current and potential investors' image of the firm

# Logistical Preparations for a General Meeting

---

- In preparing for a General Meeting, provisions must be made for the following:
  - Prepare notification and agenda
  - Prepare voting procedures
  - Meeting room facilities, registration procedures and security;
  - Food or other amenities to be provided to attendees
  - Any organization of company tours or product displays which will complement the meeting
  - Press coverage or public relations

# Notification of General Meeting

---

Goal: To provide notification of the General Meeting, in a timely and effective manner to all shareholders

- Includes
  - Date, time and place of meeting
  - Meeting Agenda (Items to be voted upon)
- Method
  - Issued a minimum of 30 days prior to meeting
  - Sent by mail or via newspaper advertisements, according to Articles of Incorporation

# Meeting Program

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- Prepared by Management Board and includes:
  - Election of Meeting chairman, minutes clerks, and voting inspectors
  - Opening remarks by Chairman
  - Management Board Chairman's Report
  - Supervisory Board report
  - Voting by shareholders
  - Questions and comments from shareholders

# Opening Remarks

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- The Chairman should:
  - Welcome shareholders and introduce board members
  - Introduce voting inspectors who confirm quorum
  - Apprise shareholders of procedural rules
  - Briefly explain the agenda

# Chairman's and Supervisory Board's Reports

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- Chairman of the Management Board or General Director describes the past year's financial performance and the outlook for next year
- The Supervisory Board reports its findings concerning the financial health of the company

# Matters to be Voted on by Shareholders

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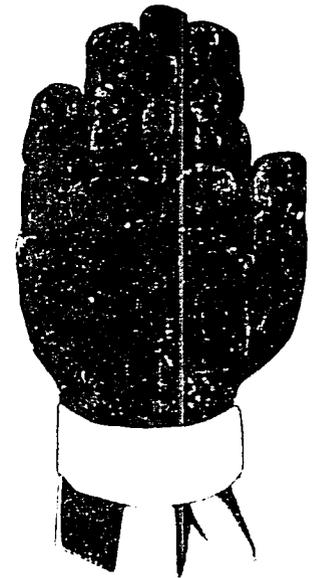
- Issues Proposed by Directors, i.e.:
  - Amendments to Articles of Incorporation
  - Nominations for Board members
  - Approval of Dividends
  - Other Issues
- Qualifying Shareholder Proposals



# Questions and Comments from the Floor

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- Shareholders may want to question directors about
  - financial soundness of the firm
  - plans to restructure
  - potential investors
  - social benefits
  - shareholder dividends



# Module 3: Summary

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- Growth of the firm depends on access to capital
- Access to equity capital depends on existing shareholders' and potential new investors' confidence in the structure and procedures within the firm which would enable them to make changes when required to protect their investment.

# Financial Reporting and Information Systems

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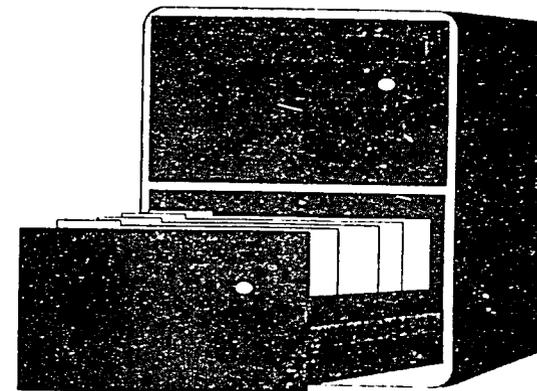
## Module 4



# Module 4: Agenda

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- **Public disclosure**
  - Annual report
  - Prospectus
- **Financial statements**
  - Accounting principles
  - Overview of primary statements
- **Management Information Systems**
  - Information needs
  - System development



# Public Disclosure: Goal

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- To provide all shareholders, the public and the regulatory bodies equal access to fair and accurate general and financial information on the activities of the firm on a regular basis.

# Types of Disclosure

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- **Periodic disclosure**
  - **Annual report**
    - **audited financial statements**
  - **Notification and agenda for General Meeting**
- **Special disclosure**
  - **Prospectus**
  - **Extraordinary events**

# Public Disclosure - Why ?

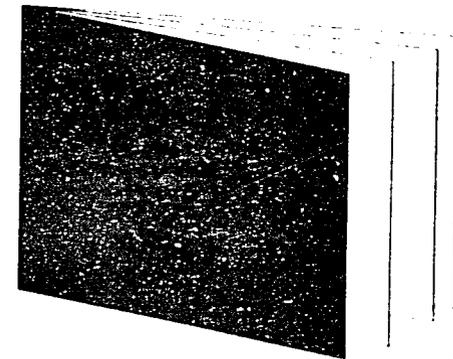
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- For shareholders and lenders
  - Primary source of information
  - Evaluate management performance
- For potential investors
  - Compare performance relative to other investments
- For state regulators
  - Ensure compliance with regulations
- For the public
  - Full disclosure increases trust in the markets and market reform

# Elements of an Annual Report

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- Chairman's and/or CEO's (General Director) message to shareholders
- Audited financial statements
- Business unit review
- Information on Board members and management
- General information



# Chairman and General Director's Letters to Shareholders

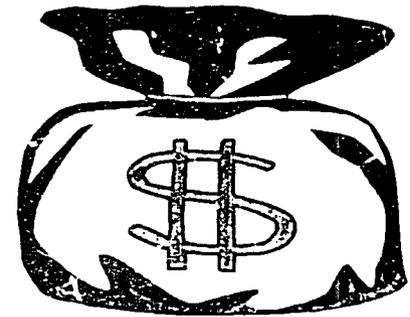
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- Questions to address:
  - ▶ How well did the firm meet its financial and strategic performance goals?
  - ▶ What drove firm performance, and what detracted most from it?
  - ▶ What is the overall strategy for the immediate future?

# Financial Information

---

- **Includes:**
  - **Balance Sheet**
  - **Profit and Loss Statement**
  - **Cash Flow Statement**
  - **Notes to statements**
  - **Auditor's report**
  - **Summary of accounting policy**
- **Management should comment on**
  - **Significant changes in financial results from past years.**
  - **Provide information of new public offerings**
  - **Future events which may materially affect financial situation of the firm.**



# Business Unit Review

---

- Provide a synopsis of financial and strategic performance for each business unit. Include comparisons over past few years and forecasts for
  - sales
  - profits
  - capital investments
- Note reasons for any significant restructuring and management changes

# Information on Board Members and Senior Management

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- Include
  - Names, titles, and principal affiliation of board members
  - Members of Board committees
  - Names and responsibilities of senior management

# General Information

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- Include:
  - Headquarters address and phone
  - Shareholder contact for additional information
  - Name and address of independent auditors

# Method of Disclosure

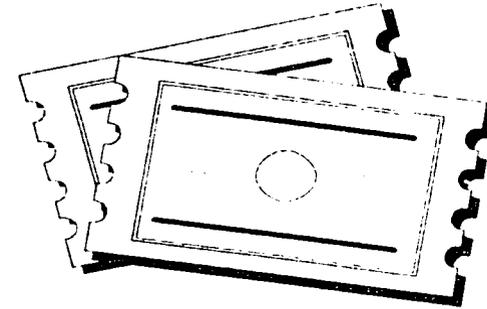
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- Direct mailings to shareholders
  - Issues:
    - Cost
    - Accuracy of shareholder lists
- Press announcement
  - Issues:
    - Adequate coverage
    - Mail upon request

# Special Disclosure - Prospectus

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- Prior to issuing new shares or bonds, a firm must provide adequate information for individuals to make buying decision.
- Prospectus must be approved by Ministry of Finance



# Elements of a Prospectus

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- **Basic information**
  - Information on primary shareholders (more than 10% of shares)
  - Supervisory/Management Board members
- **Financial information**
  - Present and past audited statements
  - Information on loans and bonds
- **Business activities**
  - Competitive situation (i.e. Market share)
  - Past capital investments
  - Overall business strategy
  - Planned investments
- **Information on security issue**
  - Type of security (share, bond)
  - Date of issue
  - Distribution

# Prospectus - Management Discussion and Analysis

---

- In addition to the basic information provided, the prospectus should include a Management Discussion and Analysis which includes:
  - Analysis of past performance
  - Discussion of future trends which are likely to affect the firm and its environment
  - Evaluation of the amounts and certainty of future cash flows from the firm's operations and outside sources

# Special Disclosure - Extraordinary Events

---

- Goal: Inform shareholders, the public and the regulator of major events which could substantially affect the value of the shares or the future of the business such as:
  - Bankruptcy proceedings
  - Major lawsuit
  - Significant changes in senior management
  - Takeover attempt

# Basic Accounting Principles

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- Statements provide a fair and accurate representation of the firm's activities
- Based on recognized International Accounting Standards
- Consistent use over time of accounting principles
- Going concern
- Prudence
- Limit subjective judgment



# Principal Financial Statements

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- **Balance sheet**
  - **Income statement**
  - **Cash flow statement**
- 
- Statements should be accompanied by additional explanations.
  - Statements must be audited by independent and qualified auditors to ensure use of good accounting principles and procedures.
  - Principle statements represent past results. They **do not** reflect future results

# Balance Sheet - Present Situation

---

## Helps answer:

- How much is the company theoretically worth at one point in time?
- Where did money come from?
- How was the money spent ?
- How much is immediately available in cash?

# Balance Sheet - Example

(December 31, 1993)

ASSETS		LIABILITIES & EQUITY	
		LIABILITIES	
Cash	25	Accounts Payable	20
Accounts Receivable	30	Short-term Debt	30
Inventories	35		
Total Current Assets	90	Total Current Liabilities	50
		Total Long-term Debt	47
Gross Fixed Assets	115		
Less Accum Depreciation	47		
Net Fixed Assets	68	TOTAL LIABILITIES	97
		SHAREHOLDER'S EQUITY	61
TOTAL ASSETS	158	TOTAL LIABILITIES & EQUITY	158

# BALANCE SHEET

	31/12/92	31/12/93
<i>ASSETS</i>		
Cash	25	25
Accounts Receivable	20	30
Inventories	25	35
Total Current Assets	70	90
Gross Fixed Assets	100	115
Less Accum Depreciation	35	47
Net Fixed Assets	65	68
<b>TOTAL ASSETS</b>	<b>135</b>	<b>158</b>
<i>LIABILITIES &amp; EQUITY</i>		
Accounts Payable	15	20
Short-term Debt	20	30
Total Current Liabilities	35	50
Long Term Debt	60	47
Shareholder's Equity	40	61
<b>TOTAL LIABILITY &amp; EQUITY</b>	<b>135</b>	<b>158</b>

# Balance Sheet

## Where did the money come from?

---

- Share capital: Owner's money
- Retained earnings: Past profit undistributed
- Loan capital: Someone else's money

# Profit & Loss Statement

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- ▶ *A Profit & Loss statement measures profits (or losses) over a certain period of time. **It helps answer:***
  - ▶ *Where did revenue come from in past year?*
  - ▶ *What expenses were incurred?*
  - ▶ *Did the firm make a profit or a loss during the year?*

**It is defined as:**

$$\text{Net Income} = \text{Revenues} - \text{Expenses}$$

# Profit & Loss - Example

(01/01/93-31/12/93)

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Revenue	100	
Direct Costs	40	
Gross Profit		<u>60</u>
Operating Expenses (incl. depreciation)	15	
Operating Profit		<u>45</u>
Interest Expenses	10	
Income Before Taxes		<u>35</u>
Income Tax (40%)	14	
Net Income		<u><u>21</u></u>

# Profit & Loss Statement

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- Does NOT indicate which products are generating profit.
- Does NOT indicate how much cash was generated.
- Does NOT look at how much cash was invested to generate profit.

# Cash Flow Statement

---

**Cash Flow =**

**Net Income + Depreciation - Capital Investment +  $\triangle$  Working  
Capital**

**Working Capital = Current Assets - Current  
Liabilities**

# CASH FLOW EXAMPLE (01/12/93-31/12/93)

## FROM OPERATIONS

+ Net Income	21
+ Depreciation	+12
- Increase in Net Working Capital	-15

Cash Flow from Operations +18

## FROM INVESTMENT

+ Sale of Assets	0
- Purchase of New Assets	-15

Cash Flow from Investment - 15

## FROM FINANCING

+ Short-term debt	10
+ Long-term debt	-13

Cash Flow from Financing -3

NET CHANGE IN CASH FLOW 0

# Why Concentrate on Cash Flow?

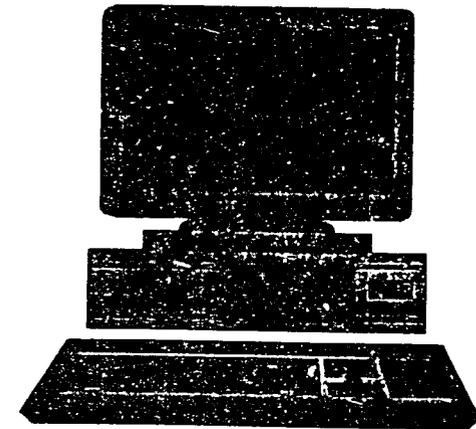
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- Cash Flow provides resources for:
  - paying suppliers
  - paying employees
  - making capital expenditures
  - repaying debts
- A company will cease to exist without sufficient cash flow

# Management Information Systems

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- Provide information for
  - Decision making
  - Public disclosure
  - Filing corporate income tax
  - Regulators and government statistics



# Decision-making process

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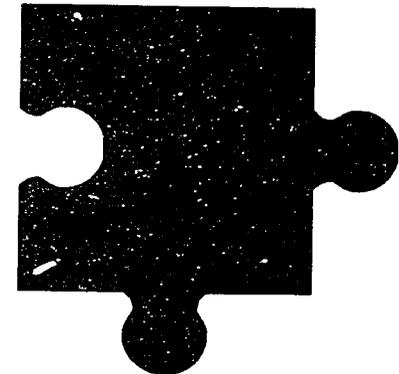
- Gathering, selecting and summarizing information
- Analyzing information
- Planning and goal-setting
- Budgeting
- Monitoring performance

*Adequate and efficient management information systems are crucial to good decision-making by directors and managers and therefore to the success of the firm*

# Information Required

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- Internal
  - Operational information such as:
    - Plant efficiency
    - Delivery turnaround
  - Management accounting such as:
    - Sales by product
    - Profitability by division
- External
  - Competitive information such as:
    - Market share



# Management Accounting

---

- Differences with Financial Accounting include:
  - No standard format and not regulated
  - Intended to plan future rather than describe the past
  - Less emphasis on precision
  - Focuses on parts as well of the whole of an organization
  - Includes more non-monetary information

*It is means to an end, rather than an end in itself*

# System development: Identify Criteria & Characteristics

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- What information do you want this new system to provide?
- Characteristics
  - what personnel needs?
  - what technology needs?
  - what information needs?
  - what organizational needs?

# Identify Problems with Present System

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- Design
  - Past system designed for state planning and control, not decision-making information
  - Considerable amounts of data. No selection.
- Organizational
  - Information flow top-to-bottom only
- Personnel
  - Lack of understanding of new information requirements and techniques
- Technology/Computerization

# Determine Options

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- Examine possible systems that will meet your criteria and needs
  - cost/benefit analysis
- Prepare for implementation

# Implementation

---

- Define project priorities, risks, and availability of resources
- Address transition issues
  - determine interim organization
  - financial cost, length of transition, organizational disruption
  - short/long-term staffing and equipment needs
  - schedule must be realistic & practical
- Management involvement
  - monitor progress regularly
  - continuously update system to changing needs

# Module 4: Summary

---

- Success of the firm depends on
  - access to capital
  - fulfilling regulatory requirements
  - development of competitive strategy
  - implementation of competitive strategy

*The key to success is information*

# Business and Financing Policy

---

## Module 5



# Module 5: Agenda

---

- Business strategy
  - Competitive analysis
  - Business plan development
  - Restructuring and investment decisions
- Business financing
  - Capital markets (domestic and foreign)
  - Debt vs. equity capital
  - Share issues and dividend policy

# Corporate Leadership (managers and directors) must:

---

- Understand changing environments, potential threats and opportunities
- Analyze strengths and weaknesses of the firm
- Develop short and long-term business plans
- Communicate and implement plan effectively
- Monitor performance and continuously adapt to changing environment

# Balancing Short-term Survival and Long-term Growth

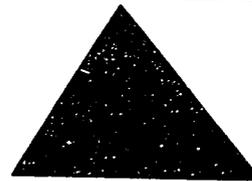
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Short  
Term

Cash  
management

Buyer/Supplier  
relationships

Crisis management  
team



Restructuring

Capital  
Investment

Share value

Long  
Term

# Short-term Survival - Immediate Measures

---

A number of steps can and should be taken to stabilize the situation immediately.

- organizational measures
- financial measures
- preparation for business restructuring

# Short-term Survival - Immediate organizational measures

---

- Appoint and empower a crisis management team
  - Set major goals, tasks and timetables for the team
  - Identify single team leader and coordinate with other key parties
  - Identify key individuals to manage key tasks (e.g., marketing, finance, distribution)
- Duties of the crisis management team
  - Get relevant information
  - Report to board and management
  - Inform creditors/owners/employees
- Key goal: maintain stable internal and external environments for later changes

# Short-term Survival - Immediate financial measures

---

- Stop cash out-flow
  - Freeze accounts payable
  - Contact major creditors and seek short-term concessions
  - Buy time and prioritize obligations
  - Freeze or reduce salaries, bonus, perks of employees
- Increase cash in-flow
  - Bring in accounts receivable
  - Sell off excess inventory
  - Sell off minor assets
  - Complete existing orders
  - Get new purchase orders

# Short-term Survival - Prepare for business restructuring

---

- Manage the information to manage the crisis
  - Get revenues and expenses for each business unit
  - Get revenues and expenses by product lines
  - Forecast major cash flow commitments and sources of cash
- Use the information to
  - Assess the degree of crisis
  - Outline potential restructuring options

# Short-term Survival - Monitor and Communicate

---

- Communicate responses to crisis with:
  - Shareholders
  - Employees
  - Management
  - Creditors
  - Government
  - Other stakeholders (public, press, etc.)

# Key Strategic Issues Facing Management and Directors

---

- management & organization
  - management: incentives and oversight
  - personnel: training and motivation
  - marketing: awareness & strategy
- operations
  - business focus
  - productive efficiency per international standards
  - price, quality and availability of inputs



# Key Strategic Issues facing Management and Directors (cont'd.)

---

- key financial issues
  - lack of cash
  - lack of cost controls and information
  - working capital: quality of accounts receivable
  - current levels of debt; current creditors
  - access to new capital

# Addressing these Strategic Issues Requires:

---

- Creating new management information systems
- Defining strategic objectives
- Focusing on core business units
  - Based on analysis of external competitive forces and internal strengths and weaknesses

# Analysis of External Competitive Forces

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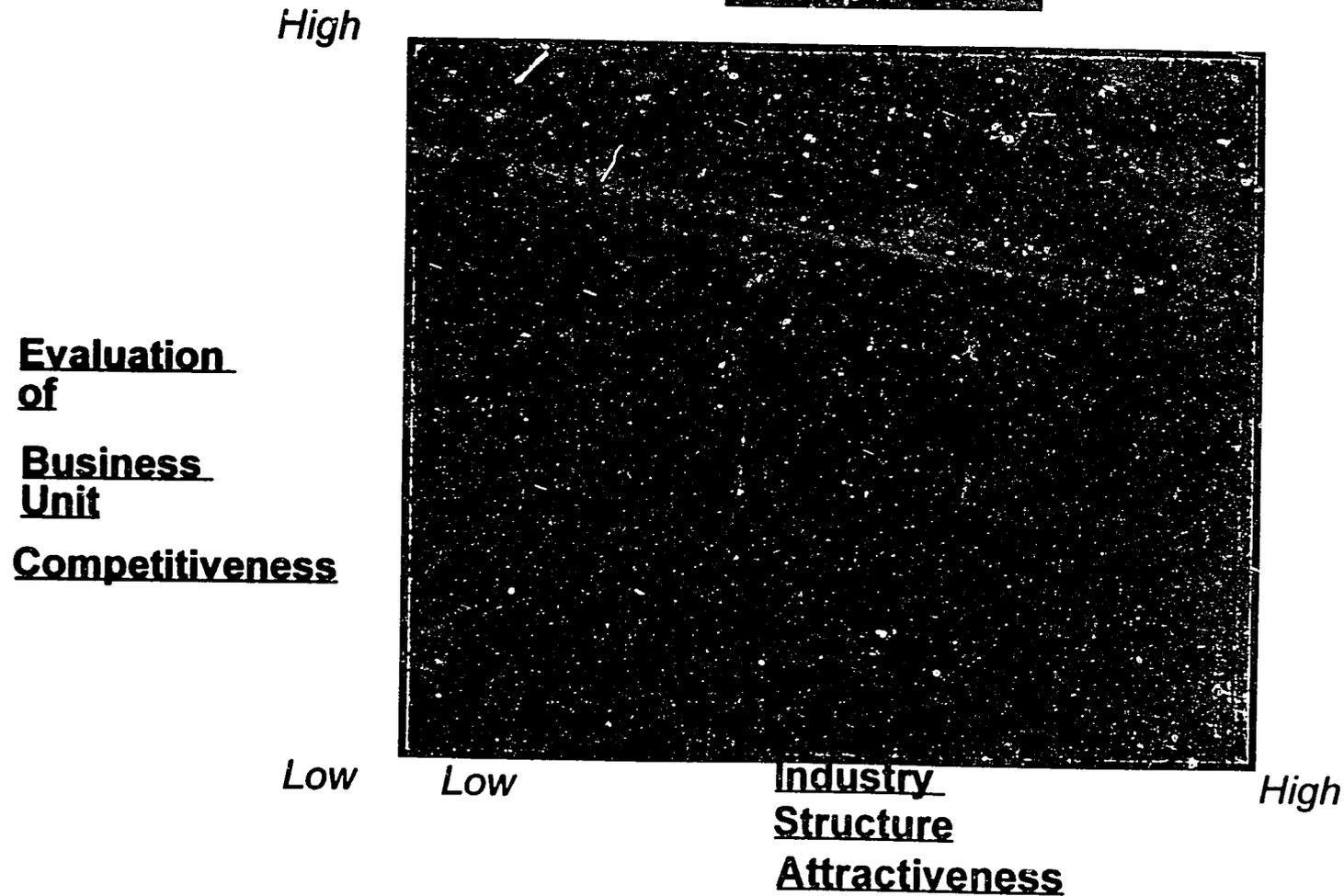
- Intensity of Rivalry
- Power of Buyers
- Power of Suppliers
- Threat of New Entrants
- Threat of Substitutes
- Government Policies

# Analysis of Internal Strengths and Weaknesses

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- Management
- Human Resources
- Production and Operations
- Marketing
- Distribution
- Information System
- Capital Structure

# Long-term Strategy Analysis



# Strategy Analysis

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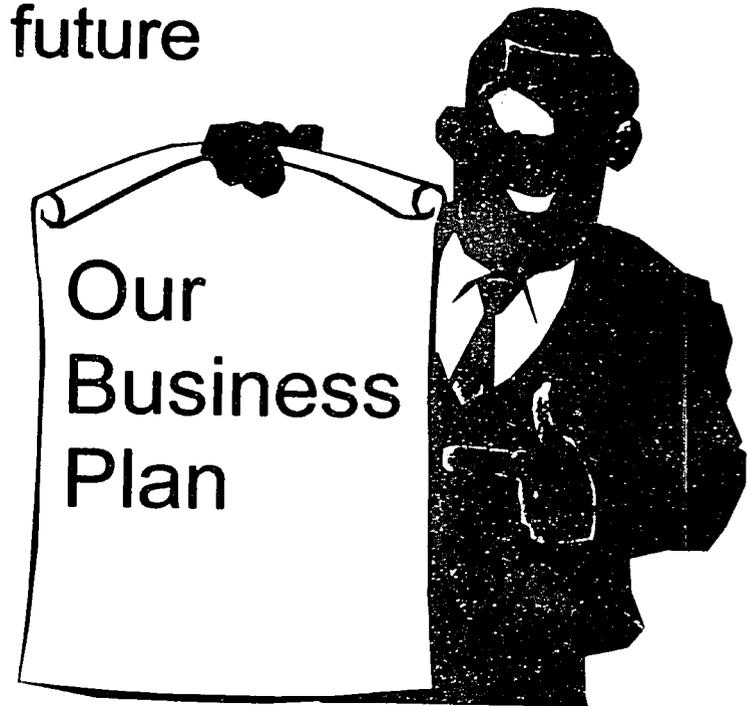
- Beware of how the following can lead to faulty logic and poor strategy choices:

- 1. The tendency to underestimate uncertainty** - do not become overconfident in projections and estimates.
- 2. Overemphasizing selected data** - do not become seduced by colorful reports, interesting anecdotal information.
- 3. Becoming too attached to one scenario** - do sensitivity analysis.
- 4. Seeing opportunities only incrementally** - think imaginatively and dare to break out of the old mindset.
- 5. Seeking only confirming evidence** - look for what will cause your strategy to fail, not just support your initial predisposition.
- 6. Using inappropriate analogies** - do not assume that because a strategy worked in one industry or segment it will work in another.

# Business Plan: Your Tool

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- a key tool of **general** business management to:
  - review past performance
  - develop strategy for the future
  - raise capital
  - plan restructuring



# Business Plan (cont'd.)

---

- what the business plan should be:
  - a tool for strategy, and implementation
  - focused on a specific time period
  - flexible and forward-looking
  - clear, concise and readable
  - easy to communicate

# Business Plan (cont'd.)

---

- what the business plan is not:
  - a five-year plan for each company
  - a rigid outline of production targets and input requirements
  - a treatise on the business and its history

# Contents of the Business Plan

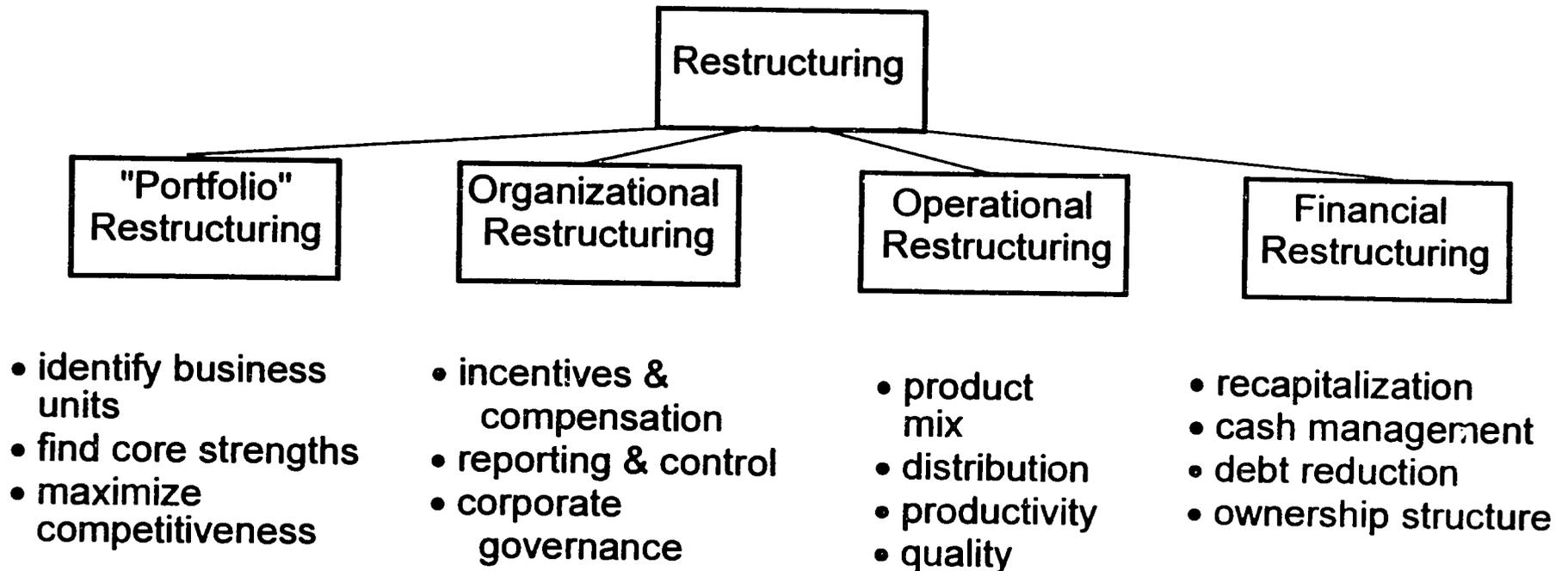
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- I. Table of Contents
- II. Executive Summary
- III. General Company Description
- IV. Products and Services
- V. Marketing Plan
- VI. Operational Plan
- VII. Management and Organization
- VIII. Capitalization and Structure
- IX. Financial Plan

# Business Restructuring

---

**There are four basic approaches to enterprise restructuring, and each has a specific objective.**



# Portfolio Restructuring

---

Key goals of portfolio restructuring are to focus on core strengths and maximize competitiveness of core business units.

## Steps:

- **identify business units**
- **evaluate business attractiveness/competitiveness**
- **evaluate interdependence among business units**
- **identify core competence of the company**
- **sell off or liquidate weak and/or non-core business units**

# Portfolio Restructuring (Cont'd)

---

- **Should business units be merged? expanded? decentralized? sold? closed down?**
- **What units are generating the highest profits? greatest cash flow?**
- **What units are generating the greatest losses? draining cash flow?**
- **What units contribute the most to revenues? expenses?**
- **What are the most highly valued assets of the company?**

# Organizational Restructuring

---

- Involves changing methods of doing business:
- Internal communication
  - Create reporting lines
  - Management information systems
- Creation of responsibilities and accountability
- Streamline labor costs/optimize efficiency
- Evaluate compensation and incentives
- Recruitment of qualified personnel

# Operational Restructuring

---

- Change product mix
- Find new distribution channels
- Improve marketing and selling activities
- Improve production process
- Increase quality control
- Create useful management information systems

# Financial Restructuring

---

- Ensure efficiency in managing cash flows
- Dispose of non-core and inefficient assets
- Restructure, repay, and refinance debt
- Identify suitable partners: Find the right fit

# Strategy Implementation

---

- Strategy Implementation Requires:
  - *Clear and quantifiable objectives*
    - Must know what the starting point is, and how progress will be measured
    - Establish clear objectives for every business unit
  - *Investment plan*
    - In infrastructure, personnel, information systems
  - *Financing plan*
  - *Personnel development plans*
    - For existing and new personnel
  - *Communication plan*
    - Share vision with all employees
    - Involve employees responsible for implementation in strategy formulation process

# Roles of Management and Directors in Restructuring

---

## ▪ **Directors**

- Evaluation and recruitment of new management (if required)
- Communication with external stakeholders
- Review of overall business strategy
- Approval of changes in capital structure

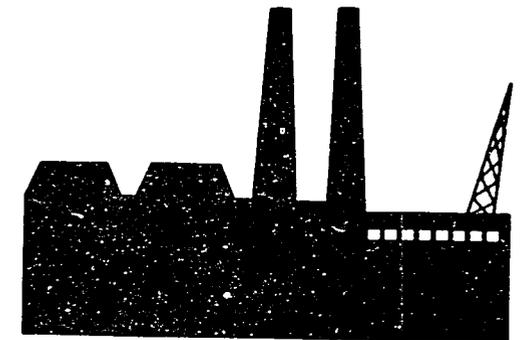
## ▪ **Management**

- Internal communications
- Design and implementation of information systems
- Working capital management
- Develop strategy and restructuring implementation plan
- Estimate future capital requirements

# Capital Investment

---

- Expand production facilities?
  - What kind of equipment? plant? technology?
- Is additional land required for expansion?
- What financial resources are currently available for these options?
- What financial resources will be required/available for these options?
- *How much cash will the firm require ?*



# Cash Flow Forecast - Future Planning

---

- Where is cash going to come from?
- What is cash going to be spent on?
- Will there be enough cash for on-going operations and for new investments?
- When is the cash going to come in?
- When is cash going to be paid out?



# Sources of Capital

---

- Internal Sources of Cash
  - Retained earnings: Undistributed past profits
- External Sources of Cash
  - Loan capital
  - Equity

# Dividend policy

---

- **Policy must balance needs of the firm and expectations of shareholders and the market**
- **Needs of the firm**
  - **Cash flow situation**
  - **Capital investments**
  - **Cost of other types of funds**
- **Expectations of shareholders**
  - **Looking for growth in share value or steady income**
  - **Can firm use retained earnings to make future profits**
  - **Looking for consistent dividend policy**
  - **Tax treatment of dividends vs. capital gains**

# What is the cost of capital ?

---

- Equity:
  - Pros:
    - No compulsory payments
  - Cons:
    - More expensive due to higher risk for investor
    - Dilutes ownership
    - Dividends not tax deductible
  
- Lenders:
  - Pros:
    - Less expensive due to lower risk for investor
    - Some interest is tax deductible
  - Cons:
    - Compulsory periodic payments



# Cost of Capital and Risk Premium

---

- Risk: How likely is it that investor will receive his principal investment and additional earnings?
  
- Sources of risk:
  - Business operations: How volatile is the profitability of the firm?
  - Financial leverage: The more debt a firm has the riskier it is
  - Country risk: How do macroeconomic and political factors affect the firm

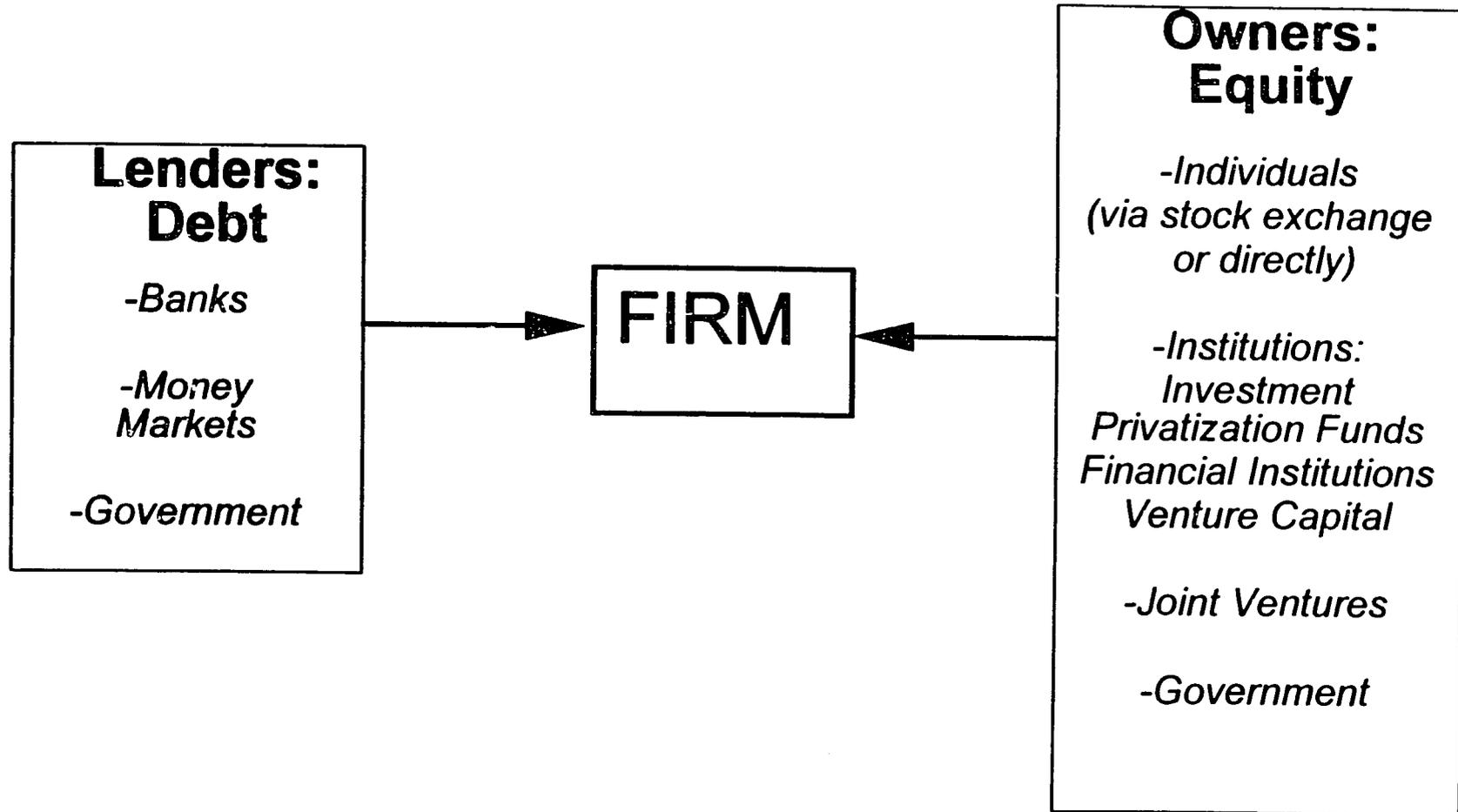
# Debt vs. Equity Capital

---

- Depends on
  - Attractiveness of the firm
    - Existing level of debt
    - Company risk
  - Availability of capital
    - Liquidity of the market
  - Transaction
    - Speed
    - Costs
    - Disclosure requirements

# Capital Providers

---



# Expectations of Lenders

---

- Expect higher return than risk-free rate (i.e., government bonds)
- Risk of default on payments (Leverage)
- Secured or unsecured

# Domestic Loan/Bond Market Characteristics

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- Loans
  - Availability of capital
    - Solvency of banks (Effect of Consolidation Bank)
  - Stringent collateral requirements
  - Primarily short-term loans
  - High interest rates
- Bonds
  - Limited liquidity of the market
  - High transaction costs

# Expectations of Equity Providers

---

- Expect higher return than lenders
- Dividends and growth in share value
- Increased control

# Role of the Stock Market

---

- **Organized exchange where securities (shares) are traded**
- **Facilitates raising of capital**
  - by facilitating trading of shares and ensuring liquidity
- **However is not a provider of capital in itself**
- **In order to function effectively**
  - access to accurate information
  - even playing field (no insider trading)
  - transparent and rapid transactions
  - low transaction costs



# Domestic Equity Market Characteristics

---

- Limited liquidity
- Pricing inefficiency due to lack of integration of stock markets and off-market transactions
- Transaction costs and delays
- Lack of enforcement of regulation
  - Disclosure requirements
  - Insider trading
- Ownership restrictions (Investment Funds)

# Globalization of Capital Markets - Why?

---

- Liberalization of financial markets
  - Privatization
  - Reduced government regulations
- Instant Communications and Computerization
- Institutionalization
  - Professional management of capital
  - Large mutual funds, pension funds and insurance companies with global networks
  - Creation of variety of new financial instruments

# Emerging Markets

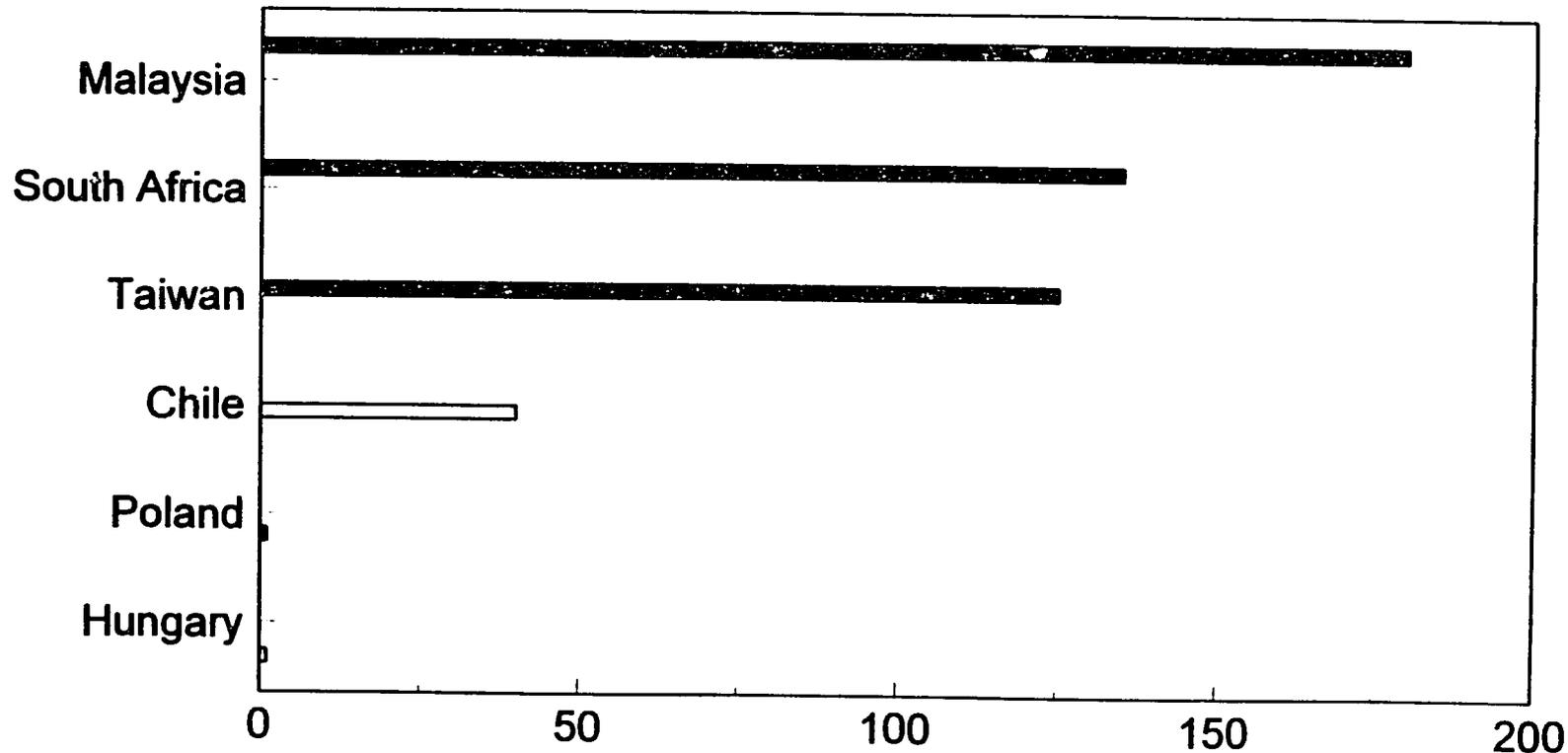
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- Dramatic growth
  - 1983: \$ 500 million (estimate)
  - 1994: \$ 50 billion (estimate)
- Why are international investors interested ?
  - Diversification of risk
  - Attractive returns
  - Increasing liquidity of emerging markets
  - Strong economic growth prospects

# Emerging Markets - Stock Markets

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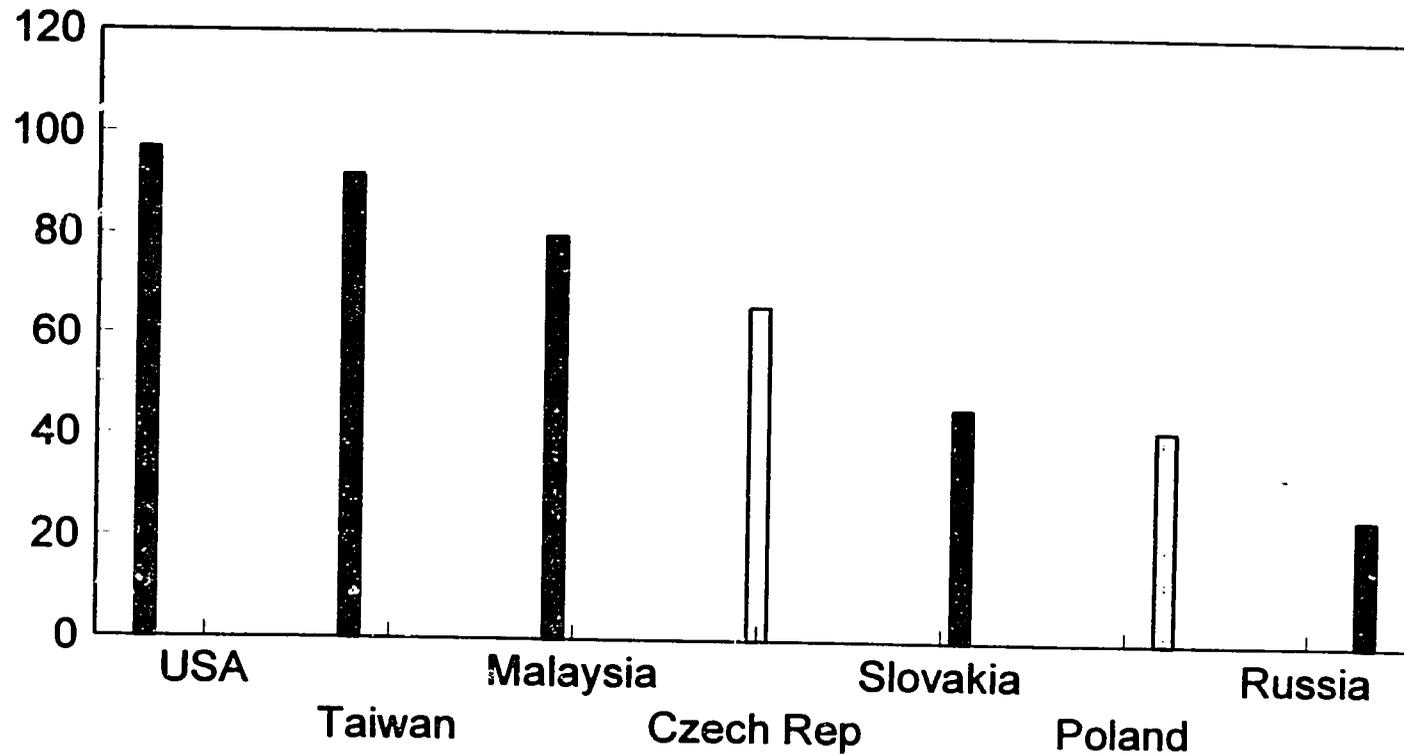
**Market Capitalization, \$ billion, November 1993**



Source: The Economist, January 1994

# Emerging Markets - Country Risk

Country Risk Ratings, March 1994



Source: Euromoney, March 1994

# Portfolio Investor

---

- Objective of the firm
  - Capital
- Objectives of the investor
  - Good and quick return
  - Ease of exit

# Framework for the Strategic Investor

---

- **Objectives of the firm**
  - management know-how
  - technology
  - marketing and access to markets
  - capital
- **Objectives of the investor**
  - adequate return
  - access to market
  - local knowledge
  - integrate into worldwide strategy

# Issuance of Shares by Firm

---

- Issuance of shares
  - Purpose: Raise capital for capital investments
  - Method:
    - Private placement
    - Rights offering (offers shares to existing owners)
    - Non-rights offering
  - Effect: Dilutes ownership and can reduce market price of shares

# Shares - Legal status

---

- **Authorized shares**
  - Number of shares that can be issued by firm, according to charter
- **Issued shares**
  - Number of shares that have been sold to the public
- **Outstanding shares**
  - Number of shares issued minus shares repurchased by the firm
  - Only outstanding shares have voting rights and receive dividends.
- **Treasury shares**
  - Repurchased by the firm from the public
  - Do not have rights to vote or dividend

# Value of shares

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- **Par value**
  - Nominal value, not significant
- **Book value**
  - Accounting value. Assets minus liabilities
  - Not necessarily good indicator of future value
- **Market value**
  - Present price of shares on secondary market.
  - Market prices are based on investor expectations of future profits
  - Price affected by past performance, dividend policy, macroeconomic factors, potential mergers/takeovers
  - Change in market value does not affect financial statements of the firm. However can affect cost of issuing new shares in the future

# Issuance of New Shares - Process

---

- Determine capital requirements
- Approval of existing shareholders
- Public vs. private offering
- Prepare prospectus
- Select underwriter and distributors
- Fulfill regulatory requirements
- Estimate share issue price
- Issue new shares

# Module 5: Summary

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- Objectives
  - Short-term survival
  - Long-term growth
- Tools
  - Short-term: Cash management
  - Long term: Business strategy, restructuring and re-financing
- Key to success
  - Corporate leadership from directors and management

**Motores, Inc.\***

Carlos Perla, Managing Director for Motores, Inc. was extremely worried about what was happening to his company. "I really need to decide what I'm going to do in the coming hours, or else it's going to be a disaster." These were his thoughts as he reviewed the situation that had just developed with his company.

The Enterprise

In 1978, Eugenio Perla and Pedro Benavides established an automobile repair shop. In 1979 two new partners, Carlos Ramirez and Joaquin Brenes, joined the business. According to Eugenio, "Things were going so well that we had no time to worry about the details of legally formalizing the relationship between the partners."

On January 23, 1981, Eugenio Perla died while being operated for a heart condition. His only son, Carlos, had to leave his own farm and retail store to "take over the old man's activities." But he was not convinced that this had been a wise move.

At the beginning things were going very well. Carlos, as the majority shareholder, took over the helm of the company and discharged his duties very competently.

Shareholders

The principal shareholders were: the Perla family, Pedro Benavides, Carlos Ramirez, Joaquin Brenes and Jacinto Baca. The Perla family held 42% of the shares, Pedro Benavides 18%, Carlos Ramirez 16%, Joaquin Brenes 14% and Mr. Baca 10%.

For Carlos Perla's wife, Meme, the repair shop represented "a strange business. I would prefer if we continue with our farm and retail shop. I know these businesses better, and I can go there to see what is going on. I don't feel that I can just drop by the automobile repair shop."

---

\*This case was written by Leonel Rodriguez for the Central American Management Institute (INCAE). It has been translated into English and edited by Dr. Tessie San Martin for the Price Waterhouse International Privatization Group. The case is meant to be used as material for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. Although the case was based on an actual company, important facts, including the company's name, have been changed. December 1993.

Mr. Benavides owned a store specializing in automobile spare parts. His store was located close to Motores, Inc. He noted, "I cannot ask for a better relation than this one. I think that for me, being part owner of an automobile repair shop is a very smart move."

Carlos Ramirez owned a store that carried many of the same products sold in Mr. Perla's own retail shop. The store was also located in the same commercial center where Perla's shop was located. He noted, "Retail trade tends to fluctuate, but the car repair business is a solid one. After all, cars will always need to get repaired."

For Mr. Brenes, the only benefit he could see to having a share of the business was in the discounts he obtained. "If it were not for the fact that I get a very good price on car repairs, I would have tried to get out of this business a long time ago."

Jacinto Baca had no idea of why he was still a shareholder. The car repair business had nothing to do with his own philosophical and literary interests. He noted that "as far as I am concerned, Perla has my full confidence. I have no idea of what he does, but he has my full support."

### The Situation

It was the morning of September 1985, and the auditors contracted by Carlos Perla had just departed. They had left behind a report that indicated quite clearly that the company was on the brink of bankruptcy.

Perla quickly convened a meeting of the shareholders at Mr. Brenes' house. Mr. Benavides arrived visibly irritated. Mr. Brenes could tell by the tone in his voice that Benavides had just been involved in a very heated discussion.

Mr. Ramirez arrived behind Benavides. He noted to his fellow shareholders in the room that it was time to formalize things: "I do not know if it is worth legalizing our contractual relationship in these circumstances, but it's obvious to me that something needs to be done."

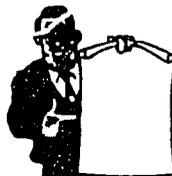
The meeting would begin shortly. Carlos Perla wondered: "What had happened? If the business always operated profitably, why do we find ourselves in this situation? What should be my next moves?"

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# Introduction to the Case Teaching Process

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## Training Program for Trainers



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## Part A Agenda

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- Section 1: Defining a Teaching Case
- Section 2: The Case Preparation and Teaching Process

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# Section 1: Defining the Teaching Case

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- What is a case?
  - The objective description of a real business/managerial situation, requiring the reader to make one or various decisions.
  - A detective story, providing information to identify and analyze decisions
    - A selection of facts from a given business situation

BUT...

***"There is no one correct solution"***

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## What a Case Is Not

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- It is NOT just an example
  - It is NOT fiction; a case should be based on an actual decision-making situation.
- It is NOT a "photographic slice of life"
- It is NOT a guessing contest

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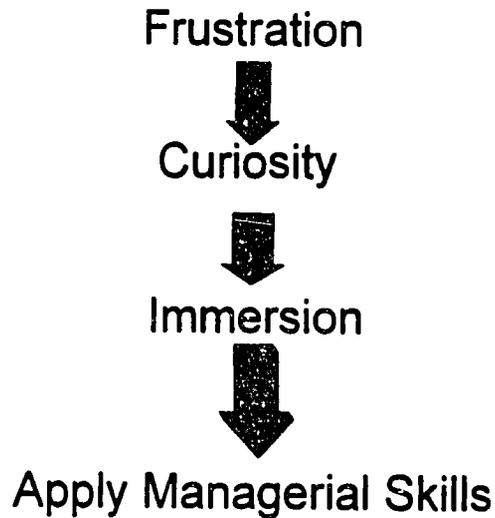
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# The Learning Process

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## Section 2: The Case Preparation and Teaching Process

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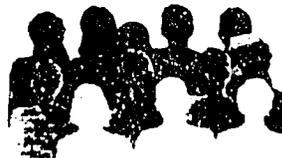
Individual Preparation



Group Discussion



Plenary Session



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# Individual Preparation

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## **Objectives:**

1. *Analyze the case, assuming the role of decision-maker.*
2. *Identify alternative solutions to the problem described in the case.*
3. *Select the most appropriate solution.*
4. *Develop a work plan.*

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# Suggestions for Individual Preparation

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- Exploratory reading
  - The case
  - Background material
- Focused reading of the case
- Analysis of the case
- Decision
- Action plan formulation

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# Exploratory Reading

---

- Read first paragraph carefully
- Read rest of text quickly
- Look at annexes
- Determine what the focus of your attention should be, given the
  - course material
  - course design
  - first paragraph
  - trainer's orientation
- Select analytic frameworks

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# Focused Reading of the Case

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- Identify relevant information
  - Qualitative information
    - *Actors*
    - *Enterprise characteristics*
    - *Environment characteristics*
    - *Problem areas*
    - *Chronology of events*
  - Quantitative information
    - *Trends*
    - *Financial information (sales volume, price, profit margins)*
  - Other Issues
    - *Conflicts*
    - *Relationships*



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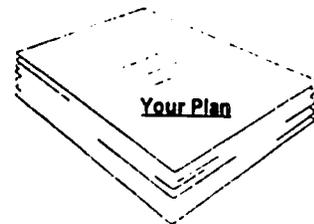
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## Focused Reading of the Case (cont'd)

---

- Identify alternatives
  - *construct different scenarios*
- Evaluate alternatives
- Select best alternative
- Prepare action plan
  - *Implementation*
  - *Planning for contingencies*
  - *Measuring results*

→ **Your Decision**



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## Individual Preparation: The Role of the Trainer

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Example from the Motores, Inc. case:

- Orient the focus of the analysis with:
  - 1. Specific questions:
    - *What are the conflicts between the shareholders?*
    - *What alternatives does Mr. Perla have?*
  - 2. An indication to the participants as to the main theme being studied:
    - *Focus on corporate governance difficulties or business management issues*
  - 3. Relevant background material

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# Group Discussion

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- **Case Learning Objectives**

1. *Exchange knowledge and experience*
2. *Share information*
3. *Strengthen analysis*
4. *Face and analyze differences in perspectives*

- **Other Teaching Objectives**

1. *Develop communication skills*
2. *Develop team work capabilities*

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## Group Discussion: The Role of the Trainer

---

- 1. Clarify doubts
  - about specific case facts
  - about concepts
- 2. Re-orient
  - when you feel the discussion has strayed far from the main didactic objectives of the case
  - when the focus of the analysis may be misdirected
- 3. Stimulate discussion

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## Effective Group Discussion Requires:

- Well matched participant strengths and weaknesses
- Strong participant leadership
- Motivated participants
- A concrete study agenda
- Good time management

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## Plenary Session

### **Objective:**

*Undertake a constructive analysis of the case, based on individual comments from the students and under the guidance of the trainer.*



### **The trainer's role is to:**

1. Clarify concepts
2. Re-orient discussion
3. Consolidate positions
4. Obtain conclusions



---

# Plenary Discussion

---

- Discussion flow depends on:
  - The trainer's style
  - The subject matter
  - The complexity of the themes being discussed
  - The background and knowledge of the participants

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## Plenary Session: Discussion Focus and the Role of the Trainer

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- Different ways to analyze an issue:

- 1. Open discussion
- 2. Directed discussion
- 3. Decision analysis
- 4. Role playing

### The Trainer's Role

- Moderator
- Director
- "Devil's Advocate"
- Guide

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# Basic Case Teaching Elements

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## A Training Program for Trainers



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## Agenda

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- Section 1: Case Preparation
- Section 2: Managing the Plenary Discussion

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## Section 1: Case Preparation

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- Steps in case preparation:
  - 1. Read and analyze the case
    - *Identify the key information*
  - 2. Define teaching objectives, depending on:
    - *the participants*
    - *the training program*
    - *the case data*
  - 3. Define discussion style
  - 4. Prepare teaching plan



---

## Step 1: Read and Analyze

---

- Some questions to guide the analysis:
  - What is the problem?
  - What are the objectives?
  - What are the alternatives?
  - Who should make the decision?
  - Who is affected by the decision?
  - How are they affected?
  - What figures or issues need analysis?
  - Is there sufficient information available to carry out the analysis?
  - Who are the key actors?
  - What is their experience?
  - What is the chronology of relevant events?

---

## Framework for Preparing a Case

---

- 1. Define the problem
- 2. Identify the decision to be made
- 3. Analyze the environment
- 4. Establish the objectives for the decision-maker
- 5. Identify alternatives
- 6. Make a decision on a course of action
- 7. Design an action plan

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## Case Preparation: Useful Analytic Tools

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- 1. Competitive Analysis Framework
- 2. SWOT (Strengths, Weaknesses, Opportunities and Threats)
- 3. Decision Analysis
- 4. Other Frameworks
- 5. Your own

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# Competitive Analysis Framework: External Factors

**Industry Structure**

**Power of Buyers**

**Power of Suppliers**

**Threat of Substitutes**

**Threat of New Entrants**

**Effect of Government Policy**

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## SWOT Analysis

<b>External Environment</b>	<b>Threats</b>	<b>Opportunities</b>
<b>The Organization</b>	<b>Strengths</b>	<b>Weakness</b>

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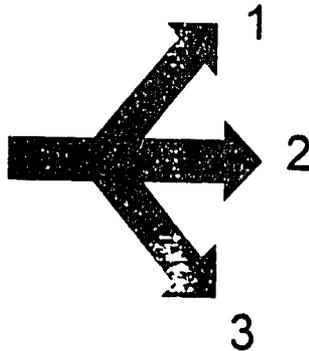
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# Decision Tree

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- Identify Alternatives
- Identify Consequences (quantify to extent possible) for decision maker, for other stakeholders

Dividend Policy  
Options



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## Step 2: Define Teaching Objectives

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*Examples of case teaching objectives for the Corporate Governance course:*

- "Identify conflicts of interest likely to arise among corporate stakeholders"
- "Apply the company analysis framework to understanding strategic challenges facing enterprises in the industry"
- "Practice reading and using the information from Western financial statements to evaluate company performance"

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## Step 3: Define Appropriate Style for Plenary Discussion

Plenary Discussion Style	Type of Case to Which it Applies	Participant Characteristics
Open Discussion	Highly qualitative case: Example, <u>Molores, Inc.</u>	Small group Business experience
Directed Discussion	Highly quantitative cases: financial analysis, valuation	Inexperienced participants Large groups
Progressive Analysis	Long and complex cases, where alternatives are not well defined, multiple problems exist. Both quantitative qualitative aspects appear: <u>Progress, Qstrava</u>	Any group
Decision Analysis	Short and simple cases, where mutually exclusive alternatives are apparent. buy not buy	Any group
Role Playing	Negotiation cases with good information on the company, the actors, and the negotiation situation.	Medium sized groups

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## Step 4: Prepare a Teaching Plan

- a. Time distribution
- b. Use of blackboard , overheads and other guides
- c. Use of questions to guide discussion and analysis
- d. Transition phrases
- e. Closing points--review:
  - *Conclusions and key points*
  - *Key concepts and tools used*
  - *Key teaching objectives*

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## Section 2: Managing the Plenary Discussion - Teaching Plan for Progress Ostrava, a.s. Part B

Time	Questions--Discussion Areas	Teaching Aides
10 minutes	The decision: Raise capital? For What? How?	See Figures 1a & 1b
15 minutes	<b>Quantitative Analysis</b> What data tells us how the company is performing? Where is it losing money? What investments are required? What is the cost of capital?	See Figure 2
20 minutes	<b>Qualitative Analysis</b> In what market segments is the company operating? What are the competitive conditions in each of these segments? What are the companies strengths and weaknesses?	See Figures 3a to 3c
10 minutes	Revise decision	See Figures 1a and 1b
5 minutes	Summary & Conclusions	See Figure 4

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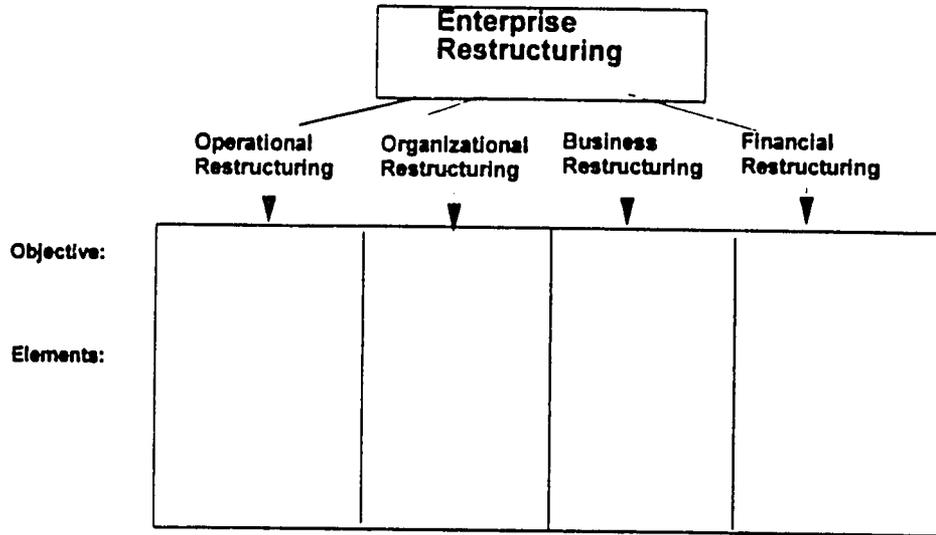
### Figure 1a: The Decision to Raise Capital

OPTIONS	AMOUNT RAISED	COSTS OF CAPITAL			
		TRANSACTION COSTS	INTEREST COSTS	LOSS OF CONTROL	FEES/COMMISSIONS
SHARE ISSUE					
BOND					
LOAN					
LEASING					

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# Figure 1b: The Decision Capital for What?



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# Figure 2: Quantitative Analysis

- Ratio Analysis
  - Inventory days =
  - Payable days =
  - Receivable days =
  - Gross profit ratio =
  - Operating profit ratio =
  - Net profit ratio =
  - Current ratio =
  - Quick ratio =
  - Debt-equity ratio =
  - Interest coverage =
- Cash Flow Analysis

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## Figure 3a. Product-Market Matrix Progress Ostrava, a.s.

		Markets			
		Domestic Commercial	Domestic Contractors	Export Commercial clients	Export construction companies
Products	Steel Frames				
	Cranes				
	Aluminum Frames				
	Turnkey construction				

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## Figure 3b: External Factor Analysis

**Industry Structure**

**Power of Buyers**

**Power of Suppliers**

**Threat of Substitutes**

**Threat of New Entrants**

**Effect of Government Policy**

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## Figure 3b: External Factor Analysis:

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*Intensity of Rivalry:*

*Number of Rivals*

*Market Share*

*Market Growing?*

*Basis of Competition*

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## Figure 3c: Internal Factor Analysis

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**Management**

**Human Resources**

**Production and Operations**

**Marketing**

**Distribution**

**Information System**

**Capital Structure**

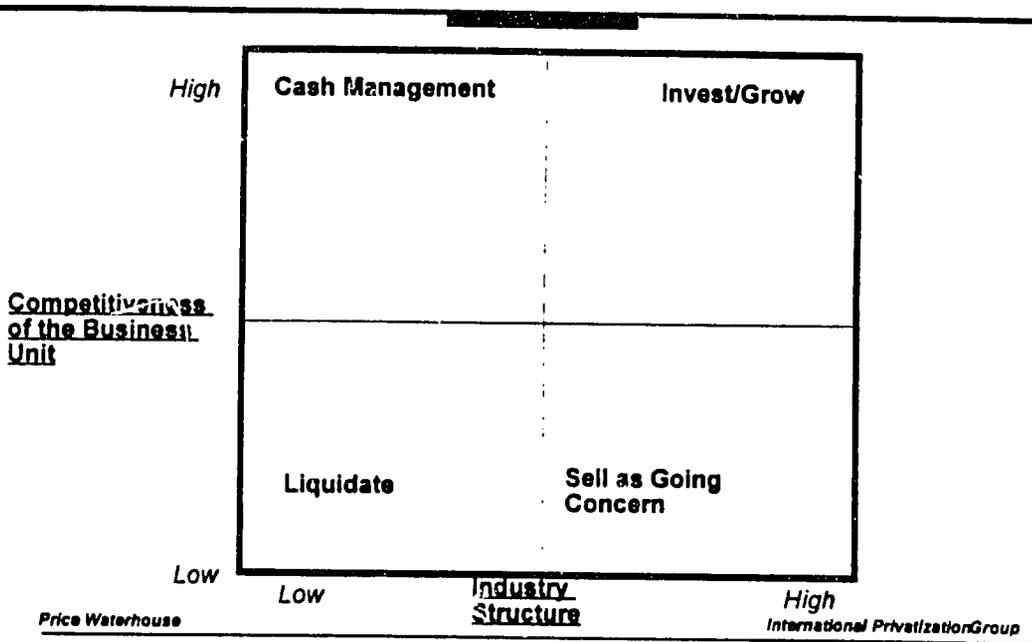
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# Figure 4: Summary



### Progress Ostrava, a.s. (A)\*

In early July of 1993, Petr Polak, a senior manager from Union Bank (a medium-sized commercial bank and privatization fund in the Czech Republic) was reviewing information on a company called Progress Ostrava. Polak had been appointed by the National Property Fund to the Management Board of Progress and was preparing for the shareholders' General Meeting. In his view, the main issue at the meeting, which would be held at the end of the month was how to provide new shareholders such as Union Bank with a voice in the management of the company. To do this he would need to evaluate the need to change sections of the company's Articles of Incorporation. He would also need to evaluate the firm's present competitive position and determine the direction Progress should take in order to survive and grow.

#### Progress Ostrava, a.s.: Background

Progress Ostrava was registered as a joint-stock company on 1 May 1992. Situated in the heavily industrial Northern Moravia region of the Czech Republic, the company had been originally founded in 1967 as part of one of the largest coal mines in Central Europe. Although its name and organizational status had changed frequently, the core of its business, construction, had remained relatively stable. Progress' main manufactured products were the steel support structures that are the skeleton of many commercial and industrial buildings; aluminum doors, windows and facades; and parts of heavy construction cranes. The company also derived revenue from construction support devices and from turnkey construction projects.

Company revenues had dropped from 309 million Kc (US\$10.3 million) in 1991 to 125 million Kc (US\$4.2 million) in 1992. Revenues as of July 1993 were expected to be 108 million Kc (US\$3.6 million), with a net loss of 5.9 million Kc (US\$199,000) recorded as of July.

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\*This case was written by Sandy W. Chen of CORUM Business Services under the supervision of the International Privatization Group of Price Waterhouse (PW-IPG), Washington, DC, as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. The author is grateful to management of the company for their support. The case was prepared with the financial assistance of the United States Agency for International Development (USAID). Price Waterhouse-IPG, Washington, DC, May 1994.

### Privatization History

During the privatization process, with the approval of the National Property Fund (the caretaker of the shares until the privatization process had been completed), the Management Board had fired the enterprise's general director as well as five other senior managers. Then, the Management Board directors themselves were replaced. The main fund shareholders and the National Property Fund named new directors for both the Management and Supervisory boards, with the exception of the employee representative on the Supervisory Board, who was elected by the employees (Exhibits 1 & 2).

For many of the senior managers and shareholders, the strategic, financial and operational situation at Progress was relatively unclear. The privatization process had forced Progress to quickly develop many functions and areas that had been previously handled by the state, or by its former parent company, the conglomerate Ostravsko-Karvinske Doly.

Progress was privatized in the first wave of large privatization in the Czech Republic, on May 1, 1992. After privatization was completed, 59% of its shares were held by investment privatization funds and 28% by individual investors (Exhibit 3). Progress shares had opened for trading at a price of 500 Kc (US\$17) per share on the stock exchange (on the over the counter Czech RM-system), but very few shares had traded.

### The Construction Industry

Future trends in Progress revenues and expenses were unclear, given trends in the construction industry.

#### **The Czech Construction Industry**

After a brief surge in 1990 and 1991, construction activity had steadily declined, dropping 30-40% each year in real terms since then. The total market for construction in the Czech Republic was 110 billion Kc in 1993.

The market for construction was segmented into three areas: industrial, commercial (including retail), and residential. The area that had seen the most activity was the commercial sector, due mainly to the tremendous increase in tourism. Most of this activity was in the renovation of old buildings into hotels, banks, offices and retail stores, centered primarily in Prague metropolitan area (Exhibit 4 & 5). In residential construction, most of the activity had been in single-family homes for wealthier Czechs. Residential construction activity had begun to decline by 1993 because the first wave of wealthy home buyers had already passed. Industry analysts felt that no further growth in the residential construction sector could be expected until real estate market restrictions were loosened and reasonable mortgage financing were made available.

The number of competitors in the construction industry had increased significantly since 1990, both because of the breakup of former state-owned companies and the appearance of the small private construction firms. The largest domestic competitors were Vitkovice Stavby, Unips, Hutni Montaze, and IPS, but there were over 1200 registered construction firms with over 25 employees. In addition, the national statistical office estimated that there were several hundred construction firms with less than 25 employees. In 1993, one-quarter (24.8%) of all construction activity was carried out by firms with less than 25 employees. These small private companies served as subcontractors for larger construction firms (e.g., bricklayers, carpenters or locksmiths), or as contractors on small commercial or residential construction projects.

Analysts had predicted that the small private firms would eventually account for the majority of construction activity, citing their aggressive pricing and their speed of delivery. The percentage of construction work done by private firms had increased from below 5% of the total market in 1991 to 80% of all construction activity by mid-1993. The large state construction companies and cooperatives had seen their market share plummet.

### **Worldwide Prospects for the Construction Industry**

The decline in the Czech construction market was mirrored in several other countries. In Germany, France, Belgium and Great Britain, the construction sector was stagnant, with an average 1-2% drop in construction activity in the first quarters of 1993. An increasing number of firms from former COMECON countries were now competing for business in Western Europe. Furthermore, unemployment problems in the construction sector was leading to anti-foreign worker and an anti-foreign construction company sentiment.

### **Progress Ostrava, a.s.: Internal Operations**

Production at Progress Ostrava, a.s. was divided between two main plants. One plant was in Ostrava, in the northeast corner of the Czech Republic on the Czech, Polish and Slovak borders, and the other plant was in Valasske Mezirici, about 50 km south of Ostrava. There had been 500 employees at Progress at the beginning of the year. By July 1993, there were less than 400 employees. Roughly half of the employees were classified as direct production workers, and the remaining were equally divided between production support (e.g., maintenance, engineering) and staff (e.g., administrative staff, senior managers).

The general director, Zdenek Tomecek, had been appointed to the position recently by the interim management board. Tomecek had worked for two decades in the industry, and possessed both technical and managerial qualifications. New plant managers had been appointed by Tomecek for both the Ostrava and Valasske Mezirici plants in March 1993.

## Ostrava Facilities

Ostrava operations included the administrative functions of the company, manufacturing of construction equipment, and construction project implementation. Progress headquarters were in Ostrava, in a small office building on the edge of the city. There were roughly 50 employees at headquarters, mainly administrative staff. The Ostrava factory was roughly 500 meters down the road from the office building, next to a large coal mine owned by its former parent. There were 140 employees in the Ostrava plant, with half of them production workers and an additional 15 production support workers (e.g., repairs and maintenance). Ostrava operations were divided between the production and assembly of aluminum building products, and general turnkey construction activities.

### *Turnkey Construction*

The turnkey construction activities included initial project design, project engineering and documentation, and actual construction and assembly work. Until 1993, Progress' construction projects tended to be large-scale (e.g., US\$5 to 10 million). In these projects Progress was always part of a larger consortium, headed by a major industrial manufacturer. Progress' role was typically construction or assembly of the steel frame supporting the structure. Most of these large construction projects took place abroad. In fact, 80% of 1992 revenues had come from foreign based projects, such as power plant assembly projects in India and China.

Progress' main export markets had been Russia and the former East Germany. However, these markets had disappeared for Czech companies in the face of the major changes in the region. Often, these projects were government funded, and the choice of consortium would often depend on the strength of the connections with the government officials involved. Company managers in the construction industry spent a great deal of time maintaining contacts and relationships with colleagues in other companies. If a new project was announced, this network of contacts would be able to quickly respond, and a consortium could be assembled where each of the members knew each other well.

Governments affected the pace and scope of these large turnkey projects in other ways as well. For example, reunification pressures had led to a great deal of labor unrest in Germany, especially among former East Germans. This in turn led to the enactment of rules and laws which restricted the rights and opportunities of foreign labor in Germany. These restrictions often caused projects in Germany to be delayed, while paperwork was being processed, and while work permits were being approved. Central planning authorities in each country often controlled the timing, pricing and payment of these large projects. In addition, laws and regulations regarding construction activities varied widely from country to country, and construction processes or materials might have to be adjusted to meet local regulations.

Progress had identified some domestic construction opportunities to replace its export revenues, but these were smaller than the foreign projects (for example, gas stations or car dealerships) and often required less time to complete. A typical small warehouse could be built in two or three weeks. In comparison, a large power generation facility had often required two or three months to complete.

Progress often served as the main contractor for the smaller turnkey projects. In these projects, Progress would often contract sub-portions of its projects out to specialists. For example, in a petrol station project, over 40% of the project could be subcontracted to specialist firms (e.g., fuel pump manufacturers, cash register manufacturers). Gas stations had the highest level of subcontracting.

By mid-1993, Progress had yet to receive any new large turnkey construction orders, either foreign or domestic.

#### *Aluminum Products and Assembly Operations*

In January 1993, Progress had purchased and installed in Ostrava a production line for aluminum doors, windows and facades. These products were manufactured under license from the Belgian firm Reynaers. Progress had chosen Reynaers because the aluminum building products had a better, higher-quality appearance than its plastic competitors, and because aluminum building products were comparatively rare in Eastern Europe.

The Reynaers production line became fully operational in June 1993. Although full-scale production had begun only recently, capacity utilization had already reached 30% to 40% by July. Ninety percent of the customers for the Reynaers products were domestic. Almost all were in the retail and commercial sectors (e.g., banks, car dealerships, shops). Progress had produced glossy color brochures for the Reynaers products. Salespeople had distributed the brochures to many retail and commercial businesses in the region, and customers had begun calling to find out more about the products.

Although other companies in the Czech Republic also held the license for production of Reynaers products, Progress competed by offering its aluminum doors, windows and facades for a slightly lower price than other competitors. Progress positioned the product as a higher quality product than plastic or wooden building products, intended for the higher market segments.

#### *Other Activities at Ostrava*

Besides the two main construction and manufacturing activities, Progress had also registered itself as a provider of several services. These included trading, shipping and import

services, and rental services for machinery, buildings and technology. These services contributed less than 10% of the revenues.

### Valasske Mezirici Facilities

Valasske Mezirici operations were divided into two main groups: steel tower crane parts and made to order classic steel structures. Production and revenues were roughly evenly divided between the two main groups. There were over 150 employees in the Valasske Mezirici plant, with over 50% of which were production workers, almost 30% of which were production support personnel, and the remainder administrative staff.

Valasske Mezirici operations were run by Alois Konecny, who had worked for many years as a civil engineer with major Czech construction companies on several foreign projects. Konecny had joined Progress as the manager in Valasske Mezirici at the end of March 1993. One of his first duties, as a part of reorganizing the enterprise was to fire 40 older employees (each employee had worked for more than 30 years), and hire 30 new production (mostly welders) employees.

#### *Classic steel structures*

Before 1993, classic steel structures had been the largest part of Progress' business. Though the main customers in Russia had largely disappeared, Valasske Mezirici management had found new foreign customers, and had obtained a major project in Holland. In addition, many of the small domestic turnkey projects from the Ostrava plant used small steel structures from Valasske Mezirici.

There was a great deal of competition in the classic steel construction business. Many competitors had cut prices drastically, both abroad and domestically. Konecny, however, had decided to maintain Progress' prices (which were higher than its competitors), because the quality of Progress' steel structures was higher.

#### *Liebherr Steel Tower Cranes*

Progress had produced tower crane parts for the German firm Liebherr since 1991. The production process for the crane parts was similar to that for classic steel structures, except that the quality tolerances were much stricter.

According to Konecny, the emphasis on quality was the key competitive advantage of Progress versus its competitors. Although Progress was producing only one type of crane for Liebherr (a static load crane arm), Konecny predicted that if Progress could maintain its

quality, Liebherr would come to trust Progress with more technically demanding (and potentially, in his view, more profitable) crane arm designs.

The yearly production volume of crane arms was expected to be 500 tons for 1993. The volume of Liebherr production had increased gradually since 1991 as Liebherr's confidence in Progress' quality grew. The sales and marketing process for Liebherr was relatively simple: Liebherr would place its orders every one or two months according to its own demand projections; Progress would produce the crane arms and ship them to Liebherr; and Liebherr would then pay for the crane arms upon delivery. Liebherr always paid its invoices in full and on time, which was often not the case with other Progress customers.

#### *Other activities at Valasske Mezirici*

In addition to these products, the VM plants manufactured small locks that were generally included as a part of larger projects. It also provided a number of services, including, machinery, technology and building rental, painting, cutting and transportation services. Finally, it ran a technical consulting and design service, that created blueprints and gave technical and design advice. Konecny estimated that these other activities made up less than 10% of the revenues.

#### Management Board

In July 1993, the management board of Progress was composed of five members, all of whom had all been appointed following the recommendation of the National Property Fund (Exhibits 1 & 2). Though in theory these five members would legally assume full responsibility after they were formally elected by the general meeting, the new management board was already operating under the assumption that they were in charge of Progress.

Polak had been appointed the chairman of the management board. In addition to his duties as director of Progress, he also sat on the management boards of two other firms. Besides Union Bank, there were several other investment privatization funds represented (Exhibit 6) on the Management Board. Like Polak, each of these directors served as directors on an average of 4 other management boards.

#### Agenda for the General Meeting

There were several topics that would need to be addressed at the General Meeting. One topic was the Articles of Incorporation. At the time of its official incorporation as a joint-stock company, Progress had approved articles of incorporation that had defined the roles and responsibilities of all the major bodies of the company, including the Management Board, the Supervisory Board, and the General Meeting. Since this version of the Articles of Incorporation had been passed by an earlier, non-private, group of shareholders, the new,

private shareholders were expected to want some changes made in the Articles. There was a request by some of the shareholders that the Supervisory Board be given more say over the affairs of the firm.

Also, it was clear from current information on the company, that it was on the verge of a crisis. The industry was changing. What direction should Progress take? What role should the Management Board have in the overall strategy? What role should the shareholders have?

Exercise:

Each stakeholder or stakeholder group will be given time to prepare their position for the general meeting. Participants will be encouraged to site information from the case when making their argument. The Management Board will chair and control the meeting.

Exhibit 1: Supervisory Board

## Progress Ostrava, a.s.

Board member (title)	Background	Represents
ing. Jozef Dejcik (Chairman)	M.A. Economics, Bratislava School of Economics Age: 32	Union banka (privatization fund)
ing. Pavel Kacmar	M.A. Economics, Ostrava School of Economics Age: 33	Investicni a postovni banka (privatization fund)
ing. Jarmila Kolarcikova	M.A. Economics, Ostrava School of Economics Age: 34	<del>Management Employees</del> (Economic director of Ostrava division of Progress, a.s.)

Exhibit 2: Board Members**Progress Ostrava, a.s.**

<p>ing. Petr Polak (Chairman)</p> <p>M.A. Economics, Ostrava School of Economics, Certificate in Business Administration, Swinburne University of Technology, Melbourne, Australia, Age: 26 Union banka (privatization fund)</p>
<p>ing. Eva Pavlu (Deputy chairwoman)</p> <p>M.A. Economics, Prague School of Economics Investicni a postovni bank (privatization fund)</p>
<p>ing. Tomas Dzik (Deputy chairman)</p> <p>M.A. Economics, Ostrava School of Economics Sporitelni investicni (privatization fund)</p>
<p>Jiri Nemecek</p> <p>Private economic consultant. Worked in OKD construction subsidiary, Age: 35 Private investor</p>
<p>ing. Zdenek Tomecek</p> <p>M.S. Construction engineering. Worked in OKD construction subsidiary as technical director Age: 48 Management (General director)</p>

Exhibit 3:  
Share Ownership Percentages by Type of Shareholder, July 1993

**Progress Ostrava, a.s.**

Type of shareholder ownership	Number of shares held	Percentage equity
Privatization funds (13 privatization funds)	60 057	58.75%
Individual "coupon" investors	28 979	28.35%
National property fund	13 187	12.90%
Total	102 223	100.00%

Exhibit 4:  
Construction activity in the Czech Republic, 1990-1992

**Progress Ostrava, a.s.**

	1989	1990	1991	1992
Index versus previous year (previous year = 100)	105.6	94.4	71.7	112.0
Total construction activity (billion Kc, current prices)	96.5	102.8	108.4	
Construction work carried out by construction enterprises according to suppliers contracts *	64.0	61.01	42.6	47.4
of which				
new construction (including modernization and reconstruction)	43.6	40.4	30.8	35.6
Repairs and maintenance	18.0	18.5	8.7	9.7
Other work	2.4	2.1	1.2	-
Completed dwellings (000)	34.1	22.1	24.1	15.7

\* 1991: enterprises with 100 or more workers, 1992: enterprises with 25 or more workers

Exhibit 5:  
Construction Investment by Region, Czech Republic 1992

Progress Ostrava, a.s.

Total construction investment (million Kc)	Investment per 1000 residents (000 Kc)	Percentage of total country investment (%)	
Prague	44 012	36 203	23.9
Central Bohemia	19 318	17 405	10.5
South Bohemia	13 746	19 679	7.5
West Bohemia	13 203	15 347	7.2
North Bohemia	23 462	19 965	12.8
East Bohemia	17 178	13 911	9.3
South Moravia	25 110	12 232	13.7
North Moravia	27 787	14 120	15.1
TOTAL	183 816	17 820	100.0

Exhibit 6  
Major Investment Fund Shareholders

**Progress Ostrava, a.s.**

Fund	Progress Director	Comments
Prvni investicni (Investicini banka)	Ing. Eva Pavlu Deputy Director Management Board	Prvni investicni was one of the largest investment privatization funds. It was closely affiliated with Investicni banka, one of the five largest banks in the Czech Republic.
SIS (Ceska sporitelna)	Ing. Tomas Dzik	SIS was the largest investment privatization fund in the Czech Republic. It was controlled by Czech Savings Bank (Ceska Sporitelna), the largest bank in the Czech Republic. SIS managed a portfolio of over 500 companies, or more than 1/3 of all companies in the first wave of coupon privatization.
Union (Union banka)	Ing. Petr Polak	Union was a regional investment privatization fund, based in Ostrava. It was closely affiliated with Union bank, which was also based mainly in the Ostrava region.

The general meeting (after a break) approved the following proposals

Year-end accounts (60 904 votes for, 0 against, 18 abstain)

Dividing profits (60 729 for, 96 against, 97 abstain)

Royalties for management board and supervisory board (60 528 for, 181 against, 213 abstain)

Change in the articles of incorporation (60 741 for, 45 against, 106 abstain)

Management board (60 741 for, 45 against, 106 abstain)

Supervisory board (60 741 for, 45 against, 106 abstain)

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**Articles of incorporation (Progress Ostrava, a.s.)**

(The full version is available in Czech; English version contains abstracts, translated by Sandy Chen)

*Article 1: Founding of the joint-stock company*

*Article 2: Company name and seat*

*Article 3: Period of operations (indefinite)*

*Article 4: Company activities*

Testing of electrical equipment

Testing of operating stoves and pressure cookers

Project activities

Industrial construction

Residential construction

Civil construction

Production of steel structures and their parts

Purchase of goods for later selling (retail?)

Trade intermediary

Renting of equipment and attachments

Technical and engineering activities

Assembly operations

*Article 5: Basic capital of the company*

Paid-in capital (including capital stock) of the company from its founding is 102 223 000 Kc.

For the increase or decrease of the basic capital of the company, the decision is made by the general shareholder meeting on the basis of required legal documentation and according to these articles of incorporation.

#### *Article 6: Shares*

The basic capital of the company is divided into 97 375 shares for "owners" at a par value of 1 000 Kc and 4 848 employee shares at a par value of 1 000 Kc.

Shares for owners are registered according to law.

Shares for employees are given to employees by name. Employee shares can only be transferred between company employees and/or retired company employees.

Employee shares are intended only for physical persons (individuals) who are working for the company. During retirement, the former employee can release the shares. Retirement does not limit the rights connected with the employee shares.

The par value of all employee shares [not paid out??] cannot exceed 5% of the total paid-in capital.

With the death of an owner of an employee share, or the departure for reasons other than retirement, the holder of the employee share must return the ownership of the share back to the company. For this returned share the company will pay the former shareholder a part of the par value of the share, if the shareholder has worked in the company for less than 3 years as of the day that share must be returned. In other cases, the company will pay a proportion of the market value of the share, which must be at least the par value of the share.

The amount, or part, of the par value of the share that will be paid by the employee for the share must be approved by the general shareholders meeting, which is required to take into account the business results of the company. The employee will pay a fee within a maximum of two years from getting the share. Payment for the share will be at least 15% of the part that will be paid (e.g., 15% of the 50% decided payment for the share), always by the end of each calendar quarter in which payment is due (e.g., payments are made quarterly). In case payment is not made, the employee is required to return the share, during which the company will pay the paid part of the par value of the share.

If the general meeting decided to issue employee shares, the condition for getting employee shares is at least 3 years uninterrupted employment with the company (including precursors of Progress).

Management board decides on the price, amount, distribution and repayment of the employee shares. Before this decision is made, the supervisory board should agree with this. Employees will be informed of the total distribution of employee shares.

Employee share dividends. If the general meeting decided about issuing employee shares, it can decide as well that a part or the whole emission can be paid from [undividable] profit of the company. Employee shares paid in this way will be retained by the company, and will be used for motivation of the employees.

#### *Article 7: Registration of the company*

*Article 8: Organization of the company*

The company has the following responsible organs: (a) the general meeting, (b) the management board, (c) the supervisory board, and (d) the prokurist.

*Article 9: The general meeting*

The position and sphere of influence of the general meeting

The general meeting is the highest organ of the company. It has final authority over all shareholder affairs.

The rights of the general meeting include:

Approving changes in the articles of incorporation

Deciding on the increase or decrease of founding capital (if the management board is not so empowered) and the issuing of debt instruments.

Voting in and voting out of members of the management board and supervisory board, with the exception of the member of the supervisory board that is elected by employees.

Approving the annual closing of accounts, including declaration of dividends, the level and means of payment of the dividend, and royalties.

Deciding on changes in the rights of any individual class of stock.

Deciding on the merging, connecting, and dissolving of the company and of other changes in the legal character of the company.

Deciding on stopping and liquidating the company, deciding on stopping the company and any changes to another form of company or cooperative, or of dividing the company.

Deciding on the means of liquidating residual assets of the company.

Deciding on the transfer and rental of real estate of the company for values in excess of 40% of the paid-in capital of the firm.

The general meeting of shareholders can according to its discretion add additional provisions.

*Article 10: Participation in the general shareholders meeting*

Each shareholder is allowed to participate in the general meeting, vote in it, and request in it clarification of and amendments to proposals.

Representative individuals or organizations can also take part, on the basis of a signed power of attorney. The representative of the shareholder is required to present the power of attorney to the management board before the beginning of the general meeting. The power of attorney must be signed by the shareholder.

The general meeting is attended by the members of the management board and the members of the

supervisory board and the prokurist of the company.

*Article 11: Voting in the general meeting*

The general meeting must be held at least once per year. The management board can declare the meeting, at the latest by the sixth month after the end of the preceding calendar year.

The management board is required to call an extraordinary general meeting when:

it has determined that the company has lost one-third of its paid-in capital

the company is illiquid for longer than three months

if there are any other serious concerns of the company

if the supervisory board requests it by its vote

if shareholders representing more than 10% of the paid-in capital request it, and there is a concrete agenda

If the management board does not declare a general meeting within 30 days of being so required according to the above conditions, the court shall declare a general meeting.

If it is in the interests of the company, a general meeting can be called by the supervisory board as well.

The general meeting is declared by sending a written invitation to all listed shareholders no later than 30 days before the date of the general meeting.

The general meeting is also declared by publishing an announcement of the date and agenda of the general meeting at least 30 days before the meeting. The management board must quickly publish a statement in the daily press with coverage throughout the country.

The invitation to the general meeting must contain the name of the company and its seat, the date time and place of the general meeting, and a note as to whether this is an ordinary or extraordinary general meeting. In addition, a program for the meeting, the conditions for voting according to the articles of incorporation, and other issues contained in the articles of incorporation or pertaining to the general meeting.

At the request of shareholders who represent at least 10% of the paid-in capital, the management board (or supervisory board) is required to include in the program additional items. The request must be made to the management board at least 4 working days before the general meeting.

The general meeting will take place in Ostrava, unless the management board decides otherwise.

*Article 12: Operations of the general meeting*

The general meeting is conducted by the chairman of the general meeting, the note-taker, two signature verifiers, and vote-counters.

The operation of the general meeting is led by the chairman of the general meeting.

The schedule/course of the general meeting is according the written documentation.

[??? check on section 4, article 12???

*Article 13: Decisionmaking of the general meeting*

The general meeting will be empowered, if the shareholders and their representatives amount to more than one-half of the basic capital of the company.

[??? section 2]

Items that were not on the program can be decided on only if all shareholders present have a [???simple agreement] to consider the item.

Every 1 000 Kc of paid-in capital represents one vote.

The general meeting decides by simple majority of votes present, unless it is specified that a qualified majority is needed.

The requirement for a qualified majority means that for approval of a proposal, there must be at least two-thirds of votes of shareholders present.

A qualified majority is needed for deciding the following:

Changes in the articles of incorporation

Increasing or decreasing the basic capital

Changing the rights of individual classes of shares

Winding up of the company

For decisions of the general meeting regarding changing the rights connected with some types of shares, it is necessary the agreement of two-thirds of all, not only those present, of the shareholders holding the specific type of shares.

The counting of votes can be stopped, once the necessary votes are collected.

Voting in the general meeting is directed by the operating and voting council of the general assembly. Voting is proportional.

*Article 14: The management board*

The management board is the statutory organ that directs the activities of the company in the name of the company.

The management board decides on every action of the company, that by the letter of the law, by the articles of incorporation, or by the decision of the general meeting, is not specified as within the power of the general meeting.

The management board is empowered to at least:

realize business operations and supervise the operations of the company

uphold employer's rights

declare a general meeting

supervise the preparation and presentation of the general meeting

make suggestions for changing articles of incorporation

make suggestions for increasing or decreasing the basic paid-in capital, including issuing debt instruments

closing year-end accounts

suggesting the dividing of profits, including setting the level of dividends and royalties

issuing the annual report of the activities of the company and the state of its assets.

suggesting policies concerning losses, including drawing from reserve funds

suggesting the increasing of the reserve fund beyond the level specified in the articles of incorporation

suggestions for management and dissolving of other (in article 8) extraordinary organs, including limiting their function and areas of influence

suggesting the winding-up of the company

(e) conduct/manage the general shareholders meetings

(f) supervise the preparation of quarterly balance sheets

(g) decide on the use of the reserve fund in accordance with the articles of the incorporation

(h) hold the list of shareholders

(i) supervise the management of documentation, accounting, order booking, and other documents of the company

(j) naming and voting out of the company director, establish his/her powers and regulate his/her activities according to the articles of incorporation

(k) empower and vote out the prokurist

(l) approve proposals relating to the nature of company activities

(m) decide on the increase of the basic capital of the company in transfers/transactions with other equity of the company. This increase cannot affect more than 1/3 of the existing basic capital of the company.

(4) The management board can negotiate on behalf of the company according to article 30.

(5) The management board directs the seating of approved general meetings.

*Article 15: The composition, establishment and functioning time of the management board*

(1) The management board has five members.

(2) During the founding of the company the founders name the first five members of the management board in the founding documents. Later the members of the management board are voted upon by the general meeting.

(3) The functional time of the management board for five years, not ending however before the new management board is elected. Reelection to the management board is possible.

(4) A member of the management board can leave their function by written announcement to the management board. In this case the management board will decide the day when the powers of the board member will end.

(5) The management board elects from its members the chairman and the two deputy chairmen.

(6) If 2 members of the management board leave their function, the management board is required to appoint replacement members by the time of the next seating of the general meeting.

*Article 16: Management board meetings*

(1) The management board must be seated at least once every three months.

(2) The management board meeting is declared by the chairman by written announcement, declaring the time, date and place of the meeting and the program for the meeting. The invitation must be delivered to each member of the management board at least 15 days before the meeting. If every member of the management board agrees with it, the meeting can be held by telephone or fax as well. Even in this case however the invitation must specify the topics of the meeting and the management board members must confirm their attendance.

(3) The chairman is always required to call a meeting of the management board when someone from the management board or the supervisory board so requests it.

(4) The management board meeting will be held in the seat of the company, unless the management board decides otherwise.

(5) No replacements or representatives can be substituted for members of the management board.

(6) The management board can invite members of other organs of the company, its employees or shareholders, according to its discretion.

*Article 17: Seating (sessions) of the management board*

(1) The management board meeting is directed by the chairman of the management board.

(2) The proceedings of the meeting and its decisions are to be recorded, and signed by the chairman and the meeting recorder.

(3) The cost associated with the meeting and with other activities of the management board will be covered by the company.

*Article 18: Decisionmaking of the management board*

(1) The management board is empowered to make decisions, if in attendance are more than half of its members.

(2) Decisionmaking requires in all instances in the meeting, that more than half of all members of the management board approve.

(3) During the election and voting out of the chairman, the concerned person cannot vote.

*Article 19: Decisionmaking of the management board outside of the meeting*

(1) If all members of the management board agree, decisions can be taken outside of the general meeting. In this case, however, all members of the management board must approve any decision unanimously.

(2) Decisions taken outside of meetings must be recorded in the notes of the next meeting of the management board.

(3) All organizational activities connected with decisionmaking outside of the meeting of the management board are supervised by the chairman of the management board.

*Article 20: Responsibilities of the members of the management board*

(1) Members of the management board are required while carrying out their functions to exercise extreme care to keep all sensitive company information confidential.

(2) Members of the management board are required to respect limits regarding non-competition, which are established by standard legal doctrines. Non-competition is absolved for members of the management board who represent investment funds and investment companies.

(3) Breaking the responsibilities outlined in sections 1 & 2 respond will be prosecuted according to the law.

(4) Members of the management board are responsible to the company according to the conditions and requirements of the law for damages which they have caused by violating the responsibilities of their function. If several members of the management board cause this damage, they shall all be held equally responsible ("together and indivisibly")

*Article 21: Royalties (fees) to the members of the management board*

Members of the management board that are satisfying their function will receive a royalty, with the level of the royalty set by the general meeting.

*C. Supervisory Board*

*Article 22: Establishment and powers of the supervisory board*

- (1) The supervisory board is the control organ of the company
- (2) The supervisory board evaluates the performance of the activities of the management board, and realizes the business activities of the company.
- (3) The supervisory board evaluates for example:
  - (a) verifying that the articles of incorporation, decrees of the general meeting, and general regulations are followed.
  - (b) testing the annual financial statements and recommendations for dividends and royalties, including amount of the dividend and the means of payment.
  - (c) testing the simple quarterly balances
  - (d) calling extraordinary general meeting, if it is in the interest of the company
  - (e) present to the general meeting and to the management board its opinions, proposals and recommendations.
  - (f) verifying company documentation, accounting, trading books and other company documents anytime.
- (4) The supervisory board as part of its activities directs the seating and approval of general meetings.
- (5) The supervisory board can vote out a member of the management board who is currently performing the function of prokurist only with the recommendation of the management board.

*Article 23: Composition and functions of the supervisory board*

- (1) The supervisory board has three members
- (2) During the founding of the company, the founder names the first members of the supervisory board in the founding documents. Later two-thirds of the members are elected and voted out by the general meeting, and one third of the members is elected and voted out by company employees. A member of the supervisory board can not be at the same time a member of the management board.
- (3) A member of the supervisory board is elected for 5 years, unless the member is voted out by the new supervisory board. Reelection to the board is possible.
- (4) Members of the supervisory board can leave their function by submitting a written declaration to the supervisory board. In this case, the rights and responsibilities of the board member end on the day that his departure is discussed by the general meeting.
- (5) The members of the supervisory board elect from among themselves their chairman.

*Article 24: Declaring a meeting of the supervisory board*

- (1) The supervisory board has a meeting at least twice yearly.
- (2) The supervisory board meeting is called by its chairman by written invitation, in which is

indicated the place, date and time of the meeting and the program. The invitation must be delivered no less than 15 days before the meeting. If all members agree, members can participate by telegraph or telefax. Even in this case, every invitation must contain a description of the topics and each member of the supervisory board must confirm their attendance.

(3) The chairman is required to call a meeting of the supervisory board whenever a member of the supervisory board, a member of the management board, or any written shareholder documentation requests it, if the reason given is sufficiently important.

(4) The supervisory board meeting will be held at the seat of the company, unless decided otherwise.

(5) The supervisory board can invite members of other organs of the company, employees or shareholders, if it so decides.

*Article 25: Holding the supervisory board meeting*

(1) The meeting is directed by the chairman of the supervisory board.

(2) During the supervisory board meeting

## Role Play: Progress' first General Meeting and the Direction of the Firm

### *Management*

You are a member of Progress' Management Board. You and your colleagues on the board are preparing for the upcoming General Meeting and are reviewing your position. You must decide your position on important issues before the General Meeting convenes, as a vote will be taken.

One of the major issues facing Progress is how will the power be shared between management and the new owners. You are worried about decision-making and demands upon your time. How will you be able to work with the changes required in the Articles of Incorporation to help you get you job done.

The other major issue facing Progress is, how does the firm define itself? That is, what type of construction does Progress wish to engage in? The market is becoming more competitive and it is generally recognized by all stakeholders that Progress can no longer afford to pursue diverse market niches. Thus, a decision must be made as to what kind of construction projects Progress will pursue. Of course, this means that Progress will need to shed some of its activities. The decision on which activities Progress chooses to pursue will eventually indicate whether the firm will continue to be profitable and will determine issues such as the size of the firm, employment, income, and cash flow.

As a member of the Management Board you are in favor of expanding ties with Liebherr and Reynaers, and also continuing the large turnkey projects. Since the domestic market is so depressed and offers only small projects, you view international contracts as the means to maintaining Progress' size and income, while at the same time allowing the firm to up-date its methods and technology through contact with Western firms and high international standards.

## Role Play: Progress' first General Meeting and the Direction of the Firm

### *Mutual Fund*

You are a director of Sportelna, a fund that owns 20 % of the shares of Progress. You are preparing for the upcoming General Meeting and are reviewing your position. You must decide your position on important issues before the General Meeting convenes, as a vote will be taken.

You are worried about the decisions made by management within the firm and your ability to influence the future direction of the company. How will you be able to do this? You are on several boards, as your fund has shares in several hundred companies. This leaves you little time to focus on any one firm. How might you balance your need to exercise authority and still spread your attention to other companies? Are there changes to the Articles of Incorporation that can help protect your position or give you greater authority?

The other major issue facing Progress is, how does the firm define itself? That is, what type of construction does Progress wish to engage in? The market is becoming more competitive and it is generally recognized by all stakeholders that Progress can no longer afford to pursue diverse market niches. Thus, a decision must be made as to what kind of construction projects Progress will pursue. Of course, this means that Progress will need to shed some of its activities. The decision on which activities Progress chooses to pursue will eventually indicate whether the firm will continue to be profitable and will determine issues such as the size of the firm, employment, income, and cash flow.

As part of your fund's marketing plan, immediate and large returns on investments have been promised to the individuals who originally invested with your fund. For this reason you and other members of your fund are keenly interested in raising cash as soon as possible, in order to make good on your pledge. Knowing that you cannot practically sell your shares in Progress, your fund seeks to obtain the highest possible dividends while assuring Progress becomes profitable quickly. For this reason your fund is initially inclined towards strengthening Progress' relationship with Liebherr and Reynaers and towards seeking out large turnkey projects. You believe that this will guarantee long-term, large cash flows and that will in-turn lead to regular dividends and profitability.

While you are representing only your fund you may wish to confer with other representatives of investment funds. However, this is not mandatory.

## Role Play: Progress' first General Meeting and the Direction of the Firm

### *Mutual Fund*

You are a director of Union Banka, a fund that owns 8 % of the shares of Progress. You are preparing for the upcoming General Meeting and are reviewing your position. You must decide your position on important issues before the General Meeting convenes, as a vote will be taken.

You are worried about the decisions made by management within the firm and your ability to influence the future direction of the company. How will you be able to do this? You are on several boards, as your fund has shares in several hundred companies. This leaves you little time to focus on any one firm. How might you balance your need to exercise authority and still spread your attention to other companies? Are there changes to the Articles of Incorporation that can help protect your position or give you greater authority?

The other major issue facing Progress is, how does the firm define itself? That is, what type of construction does Progress wish to engage in? The market is becoming more competitive and it is generally recognized by all stakeholders that Progress can no longer afford to pursue diverse market niches. Thus, a decision must be made as to what kind of construction projects Progress will pursue. Of course, this means that Progress will need to shed some of its activities. The decision on which activities Progress chooses to pursue will eventually indicate whether the firm will continue to be profitable and will determine issues such as the size of the firm, employment, income, and cash flow.

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While you are representing only your fund you may wish to confer with other representatives of investment funds. However, this is not mandatory.

## Role Play: Progress' first General Meeting and the Direction of the Firm

### *Individual Shareholder*

You are an individual shareholder of Progress stock. You are preparing for the upcoming General Meeting and are reviewing your position. You must decide your position on important issues before the General Meeting convenes, as a vote will be taken.

The major issue facing Progress is, how does the firm define itself? That is, what type of construction does Progress wish to engage in? The market is becoming more competitive and it is generally recognized by all stakeholders that Progress can no longer afford to pursue diverse market niches. Thus, a decision must be made as to what kind of construction projects Progress will pursue. Of course, this means that Progress will need to shed some of its activities. The decision on which activities Progress chooses to pursue will eventually indicate whether the firm will continue to be profitable and will determine issues such as the size of the firm, employment, income, and cash flow.

Individual shareholders are inclined towards seeing shares grow in value and in receiving a regular, healthy dividend. Thus you would like to see Progress engage in large activities outside the country and are also in favor of expanding relations with Liebherr and Reynaers, and other such companies, if possible. Yet no matter what decision is met, you intend upon obtaining from the Management Board and Supervisory Board a promise that dividends will be paid.

The additional issue with which you are concerned is the power given to the Supervisory Board. You intend to bring up the issue that in other countries the Supervisory Board plays a fuller role in the management of the company. You believe Progress and the individual shareholders and funds would be better off if its own Supervisory Board had greater purview.

While you are representing yourself, you may wish to confer with other individual shareholders. However, this is not mandatory.

**Progress Ostrava, a.s. (B)\***

By early February 1994, the situation at Progress had changed in several ways. Parts of Progress' customer base had changed dramatically, and the initial phases of company restructuring, which had just begun in July, had been completed. Petr Polak was reviewing these developments, in preparation for another board of directors meeting.

Several key strategic issues had become clearer by now. Progress had invested 24 million Kc in improvements to plant and equipment since 1990. Company management estimated that they would need to invest an additional 100 million Kc in production equipment, research and development, and employee training, in order to maintain competitiveness. A key issue for Petr was how these investments would be financed. Several options were available: to issue shares, obtain loans, and leasing. The costs and benefits of each of the options needed to be considered carefully before proceeding.

**Structural Changes in the Construction Industry**

Progress management believed that recent changes in the construction industry presented a number of serious threats to their company. Survival in their view required continuous investment in new plant and equipment.

**Construction in the Czech Republic**

Although there was the usual summer surge in construction activity, the market for construction was stagnant, especially for companies with more than 25 employees. The 1993 index of construction activity was 40% below 1990 levels, with the previous years 1991 and 1992 only marginally better than 1993.

Construction activities of Czech companies (including exports) amounted to 118.9 billion Kc for 1993. This represented a 7.5% decline in construction activity versus the previous year. According to government estimates, small construction companies (less than 25 employees) now accounted for 24.8% of this construction activity, registering a 1.5% increase in activity, while companies with more than 25 employees had registered a 10.1% decrease in activity.

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\*This case was written by Sandy W. Chen of CORUM Business Services under the supervision of the International Privatization Group of Price Waterhouse (PW-IPG), Washington, DC, as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. The author is grateful to management of the company for their support. The case was prepared with the financial assistance of the United States Agency for International Development (USAID). Price Waterhouse-IPG, Washington, DC, May 1994.

The largest domestic competitors in this sector (and in the classic steel construction and aluminum building products sectors as well) were Vitkovice Stavby, Unips, Hutni Montaze, and IPS. These competitors employed thousands of engineers, production workers, and other specialists. These companies had the resources to develop large-scale proposals. In addition, the larger companies generally offered project financing (e.g., bank guarantees). This was becoming especially effective for getting large domestic contracts.

Financing mechanisms for large-scale domestic projects were changing. Before, most large-scale projects had been financed from a central state budget, from plans drawn up before the economic reforms. Now, however, the process was becoming increasingly decentralized, with federal, regional and municipal authorities in the region were reorganizing their own financing mechanisms. In addition, project financing priorities had shifted towards tourism-related projects, in which Progress had more limited experience.

The small private firms, with their lower cost bases, had consistently pushed margins lower. In fact, several of the larger construction firms in the Czech Republic acknowledged that it had become unprofitable to pursue smaller construction projects.

### **Construction in Europe**

Construction activity was stagnant in every major country in Europe in 1993. In the current economic recession, neither individuals nor companies had sufficient funds to invest in construction, either for residential homes or commercial real estate development. Analysts predicted that construction activity would not revive until interest rates had fallen, and companies had felt secure about long-term prospects for economic growth. Neither of these conditions had been fully satisfied in 1993.

In Western Europe, demand was for small to medium sized projects, focused on service businesses, office buildings, and small production halls. According to management, price, timing and flexibility were the keys to getting an order from a West European customer.

### **Progress Performance and the Stock Market**

By the beginning of 1994, Progress derived 40% of its revenues from construction of steel structures, 30% from turnkey construction projects, 20% from construction assembly work (including the Reynaers building products), and 10% from other activities (e.g. rental of facilities, design and consulting work, trading activities -- Exhibit 1) .

Progress' financial situation had improved markedly, by early 1994. After three quarters of losses in 1993, the final quarter of 1993 saw a small net profit (Exhibit 2). Management predicted that the improved financial performance would continue.

Progress still faced financial challenges, however. One was the threat of secondary insolvency, where if Progress' customers were unable to pay their invoices, Progress itself would be unable to pay its own invoices. At the end of 1993, accounts receivable were 55,144,000 Kc, while accounts payable were 65,817,000 Kc. Estimates of possible bad debts ran from 5% to 25% of accounts receivable (Exhibit 3).

Progress' share price in 1993, in both the stock exchange and the RM-system, were far below the opening price of 500 Kc per share obtained in June/July 1993. Progress stock was currently selling at 200 Kc per share, with a 365-day low of 150 Kc on the RM-system. Trading volume on Progress stock was very low, making it difficult to either purchase or sell large amounts of shares without drastically affecting their price.

The combination of high price volatility and low trading volume experienced by Progress was common. In part, it reflected uncertainty over the company's future and the uncertain environment in the Czech Republic. But the volatility was also a function of thin capital markets. Total trading volume in the two trading sessions of the stock exchange in January (the 9th and 10th sessions) was 288 million Kc. A few firms accounted for most of the trading volume (Exhibit 4). But most of the trading took place outside the stock exchange and the RM-System, where reporting and regulations were less stringent.

### Organizational Changes

At the beginning of 1993, Progress had employed 550 people. By October of 1993, the workforce had been reduced to 346 employees. Originally, management had planned to reduce the workforce to about 279 employees. However, due to the high volume of projects they had during the second half of 1993, the workforce was cut by only 22 employees, to 324 employees.

### **Ostrava Business Unit**

Although individual profit and loss accounts for each business unit had not been completed for 1993, the preliminary results indicated that the Ostrava business unit was losing money. There were no estimates of a breakeven production figure for the unit or its component activities.

#### *Ostrava Turnkey Construction Projects*

During 1993, Progress had begun to build a good reputation in the domestic market for small scale construction projects. It focussed on higher-quality small projects, such as bank lobbies, small retail shops, and car dealerships. It emphasized speed, quality and reliability.

Nevertheless, Ostrava turnkey construction activities were losing money for Progress, though management lacked the information systems to know exactly how much money was being lost.

Tomecek believed there were two related causes for the losses: (a) changes in the customer base and (b) changes in the scale of the projects.

Ostrava had traditionally derived most of its revenues from large scale, foreign turnkey construction projects. Although Progress was involved in a power station construction project in Iran (again, as part of a consortium), and another foreign turnkey construction project was being negotiated for 1995, much of its foreign customer base had disappeared in 1994. Projects in the former Soviet Union, Progress' traditional markets, had ceased during the widespread changes of 1990-1993. This had forced Progress to look for and become familiar with the requirements of alternative project sources. Progress management discovered that many of the principal financing sources for large infrastructure projects in developing countries, such as the European Investment Bank, The European Bank for Reconstruction and Development and the World Bank, were changing the investment strategies and priorities. Winning a piece of development projects financed for these institutions required familiarity with different rules and requirements.

In addition, competition in these foreign markets was very tough. There were tens of thousands of competitors globally, with a few giant competitors, such as Bechtel, Siemens and ABB dominating the market for large-scale projects. Even the smaller scale foreign projects financed by a major multilateral institution might have as many as 50 or more bids from various competitors. The main purchase criteria was often price, and the price often involved some long-term financing package.

Since January 1993, the average size of Progress' turnkey construction projects had shrunk considerably. Zdenek Tomecek, Progress' general director, noted to the board that the days of the 200 million Kc (US\$7 million) projects had disappeared. Now most of Progress' turnkey construction projects were in the 2 to 15 million Kc (US\$70,000 to 500,000) range. Most of these smaller turnkey construction projects were domestic, primarily small banks, car dealerships, and gas stations. Progress was the lead company in these projects, hiring several subcontractors to help do the work. The only larger domestic turnkey construction project in which Progress was involved was the renovation of a small airport terminal in Ostrava. This project was awarded to a consortium of local companies, in which Progress was a subcontractor.

Most of the turnkey work took place at the client site, and Ostrava was used mainly as a transshipment warehouse, where the various raw materials for a specific project were collected, and then put on a railcar or truck for shipment to the construction site. But changes in the scale of the projects had led to excess capacity. Consisting of four warehouses (one of which was used as a production hall), a railyard and a large transport crane, the Ostrava facility was far too large for Progress' existing needs. Progress had found some alternative uses for the space, such as leasing one of the warehouses as office space, and leasing the transport crane, but these revenues were limited.

*Ostrava Reynaers Building Products*

Sales of the Reynaers products had been better than expected. Currently the production line was operating at 30 to 50% of capacity. Management wanted to increase production by adding a second shift of workers. Domestic customers made up 90% of Reynaers revenues. Most of the domestic customers were banks, offices and retail stores. One German customer made up the remaining 10% of revenues. The high quality and technical features of the products had made it attractive to upper end customers. Broader demand, however, was limited because the product price was higher than comparable wooden or plastic substitutes.

Management in Progress believed that the Reynaers line was "slightly profitable", but also feared that shrinking margins were a possible threat. There were about 15 other Czech companies that also assembled Reynaers building products, and over 100 companies that manufactured competing wooden and plastic building products.

Progress competed against the other Reynaers producers by pricing its products slightly lower. Also, Progress avoided competition in the crowded Prague metropolitan area. Fewer direct competitors operated in northern Moravia, where Progress was based. Some foreign competitors had entered the Czech market, but almost all of these offered high-end, high-priced products that were targeted at high-end Western companies located in Prague.

Valasske Mezirici Business Unit

By October of 1993, Liebherr cranes made up 80% of production tonnage at Valasske Mezirici and 85% of revenues. The remaining 20% of production volume was classic steel structures.

Although the individual income statements had not been prepared for each business unit, the Valasske Mezirici plant manager, Konecny, had estimated that 1993 had been a profitable year for the Valasske Mezirici business unit. A 3 million Kc loss was expected in for the first quarter of 1994, and by end of 1994, Konecny predicted a 5 million Kc operating profit.

**Classic Steel Construction**

Competition in the domestic market was fierce because many private construction companies had emerged. Generally, success in this business meant keeping costs down and matching the competition's prices. But Progress competed by assembling its structures quickly, with lower installation weight, flexible production capabilities, and standardized structures.

In the last half of 1993, Valasske Mezirici received its first Western European project, the steel structure for a sports stadium in Holland. This project had turned out to be a 500,000 Kc loss for Valasske Mezirici, but Konecny regarded the loss as a training investment, claiming that it had taught a lot to Progress employees about Western construction standards and work practices.

The key lesson learned in the Holland project was that meeting the project deadline was essential. If the deadline was missed, project revenues dropped every day that the project was late.

### Valasske Mezirici Liebherr Tower Cranes

Management estimated that the Liebherr contracts had generated the most operating profits for Progress. Liebherr, impressed by the quality and reliability of Progress' crane arms, had steadily increased its order quantities throughout 1993.

The relationship with Liebherr had been strengthened thanks to a risky decision taken by management in mid 1993. Realizing that production costs were much higher in the winter months due to the temperature conditions, the management at Valasske Mezirici had devoted two full shifts to Liebherr crane production starting in the second half of 1993, despite the fact that they did not have any new orders from the German manufacturer at this time. In late 1993 Liebherr sent a new order for cranes. The gamble paid off, as Progress needed only to put the finishing touches on the those cranes begun during the warmer months. The result was that Liebherr was very impressed by the speed of delivery, and the contract was extremely profitable for Progress.

In the last quarter of 1993, Liebherr had told Progress that they expected to place even higher orders for 1994. In addition, Liebherr planned to give Progress the production specifications for the K140, a lighter, more advanced crane arm that required less raw materials and more expert labor to manufacture.

Konecny and the other managers regarded the Liebherr contract as a very good source of revenues. Although they realized the risk of committing to a single major customer, Konecny said,

*"Liebherr always pays its bills on time. And they are one of the leading producers of tower cranes in the world. This is a good way for us to profit from the construction activity in Germany, because anytime Liebherr sells a tower crane to a customer, it may have a crane arm from Progress in it."*

In the future, Konecny expected the Liebherr production tonnage to decrease, because the higher technology crane arms that he expected Liebherr to order were lighter than the basic arms and due to the seasonality in orders from Liebherr.

Company Investments

Over the past three years, Progress had invested a total of 24 million Kc in improvements in plants, equipment, and technology. Valasske Mezirici accounted for 20 million Kc of this, mainly for investment in painting and welding equipment (16 million Kc) and a welding line and other equipment (4 million Kc). In Ostrava, 4 million Kc had been invested in a new production hall and the purchase of the Reynaers production equipment.

Some of the specific 1993 investments in the Valasske Mezirici business unit were 350,000 Kc in a welding school for its employees, 90,000 Kc for a new company cafeteria, and 110,000 Kc for new cleaning jets. Konecny said that all of these investments were directly connected with improving the quality and performance of operations.

The 100 million Kc management felt it required to remain competitive covered a wide range of areas. In Valasske Mezirici, planned purchases included some advanced welding equipment, as well as some painting equipment. Konecny wanted to build a new production hall with better heating equipment, in order to enable efficient production year-round.

In Ostrava, several additional investments were planned, in order to convert production facilities that had been formerly oriented towards the export market to the needs of domestic customers. Progress felt that there were good prospects for turnkey projects in Asia, Africa and the Middle East because of the high level of construction activity in these regions. In particular, management saw opportunities in the construction of power stations, industrial complexes, and the chemical and oil industry projects, as a part of consortia with major industrial conglomerates. Planned purchases for Ostrava included new mixing machines, conveyor belts, saws and scaffolding, as well as metalworking equipment and transportation and storage facilities.

In both business units, an investment in computer systems was being planned. Although there were computers in both locations, there was no standard information system at Progress, and thus detailed analyses and comparisons were difficult to make. This investment would also be combined with an investment in building a strong sales team, to meet the sales and marketing needs of both business units.

Key financing Issues

The following options were being considered at the next board meeting:

- Debt capital. Short and medium-term bank loans were available, but most of these loans required at least 100% security in the form of real estate. In addition, prime lending rates ranged from 9 to 15%, and banks often charged up to double the prime rates, depending on the level of risk. The longest term on a commercial loan was seven years, and a five-year loan was considered a

long-term loan. Most loans were still in the two to three-year range. Petr Polak wondered whether Progress would be able to meet payment terms. What was the company's cash position and how was this cash position likely to change over the coming months? What were the cash flow implications of this option?

- A bond issue or a share issue was also being considered. There were several aspects of this option that worried Petr. A share issue would dilute ownership, among other things. There were other potential costs involved in finalizing the prospectus. Finally, given the condition of the Czech capital market, it was not clear to what extent the company would be able to raise this capital.
- Another option being considered was financial or operating leases. These were quite widely available, and the only major requirement was an initial deposit of 25-35% of the lease amount. The only major drawback to leases was the cost. For example, a typical three-year financial lease might be computed at a "leasing coefficient" of 1.30, e.g., a 100,000 Kc piece of equipment would be leased at 130,000 Kc, with 30% of the leased amount (30% x 130,000 Kc) as a deposit.

#### Agenda For the General Meeting

The main items on the agenda for the General Meeting are:

- What areas should Progress invest in? How were they connected to the long-term goals? How much should be invested?
- How would Progress finance these investments?
- What needed to be done in terms of general shareholder approval, supervisory board approval, regulatory approvals, etc.?