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CASE STUDIES

Privatization Phase I Program Evaluation:

Early Experiences of Privatization in Hungary, Poland, and the Czech and Slovak Republics

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HUNGARY

GYGV-MONTEX
Gyár- és Gépszerelő Vállalat
(FMRC - Factory and Machine Repair Company)

1132 Budapest
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Tel.: (36-1) 1327-360
FAX : (36-1) 1125-070

SUMMARY:

During January, 1992, 2,700 employees of GYGV-MONTEX (out of a total of 3,558) became owners of 82% of the company in the first successful ESOP-type buyout in Hungary. It was not the first "real" ESOP, since the law making true ESOP's possible did not become effective until July 14, 1992 (the MRP law: "Munkavállalói Résztulajdonosi Program"). The employee-owned GYGV-MONTEX ranks number 106 in Figyelő's 1992 "Top 200" list of Hungarian enterprises (up from number 193 in 1991); during 1991, the company made US$ 1,400,000 in net income on sales of US$ 70 million; it had total assets valued at US$ 15 million. GYGV-MONTEX is one of the leading companies in Hungary and Central Europe specializing in the manufacturing, erection and assembly of industrial machinery, pipelines, tanks and entire plants for the petrochemical, aluminium, paper, food, as well as the oil and gas industries.

BACKGROUND:

Since its establishment in 1952, Gyár- és Gépszerelő Vállalat built a reputation as one of the premier enterprises in Central and Eastern Europe focusing on a wide range of services related to the manufacturing, erection, assembly, testing and repair of industrial machines, pipelines and entire plants; it also specializes in the execution of special and complicated welding and lifting tasks.

Its 3,558 employees include approximately 500 qualified welders and 2,000 pipe-fitters, turbine-fitters, reactor-fitters, engine-fitters, and mechanics skilled in a variety of specialties. During the past decades, GYGV-MONTEX has been involved in one capacity or another in work at virtually every large industrial plant in Hungary, including the nuclear power plants at Paks.

In addition to its headquarters in Budapest, GYGV-MONTEX also has facilities throughout Hungary and a complete testing laboratory at Székesfehervár, equipped to conduct both destructive and non-destructive tests. At the Szekszárd training and qualifying center, GYGV-MONTEX's workers undergo instruction and qualification examinations to meet Hungarian standards as well as those of Germany (TUV-Rheiland licenses).

MARKETS:

Throughout its history, Hungary, Germany and Austria have been the most important markets for the products and services provided by GYGV-MONTEX. However, it has also completed a significant amount of work in the former Soviet Union. Additionally, GYGV-MONTEX has worked in Cuba, Mauritania, Lybia, Tunisia, Cyprus, Finland, Greece, Holland, Sweden, Bulgaria, Czechoslovakia, Poland Iraq, Syria, Kuwait, and Mongolia. Today one-fifth of its work force is employed in West European projects.

FINANCIAL AND STATISTICAL SUMMARY:

	1990	1991
Net Sales:		
(HUF million)	3,293	5,245
(US$ million)	44	70
Of which: Exports		
(HUF million)	1,721	2,716
(US$ million)	23	36
Net Income:		
(HUF million)	124	102
(US$ million)	1.7	1.4
Total Assets:		
(HUF million)	1,086	1,122
(US$ million)	14.5	15
Employees:	4,112	3,558

THE PRIVATIZATION PROCESS:

The ESOP-type privatization of GYGV-MONTEX was concluded in January, 1992, a full six months before Parliament approved the Bill on Employee Share Ownership Program ("MRP"). Therefore, GYGV, its privatization advisor, Riverside Kft, as well as the State Property Agency were exploring and testing new concepts. The following paragraphs describing some of the issues and solutions are quoted from the SPA's official publication PRIVINFO:

"The 10-year business plan prepared by Riverside sought to prove that FMRC would be capable of producing enough profits in its new form to support the local organization responsible for the smooth operation of the ESOP and repay the privatization credit.

"The privatization process was twofold. For lack of adequate legislation, the company had to develop a quasi ESOP organization, in the form of a foundation, and also had to find sources of finance for the programme.

"The share capital (based on market value) of FMRC, which was transformed into a limited liability company on December 31, 1991, amounted to HUF 800 million. In accordance with the relevant regulations, employees were entitled to a privatization allowance to the tune of 15 percent of this amount. Despite this, the company needed to take out a privatization loan. According to the conditions of the 10-year loan, however, 33 percent of the principal had to be paid upfront by the future owners of the company.

"How could this money be produced? The company and Riverside decided that, in addition to employee's payments, the State Property Agency would be asked to provide the 15 percent employee shares in cash. This was the first time that the government agreed to give cash instead of shares. The unusual solution made it possible for the company to include this amount in the founding capital of the ESOP organization, thus, a privatization credit of HUF 436 million, almost twice the original sum, could be obtained.

"The following actions had to be takent: by way of an open bid the employees purchased 50.3 percent of FMRC by paying HUF 100.6 million in cash and taking out a loan of HUF 301.8 million. Following this, the equivalent of 15 percent of the share capital provided as employee allowance (HUF 120 million) was paid into the Foundation from the capital of the company exceeding its share capital. In return, employees waived any further rights to purchase preferential employee shares. Finally, by obtaining another privatization loan of HUF 134.2 million and transferring the above HUF 120 million to the Foundation, ESOP will buy another 31.7 percent of the company's shares within the next 10 years.

"The final capital structure of the company will be the following: 14 percent of the shares will be owned by the

SPA, 82 percent by the Foundation and four percent by the local governments. The ESOP organization will be financed by the HUF 120 million supplied by the company, HUF 100.6 million paid by the employees and privatization credit of HUF 436 million."

SOURCES OF INFORMATION:

(1) Interview with Dr. Ferenc Petró, Chief Financial Officer, GYGV-MONTEX: Gyár- és Gépszerelő Vállalat. On November 18, 1992.

(2) Interview with Dr. Ferenc Vidovszky, Managing Director, Riverside Kft (ESOP privatization advisors to GYGV-MONTEX). On November 18, 1992.

(3) "PRIVINFO: Privatization in Hungary," VII/1 1992. Volume 1. Number 6.

(4) "FIGYELŐ: Gazdasági Hetilap Különszám," July 1992.

(5) Creditreform - Interinfo Kft.

METRIMPEX RT.
METRIMPEX CO. LTD.

H-1051 Budapest
Nador ut 21
Tel.: (36-1) 112-5489
FAX : (36-1) 153-4719

SUMMARY:

METRIMPEX is a traditional Hungarian foreign trading company offering a variety of products and service in Hungary and throughout the world. It has been in existence since 1956, initially to import and export measuring instruments. Today, approximately 70% of its business (by value) comes from the wholesale trading of a wide range of measuring, testing, weighing and control equipment/instruments. METRIMPEX became the first Hungarian enterprise to complete successfully an employee buy-out under the new MRP law (Munkavállalói Résztulajdonosi Program), published on June 29, 1992, and effective July 14. On October 30, in accordance with the MRP law and by completing successfully and quite rapidly a series of requirements, 321 METRIMPEX employees acquired 90% of the company's shares from the State Property Agency. The workers' bid was declared the winner out of three submitted by the August 15 deadline.

BACKGROUND:

The collapse of the eastern markets represented by the former Soviet Union has had a significant negative impact on all state-owned Hungarian foreign trade companies. METRIMPEX Foreign Trade Company (as METRIMPEX Rt. was known before its transformation into a limited liability share company on December 31, 1991) was among the most successful in reacting to this change: it expanded its business profile and product range to become more competitive in the western and third world markets; it increased the proportion of business done for its own account; and adopted a new business strategy designed to expand its domestic trading activities. The company also offers comprehensive services in the fields of warehousing, domestic and international transportation, forwarding and customs clearance; it has a warehouse center close to Ferihegy Airport in Budapest.

The new domestic expansion strategy is based on opening retail outlets throughout Hungary, establishing a nationwide wholesale distribution network, and actively searching for foreign joint venture partners interested in such an expansion.

The new export strategy has identified several products which METRIMPEX believes it can market to third world countries successfully; "education exports" are an example: the complete outfitting of third-world schools under long-term, guaranteed contracts.

METRIMPEX became a limited liability share company in December, 1991. Shortly thereafter the State Property Agency (owner of 81% of METRIMPEX shares) selected Z-LB Capital Markets through a public tender as the company's privatization advisor. By June, 1992, an information memorandum and a business plan were prepared and a systematic search for potential foreign and domestic investors was started respectively by Z-LB Capital Markets and its sister company, Bank Austria Broker Budapest Kft.

Also at this time Riverside Budapest Kft., a Hungarian consulting firm, contacted senior management at METRIMPEX to advise them of pending legislation which would enable employees to purchase majority ownership in their companies if their offer was competitive. At a presentation attended by more than 300 of the company's 470 employees, it was decided that they would bid for ownership of METRIMPEX and that Riverside would be contracted as the consulting firm to advise the workers on this employee buyout attempt. The State Property Agency designated August 15, 1992, as the deadline by which all offers had to be submitted.

FINANCIAL AND STATISTICAL SUMMARY:

INCOME STATEMENT
(HUF millions)

	1990	1991	1992(e)
Turnover	18,000	12,000	12,000 US$ 150 mill
Profit Before Taxes	864	224	153 US$ 1.9 mill
Taxes	355	91	61 US$ 762,000
Net Income	509	133	92 US$ 1.1 mill
Share Capital	518	518	777 US$ 9.7 mill

MAIN MARKETS

EXPORTS		IMPORTS	
Germany	21.54%	Germany	18.09%
Brazil	17.63%	Austria	14.81%
CIS	16.57%	Japan	10.14%
Ecuador	13.67%	CSFR	9.72%
Austria	10.78%	USA	9.01%
CSFR	10.06%	France	6.93%
Italy	1.88%	Switzerland	6.87%
Others	7.87%	UK	6.29%
		Italy	5.89%
		Others	12.25%
TOTAL:	100.00%	TOTAL:	100.00%

(SOURCE: Information Memorandum prepared by Z-LB Capital Markets, Bank Austria Gruppe).

PRIVATIZATION TIME-TABLE (1992):

* July 16: Out of 420 employees contacted by the July 16 deadline, 340 replied in writing; of these, 331 indicated a desire to participate in an employee buyout.

* July 17: The METRIMPEX Rt. MRP Organizing Committee ("MRP Szervező Bizottság") is established as required by the MRP law.

* July 20: Riverside Budapest Kft. is contracted as consultant to advise on the employee buyout process.

* August 7: METRIMPEX management and the MRP Organizing Committee complete all documentation needed for the bid.

* August 7 to 10: Commercial banks are contacted to solicit credit under the MRP "E-credit" lines.

* August 14: The MRP Organizing Committee, with management's concurrence and support, submits its buyout bid to the State Property Agency; a financing letter of support from POSTABANK ÉS TAKARÉKPÉNZTÁR Rt. is included with the bid.

* August 18: Public opening of bids at the SPA. A total of three bids are accepted and registered.

* September 23: The State Property Agency declares the METRIMPEX MRP Organizing Committee's bid the winner; the bid

is formally accepted pending proper documentation and closing.

* October 6: POSTABANK ÉS TAKARÉKPÉNZTÁR Rt. and the METRIMPEX Rt. MRP Organizing Committee execute loan documentation to finance through E-credits the employees' share acquisition. The loan is repayable over 10 years and is secured by the company shares to be acquired with the proceeds and cash down-payments.

* October 8: The State Property Agency sells 87.87% of METRIMPEX Rt. to the METRIMPEX Rt. MRP Organizing Committee.

* October 30: The METRIMPEX Rt. MRP Organizing Committee (owned by 321 METRIMPEX workers) completes all documentation required by the SPA under the MRP law and becomes 90% owner of METRIMPEX.

SOURCE OF INFORMATION:

(1) Dr. Tomolak Tivadar, President, METRIMPEX Rt.

(2) Interview with Berkes Gézáné, Assistant Financial Director, István Tompa, and Györgyi Lajtai, of METRIMPEX Rt. On November 18, 1992.

(3) Interview with Dr. Ferenc Vidovszky, Managing Director, Riverside Kft., privatization advisors to METRIMPEX Rt. On November 18, 1992.

(4) The State Property Agency, Budapest.

(5) Z-LB Capital Markets, a subsidiary of Bank Austria Gruppe, privatization advisors to METRIMPEX Rt.

(6) "Magyar Közlöny, A Magyar Köztársaság Hivatalos Lapja" (The Republic of Hungary's Official Gazette), issue number 69, June 29, 1992 (text of the MRP law).

(7) "PRIVINFO: Privatization in Hungary," Numbers 8, 9 and 10.

MMG AUTOMATIKA MŰVEK RT
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H-1037 Budapest
Szépvölgyi út 41.
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FAX : (36-1) 168-6476

SUMMARY:

MMG-Automatika is Hungary's leading manufacturer of industrial instrumentation and process control systems. Employing 2,800 workers at six major plants (including two in Budapest), MMG dominates domestic production in a number of products, with an estimated share of approximately 90% in: vehicle instruments, certain types of electronic transmitters, gas taps, and temperature regulators / limit switches.

It has a strong reputation in the former Soviet Union. Its main exports to Russia are: (1) control systems to the country's large oil and gas gathering/distribution companies; and (2) car instrument panels to the LADA car manufacturer.

MMG has successfully expanded its sales and marketing to Western markets. Today, its main exports to Europe and the United States are products manufactured to specification on contract to be marketed by the client under its own name; typical products include mass flow meters, precision castings, pneumatic components, cash register components and heat pressure sensors.

MMG illustrates many of the problems faced by most large, diversified Hungarian state-owned enterprises: the negative impact of losing virtually overnight the former Soviet Union as a major market; the difficulties of attempting to privatize as one unit an enterprise which consists of a wide range of diverse products and services; and the difficulties of staying technically up-to-date and competitive while moving through the stages of privatization over a two to three year period.

At this time MMG is actively searching for a strategic partner or investors interested in acquiring up to 100% of a high-quality, low-cost production enterprise in Central and Eastern Europe.

MMG's registered capital is HUF 2.8 billion (US$ 35 million) and 85% of the shares are owned by the State Property Agency; the additional 15% are owned by local municipalities.

BACKGROUND:

Ferenc Marx started MMG's first predecessor by establishing in 1900 a factory to manufacture instruments and control devices. This small firm grew into significant medium-sized factories under the name of Marx es Merei Tudományos Műszerek Gyára (Marx and Merei Factory for Scientific Instruments) and Marx Első Magyar Repülőműszer Gyár (Marx First Hungarian Factory for Aeroplane Instruments) respectively, by the years preceding the Second World War. During the nationalizations that followed the war, the Mechanikai Méröműszerek Gyára (MMG) Nemzeti Vállalat (National Enterprise for Manufacturing Mechanical Instruments) was established in 1948 by combining these two factories with five other small workshops. The company assumed its current official name in 1977 as a result of a major change in its range of products, with greater emphasis on electronics.

PRODUCTS:

Project engineering and the "turn-key" installation of process control and safety systems accounts for approximately one half of all revenue. The major clients for such services are the top companies in Hungary and the former Soviet Union in oil and gas production and distribution, electricity transmission, power generation, public and civil works, as well as large aluminium and petrochemical enterprises.

Additionally, MMG-AM manufactures the following products in large series:

* liquid-filled temperature controllers and temperature limiters;
* safety gas cocks;
* room temperature controllers;
* elements of pneumatic systems;
* welding equipment;
* instrument panels for cars;
* household appliances.

The following electronic devices are manufactured in small and medium series:

* electronic transmitters (pressure, differential pressure, and temperature transmitters);
* tank level meters;
* volumetric and mass flow meters;
* gas-hazard and smoke detectors;
* fire extinguishing equipment;
* flow computers;
* programmable logic controllers; and
* microprocessor-based industrial devices and remote terminal units.

FINANCIAL AND STATISTICAL SUMMARY:

	1988	1989	1990	1991	1992
Sales Volume					
(HUF million)	3,729	4,480	4,167	3,872	4,000
(US$ million)			52	49	51
Profit Before Taxes					
(HUF million)	375	322	34	146	
(US$ million)			0.4	1.8	
Permanent Capital					
(HUF million)	2,574	2,744	2,828	2,800	
(US$ million)			35	35	
Nbr. of employees	4,726	4,680	4,426	3,676	2,800

SOURCES OF INFORMATION:

(1) Interviews with Mr. Sándor Dékány, General Manager. On October 27, October 29, and November 10, 1992.

(2) Interview with Mr. György Várnai on November 10 and November 17, 1992.

(3) The State Property Agency.

ZWACK UNICUM BUDAPEST LIKŐRIPARI RT

1095 Budapest IX
Soroksári út 26.
Telephone: 36-1-133-6113
FAX: 36-1-114-1697

NOTE: TO BE USED AS A "CASE STUDY" ADDITIONAL INFORMATION NEEDS TO BE OBTAINED FROM THE COMPANY, THE STATE PROPERTY AGENCY, AND OTHER SOURCES IN BUDAPEST.

MORE DETAILED FINANCIAL INFORMATION IS CURRENTLY BEING PREPARED AND SHOULD BECOME AVAILABLE IN CONJUNCTION WITH PLANS TO TAKE THE COMPANY PUBLIC AND OFFER SHARES ON THE BUDAPEST STOCK EXCHANGE (PERHAPS AS EARLY AS MARCH, 1993).

BACKGROUND:

The Zwack Family began producing liqueurs and alcoholic beverages in Hungary more than 200 years ago and family members had continuous ownership of the plants and associated trade names until the forced nationalization in 1948. Throughout this period, their best-known product was Unicum, a liquor popular throughout Hungary and the Austro-Hungarian Empire because of its unique taste and also its alleged ability to improve digestion.

When the family left Hungary after World War II, it took with it the original (and secret) formula for making Unicum and began producing it in 1969 in Italy, marketing it world-wide under the Zwack trade name. At the same time, the Hungarian enterprise -- now called Budapesti Likőripari Vállalat (BULIV) -- continued to make a version of Unicum for the domestic market, eventually reaching an annual production of three million liters; according to Peter Zwack, at one point the production of Unicum by the Hungarian state monopoly represented 4% of its annual liquor production and 25% of its revenues. BULIV was unable to market Unicum legally in the Western and other markets where the Zwack Family owned the rights to the trade name.

On July 10, 1989, BULIV and Peter Zwack Consorten AG reached an agreement to form a joint venture called Zwack Unicum Budapest Kft., which began the production of the original liquor in Hungary at the Budapest factory and made possible its marketing world-wide under the Unicum name.

In 1991 the State Property Agency began the process of privatizing the company. By September, 1991, United Distillers and Peter Zwack were vying for ownership of the company in a bidding war that was followed with great interest in the Hungarian press.

In December the SPA declared the Zwack bid the winner and sold the majority of the state-owned shares to the Zwack consortium. At this point, the company plans to go public during the first half of 1993.

RESULTS FOLLOWING PRIVATIZATION:

* Within two months of privatization, the new owners replaced the entire senior management with a group of young, Hungarian managers.

* The total number of employees was reduced from 1,300 to 900.

* Salaries and wages were increased by approximately 25 %.

* Five to six of the 14 plants are being sold, concentrating production on the fewer, remaining facilities.

* A sales force was created by hiring and training for this purpose 45 persons; all are university graduates who speak at least one foreign language (typically German or English); part of their incentive package is use of a new FORD car.

* The number of different products made was reduced from 220 to 60.

* The quality of the lower-priced products was improved to offer "the best quality for the money."

* The company participates visibly in a number of community activities (among others through an anti-drug foundation, the sponsorship of educational programs and of projects to improve the environment).

* Financial results: with fewer products and fewer people, the company increased revenues to US$ 120 million during the year ending December 31, 1991. According to Peter Zwack, the 1992 results will show a further improvement.

SOURCES OF INFORMATION:

(1) Interview with Peter Zwack, principal and chief operating officer, Zwack Unicum Budapest Rt. On November 11, 1992.

(2) Creditreform-Interinfo Kft.

PETŐFI NYOMDA RT
PETŐFI PRINTING COMPANY CO. LTD.

H-6000 Kecskemét
Külső - Szegedi út 6.
Tel.: (36-76) 328-777
FAX : (36-76) 328-294

SUMMARY:

With beginnings in 1841, Petőfi Printing today is generally recognized as the leading packaging and printing company in Hungary. Its privatization began September, 1990, when it became a limited liability share company; during the first half of 1991 Petőfi became fully privatized when three additional private share-holders bought into the company and increased its capital. The company employs 580 persons in Kecskemét and dominates the key folding cartons, flexible-wall packaging and conventional label markets. Since its privatization, Petőfi has shown an impressive series of positive results: significant increases in sales (including exports), income, productivity, average salary, and value of business. On annual sales of approximately US$ 39 million in 1991 the company has shown after-tax profits of US$ 3.5 million; 38% of 1991 sales came from exports. In 1991 Petőfi was valued at US$ 36 million.

BACKGROUND:

For much of its 150-year history Petőfi Printing House and its predecessor Károly Szilády Printing Institute focused on the production of conventional newsprint, magazines and books. In 1968 its product line was expanded to include the production and printing of labels and folding cartons.

The company's privatization began in 1990 when 50% of its common shares were sold by the State Property Agency to Compagnie Financière pour l'Europe Centrale; COFINEC was established in Paris in 1989 for the purpose of making industrial investments in Central Europe. By the summer of 1991 the Hungarian - American Enterprise Fund (HAEF) and two other investment funds had also purchased Petőfi shares; at February 20, 1992, Petőfi's shareholders were:

	Common Stock (%)	Preferred Stock (%)
COFINEC S.A.	50.77	42.98
The First Hungary Fund (FHF)	16.36	14.04
The Hungarian Investment Company Ltd (HICL)	10.22	8.74
The Hungarian - American Enterprise Fund (HAEF)	10.16	8.60
ESOP & MSOP	7.15	6.73
K & H Bank	5.11	4.73
Other	0.23	14.18
TOTAL	100.00	100.00

FHF was the first investment fund established in late 1989 to make investments in Hungary. The fund's paid-in capital totals US$ 80 million and among its most important owners are the National Bank of Hungary and the International Finance Corporation.

HICL (the John Govett Fund) is a publicly-owned UK fund traded on the International Stock Exchange in London with paid-in capital of US4 100 million.

HAEF is a private US corporation funded in 1990 under the United States Support for Eastern European Democracy (SEED) program.

ESOP (the Employee Share Ownership Program) is a trust established in 1990 and funded by COFINEC S.A. to hold the ordinary voting shares of the company which were issued at privatization for the benefit of Petofi's employees.

MSOP (the Management Share Option Program) was established in 1992 based on HUF 60 million (US$ 750 thousand), five per cent priority-dividend non-voting ordinary shares of the company. Options to purchase the shares will be granted to management as part of their remuneration package. Funded by current shareholders, it is the first MSOP of its kind in Hungary.

K & H Bank (Kereskedelmi Bank Ltd.) is a Hungarian government-owned commercial bank. It is one of the largest lenders to Hungarian industry and commerce and has provided long-term loans to Petőfi.

The other shareholders are local government councils in Kecskemét, Szarvas, Baja, Kiskunmajsa and Lajosmizse, locations where the company has or used to have operations.

PRODUCTS:

Petőfi's product mix and emphasis was changed significantly as a result of the company's privatization. Folding cartons is by far the most important product, having provided 45.1% of sales by value during the year ending December 31, 1991. The four major product categories are:

Folding Cartons: despite a decline in industry demand, sales of folding cartons grew 31% during the first year after privatization. Among the more than 140 customers are GE Tungsram, McDonald's, Master Foods and Henkel. The infusion of new equity, a DM 10 million industrial loan from the European Bank for Reconstruction and Development (EBRD) and the ability to raise capital from Western capital markets has enabled Petőfi to upgrade its equipment and to reach and maintain the highest quality standards. Petőfi has ordered a Bobst Champlain Lemanic 820 eight-color, on-line printing and die-cutting machine -- the only machine of its kind in Europe -- to be used in the production of flip-top cigarette cartons and fast-food packaging.

Flexible-wall Packaging: this was the fastest growing product division in 1990/1991, with sales increasing by 47.8% (to US$ 4.5 million). Major packaging materials used include paper/polyethylene laminates (for chocolate), paper/aluminium foil laminates (for coffee beans), and polyester/polyethylene/aluminium foil laminates (used in vacuum-packed coffee and instant drinks packaging). The availibility of funds to purchase modern equipment has been a major factor in attracting new customers; the division increased its in-house capacity through the purchase of a horizontal, dry-mounting, flexible-wall packaging laminator (made possible by the EBRD industrial loan).

Labels: accounted for 27% of sales. As a result of the significant decline in trade with the former Soviet Union, the self-adhesive label market has been stagnant during the past 18 months; nevertheless a greater emphasis on marketing and sales resulted in a 37% increase (to US$ 5.1 million) in sales over the previous year. Among the 625 customers are GE Tungsram, PepsiCo, and Shell. The division's printing capacity will be increased by the acquisition of a new

Gallus self-adhesive labels printing press and of a high precision blade grinder and Atlas label cutting line.

Conventional Printed Products: range from telephone books for Germany to newspapers, magazines, leaflets and Hungarian grade school textbooks.

FINANCIAL AND STATISTICAL SUMMARY:

The calendar year ending December 31, 1991, is the first year for which Petőfi prepared audited financial statements in accordance with international accounting standards. The following is a summary (based on data from the HAEF and the Petőfi's 1991 Annual Report):

	1990	1991
Sales	US$ 32.0 Mil	US$ 39.0 Mil
Gross Profit		US$ 9.2 Mil
After Tax Profit		US$ 3.5 Mil
Value of Business	US$ 15.4 Mil	US$ 36.0 Mil
Exports (% of total revenue)	8%	38%
Employees working at free market standards	905 (?)	612
Productivity (HUF sales/employees)	2,701,000	4,854,000
Average salary increase	47%	63%

ISSUES RELATED TO PRIVATIZATION:

* The positive impact of knowing who is the company's owner and what are the company's objectives and goals.

* Positive financial consequences: Petőfi's capital doubled during the past two years; significant increases in revenue and profits (primarily due to increased market share and focus on profitable lines of business); computerized financial monitoring and control systems; ability to negotiate 20% discounts on capital equipment purchases from the West; ability to raise capital from the Western capital markets; major new sources of cash, such as the industrial loan from EBRD.

* Market/customer oriented organization: ability to quote prices within 24 hours; "just in time" delivery; use of consignment warehouse; training programs to emphasize customer service.

* Ability of managment and shareholders to make rapid decisions.

* Ability to acquire and to maintain state-of-the-art technology: have made significant investments in new equipment, computers, plant and other facilities.

* Positive impact of newly-introduced employee incentives: salaries have been tripled; employee share ownership program (ESOP); management share option program (MSOP); wide-spread profit-related bonuses for achieving operating and profit targets; frequent training (technical, management, foreign languages) at all levels.

SOURCES OF INFORMATION:

(1) Interview with Mr. Peter Grace, Chief Financial Officer and Director, Petőfi Printing Co. Ltd., Kecskemét. On November 13, 1992.

(2) Interview with Mr. Andrew W. Kosztyo, the Hungarian - American Enterprise Fund, Budapest. On November 9, 1992.

(3) 1991 Annual Report, Petőfi Printing Co. Ltd.

(4) Second Annual Report, Hungarian - American Enterprise Fund.

POLAND

THE GDAŃSK INSTITUTE FOR MARKET ECONOMICS

JAN SZOMBURG

PRIVATIZATION IN POLAND
THE CASE OF THE "CHEMIA" COMPANY

Method of Privatization:
Leasing
(Management and Employee Buy-Out)

Paper prepared for the project financed by the USAID
"Lessons Learned from Central European Privatization"

GDAŃSK, DECEMBER 1992

"Chemia" Chemicals Trading Co.Ltd.

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A wholesale trading company (75% of sales) involved as well in retail trading (25% of sales) of chemicals (paints, lacquers, plastic goods etc.). Caters to the needs of the local and regional markets (its market share amounts to some 3%). Employs 130 persons. Located in the downtown area of Gdańsk, it has a subsidiary in Elbląg. The fixed assets comprise i.a. an administrative building, 3 stores and 5 retail shops.

In October 1991 the "Chemia" company took over the whole state enterprise having the same name ("Chemia" State Enterprise) into a 10 year financial lease.

A. The Essence of Privatization Leasing

According to the Pclish law on privatization (Art.37 item 1 para.3) there is a possibility to privatize state enterprises via letting them on a contractual basis to a company that has to fulfill two conditions. First, it has to be a company established by at least 51% of the overall number of employees of a given enterprise that is to be privatized. It means that to that enterprise, often called "employees' company"- private external investors (from outside the "basic"enterprise) may adhere, and that they may practically invest practically any amount of initial equity capital - law does not impose any constraint here. Secondly, the company has to raise at least the equivalent of 20% of needed funds - something like equity capital of a company - of the state enterprise that is to be leased. After fulfilling those two conditions such a newly created company (a limited liability or a joint stock company) may take over the whole enterprise or its isolated part for a long term lease. Two options are available: either a pure (operational) leasing (operational leasing meaning that only the running expenses are being covered) or a financial leasing, where the capital is being repaid in subsequent instalments. In this latter case the enterprise becomes automatically the property of the employees' company upon termination of the term of the lease.

B. The History of the Transformation

1. The Situation of the Enterprise Prior to the Transformation

At the beginning of the Balcerowicz reform (1.01.1990) the "Chemia" State Enterprise (founded in 1945) had two storage buildings, two shops , an administration building and a subsidiary in Elbląg. It was involved in wholesale trading (90% of sales turnover) and in retail trading (10% of sales turnover). 80% of sales were made to state enterprises and the remaining 20% of sales were directed towards private customers. The Gdańsk and Elbląg voivodships consituted the area covered by the company's activities.

The financial condition of the company was good. The enterprise was not indebted and did not have problems in attaining sufficient level of profitability. In 1993, when sales amounted to 93 bln zloties the gross profit before interest and taxes amounted to 17.4 bln zloties and net profit amounted to 8.7 bln zloties. At the beginning of 1990 the enterprise employed 170 persons.

After elimination of the shortage economy thanks to the Balcerowicz plan the market condition of the enterprise changed - the company had to face more competition - new private competitors entered the market[1], besides that the

[1] E.g. the "Metalzbyt" and "Elmet" companies which until then did not trade in chemical goods at all.

customers became more discriminating. Some pressure on cost rationalization has also been felt.

Adjustments to new environment have been undertaken under conditions of state ownership. "Chemia" is a good example of possibility of attaining substantial performance improvements even under state ownership if the enterprise is relatively small and the management team is strong enough. The number of employees was reduced from 170 to 120 in 1990 already. The organizational structure of the enterprise was quite rapidly rationalized, a number of cells was liquidated and consolidated so that the organizational structure became flatter and a number (a half) of middle management positions were eliminated. The sales systems were also streamlined; i.a. direct sales from stores were introduced, price policies became more flexible, advertising was made more lively etc. All these changes were initiated by the general manager, who, under conditions of small character of the enterprise managed to persuade both the trade unions and the employee council to adopt them without much hassle. "Chemia" was then, in spite of the state character of ownership, an enterprise with a strong, concentrated leadership.

2. Initiators of Privatization and Motives For It.

The actual initiator and promoter of privatization was the manager of the company, who quickly gained support for the idea from the Employee Council as well as from the "Solidarność" Trade Union. The factors that motivated the director was the game for ownership and his want to retain control. The game for ownership was further stimulated by the fact that there was no great amount of property involved and the enterprise was in a good financial condition. It created a favourable situation at the start for the so-called internal buy-out, where payment would have been realized from future profits. On the other hand - because of the central location of the enterprise in Gdańsk downtown area - there was a danger of external buy-out and resulting loss of control. These motivating factors - related somewhat individually to the person of the general manager - were complemented by several factors related to the whole enterprise:

- elimination of tax called a "dividend",
- elimination of tax blocking the wage increases (tax on excessive wage payments and possibility of wage increases related to it).

The idea of the game for ownership and possibility of raising wages was taken by the whole staff. In 1990 a Privatization Commission was organized in the enterprise, led by the Chairman of the Employee Council (a woman). This Commission was given the task to prepare the idea of privatization.

3. Selection of the Privatization Procedure

The procedure of privatization was selected formally by a referendum, in which the whole staff of the company took part. Actually the selection was determined by the following factors:

- relatively favourable financial condition of the company and favourable assessment of its future, including its ability to pay the leasing instalments covering both the current expenses as well as the capital charges,
- reluctance to let the management of the company be taken by some unknown external investor,
- lack of debts and substantial investment or modernization needs,
- wish to take part in the game for ownership (aspirations) of nearly the whole staff.
- optimistic assessment of capability to accumulate the initial equity capital of the "employee company" by the insiders themselves; it was to amount to an equivalent of 20% of the value of equity capital of the "basic" enterprise.

The form of leasing was definitely preferred. There was an argument about the amount of individual contributions to the employee company. At the beginning part of the staff wanted to make the shares equal for all. The general manager's intention was to make it possible to differentiate the value of shares so that he could assure more influence for himself (concentration of votes during the general assembly of shareholders). His opinion was supported by the Ministry of Ownership Changes which also opted for the adoption of differentiated shares approach and did not favour the idea of egalitarian distribution of votes in the employee company. The argument ended up in a consensus that the value of shares may be differentiated. Training played an important role in achieving that consensus: all the staff members took part in four sessions of training on privatization.

4. Timing

- 18th December 1990	- establishment of an employee company, that was to lease the whole property of the "Chemia" State Enterprise.
- 28th April 1991	- motion of the Employee Council to the Gdańsk Voivode (governor) being the founding organ to liquidate the "Chemia" State Enterprise and lease it for a predetermined period to an employees' company.
- 2nd July 1991	- the Gdańsk Voivode nominates a preparatory team that has to prepare a privatization decision.
- 12th September 1991	- increase of the amount of equity capital of the employees' company to 5,480 mln zloties.
- 30th September 1991	- Gdańsk Voivode's decision letting the enterprise be leased to the employees' company.

5. Ownership structure in the Employees' Company

The company, which had to lease the property of the "Chemia" State Enterprise was established on 18th December 1990. 98% of the empoloyees (97 persons) joined it.At the moment of creation the company its equity capital amounted to 1,085 mln zloties and was divided into 1085 shares valued 1 mln each.

The structure of ownership looked as follows:

TABLE NO.1

No of shareholders	Value of portfolio	% share of portfolio value in the total value of shares
85	10	0.92
5	15	1.38
6	20	1.84
1	40	3.69

After the registration the company was somewhat suspended until the moment when the privatization procedure was sufficiently advanced. In September 1991 the equity capital of the company was increased to the 20% threshold mentioned above so that the leasing privatization requirement could be met. After that the equity capital of the company amounted to 5,480 mln zloties and was divided into 548 equal shares valued at 10 mln zl each.

The present structure of ownership looks in the following way:

TABLE NO 2

No.of shareholders	No of shares owned by an indiv.shareh.	% of stock in the total no.of shares
3	1	0.18
2	2	0.36
20	3	0.35
30	3	0.55
12	5	0.91
8	6	1.09
3	7	1.28
6	8	1.46
1	9	1.64
1	10	1.82
2	11	2.01
1	12	2.19
2	16	2.92
2	18	3.28
1	25	4.56
1	38	6.93

The distribution of voting rights is indentical since one voting right is assigned to one share.

The largest portfolio of shares (7%) is in the hands of the general manager. The first six largest shareholders are in the possession of some 24% of voting rights.

In the charter of the company it was written down that if shares were to be sold, the remaining shareholders would have priority rights in buying them out. The price of the shares offered for sale would be determined by a tender organized among the shareholders during the general assembly of shareholders. The shareholders, who would cease to work in the company would not have the obligation to sell their shares. The founders of the company were also given the exclusive right to take over the shares created thanks to the increase of the initial equity capital of the company. This right may be excercised in proportion to the shares owned at the moment of registration of the company.

In November 1992 73% of the employees were shareholders of the company. The relative decrease of the number of shareholders in the total number of employees results from the increased employment during the last six months.

In a rather particular way the problem of financing the shares of the employees in the company was resolved. The initial equity capital was financed from individual savings of particular employees. The value of one share (1 mln zl) amounted then to some 60% of the average wage prevailing in the whole country. In September 1991, when the increase of the initial share capital became necessary, the value of one share was 10 mln zl, i.e. four times the value of the average monthly wage. The majority of the employed could not afford such an expense.

This problem was solved in the following way. When the net profit (profit after taxes) for 1990 was divided, 4 bln zloties were transferred to the account of the Foundation for Social and Economic Initiatives. Then this Foundation concluded with each shareholder of the company a civil law contract lending him a 6 years lasting no-load loan for increasing the capital. The repayment of the loan is being made via the intermediary of the company, which charges the wage payments with preset amounts and transfers them to the account of the Foundation. The whole procedure may be considered as somewhat illegal but it proved to be practically efficient. Then in reality not only the gradual repayment of the leasing charges will be made from internal cash income of the company but also 75% of the initial equity capital of the new company will be financed this way.

6. The Distribution of Power in the Employees' Company.

The decision making powers in the employees' company are distributed among the following bodies: the Managing Board, The Supervisory Board and the Shareholders'Assembly. The Managing Board of the company is composed of a single person - the general manager. Such a situation means concentration of power in comparison with the former arrangement[2].The general manager of the company is nominated by the Shareholders' Assembly, in practice it means direct election by the employees. Formerly - in the state enterprise situation - the general manager was appointed by the Employees' Council, i.e. indirectly by the employees. Both changes mean strengthening of the position of the CEO. The Supervisory Board is made of 5 persons nominated to that position for 3 years by the Shareholders'Assembly. It is like an equivalent of the Employees' Council in the state Enterprise. Yet its decision making powers defined by the Commercial Code and the charter of the company are much constrained. Its competences are limited to the right to determine the remuneration of the members of the managing board. Besides that it has supervisory functions, evaluates the annual balance sheet and the profit and loss account, gives opinion about annual reports of the managing board and its suggestions concerning the distribution of profits. The Shareholders' Assembly, which is in this particular situation the equivalent of the General Assembly of Employees of the state enterprise, has quite a few decision making powers, including i.a.:

- decisions about selling or buying real property,
- giving or denying consent to sell or to pledge the shares of the company.

7.Rules of Privatization (Leasing)

On 30th September 1991 the Gdańsk Voivode, in his role

[2]In the "Chemia" State Enterprise the management of the company was composed of the general manager and his four deputy managers.

of the so-called state founding organ liquidated the "Chemia" State Company and leased the entire property ofthat enterprise to the Employees' Company bearing the same name. The value of the property was assessed on the basis of experts' opinions and negotiations - it had been assumed that it amounted to 29,428 mln zl. The new company took over all the rights and duties of the liquidated enterprise. It took over all liabilities resulting from employment contracts concluded before the liquidation. The employees of the liquidated company became automatically the employees of the new company.

The period of duration of the leasing contract was set for 10 years. During the realization of the contract the company would pay to the State Treasury the capital instalments and the so-called additional fee. The value of capital instalments amounts to 2,943 mln zloties per annum; it was determined by dividing the total value of leased property by 10 years. Additional fees were a result of calculating interest on the sum of capital instalments due equal to 3/4 of the basic lending rate used by the National Bank of Poland while granting loans to other banks[3]. Both the capital instalments and additional fees are paid on a quarterly basis. During the first year the company has the right to pay only 1/3 of the aditional fee and in the second year only 1/2 of the additional fee due. Payments credited in such a way have to be paid in the third year of activity. Actual amounts of payments due in subsequent years are presented in the following table.

[3]It is a rule generally applied in privatization leasing cases.

TABLE NO.3

Capital Instalments and Addtitional Fees of the "Chemia" Company Paid to the State Treasury on the Base of the Leasing Contract in the Years 1992-2001

Year	Capital Instalm.	Debt at the begin. of the Year	Addition. Fee	Addition. Fee with Allowance	Total Amount due with Allow. deduct.	Debt result from addit. fee
1992	2,943	29,428	8,497	2,828	5,771	5,669
1993	2,943	26,486	7,615	3,807	6,750	3,807
1994	2,943	23,543	6,732	-	9,675[4]	
1995	2,943	20,600	5,849	-	8,792	
1996	2,943	17,657	4,966	-	7,908	
1997	2,943	14,714	4,083	-	7,026	
1998	2,943	11,771	3,200	-	6,143	
1999	2,943	8,828	2,317	-	5,260	
2000	2,943	5,883	1,434	-	4,377	
2001	2,943	2,943	552	-	3,495	
1992-2001	29,428		45,246	-	65,198	9,476

According to the leasing contract, the company has the right to sell movable goods as well as to let the parts of the property to other persons for use and to charge them with contractual liabilities. The sale of real property by the company during the leasing period is not allowed. The Company may dissolve the contract earlier but it will not have the right to claim the capital instalments paid until that date. On the other hand the company may pay the dues earlier and then it would sooner acquire full ownership rights.

[4]To this amount the allowances from the additional fee charged for two initial years are added. At the beginning of 1993 new legislation will be adopted, allowing to distribute those payments more equally during several subsequent years.

B. THE COMPANY'S PERFORMANCE AFTER THE TRANSFORMATION

1. Management of the Company

The function of the Managing Board of the Company is fulfilled by the former general manager of the former state enterprise who executes a very strong leadership position. It is a very gifted person , in the sense of technically perceived managerial capabilities as well as in the sense of being capable to persuade others to his ideas. Thus the company is practically controlled by a single individual, whose involvement has a definitely long-term character. It results in high level of performance and taking care of the future of the company. The CEO managed to persuade the other shareholders not to distribute dividends (profits) during the first three years of activity. It is obvious that the general manager has fully bound all his material interests with the interests of the company and apart from control resulting from his authority he would like to cumulate his shares and gradually, without arousing any conflicts, create a controlling portfolio of shares. In spite of his having only 7% of shares it should not be expected that he would like to exploit the enterprise in the interests of some other, fully owned business functioning "beside" the employees' company - as it is sometimes the case. His strong position is for him a guarantee that his long term strategy of acquiring the company will find a successful conclusion.

The Supervisory Board is composed exclusively from the employees (shareholders), its members are the members of the middle management. Four members of that team used to be the members of the Employees' Council. The Chairman of the Supervisory Council used to be the president of the Enterprise's Commission of the "Solidarność" Trade Union. It is an expression of consistency of goals and intentions of the elites of the company, it is as well an expression of personal continuation in the management sphere. The Supervisory Council usually represents the interests of the shareholders - the employees rather than some particular interests of one of its groups. It does not form, however, any threat to the leadership position of the CEO.

In the area of organization and management the former directions of change were continued after the transformation. The organizational structure was made even flatter and simpler. The internal cost accounting system was thoroughly reformed and the whole company was computerized.

2. Overall Financial Condition of the Company

After privatization the company shows good performance in the area of financial results, presented in the following table:

TABLE NO.4

	1st quarter 1992	2nd quarter 1992	3rd quarter 1992
1. Sales (bln zl)	39.41	50.57	60.15
2. Operating cost (bn zl)	37.92	47.06	55.12
3. Gross profit	1.52	3.54	5.10
4. Net profit	0.90	2.14	3.06
5. Gross Profit Ratio (3:2)	4.0%	7.0%	8.5%
6. Current Liquidity Ratio	5.74	4.55	5.35
7. Net Profitability of Sales Ratio	2.3%	4.2%	5.2%

The improvement of net profitability of sales was i.a. due to introduction of sales costs reducing measures (rationalization of energy consumption, transportation and use of materials etc.). The company uses the same margin on costs (10%). According to the rules used until now the company would have to face a finacial crisis in 1994 (third year of leasing) when on one hand it would not have any allowances in payment of the additional fee and on the other hand it would have to pay cumulated allowances from the first two years (total charge would amount to some 19.15 bln zl). Such crises were seen in a number of other such employees' companies - that is why a modification of the resolution of the Minister of Finance is expected, according to it it would be possible to pay the allowances from the first two years of the leasing contract (without interest accrued) not in one year but in five years. Taking all this into consideration one may expect that the company will be able to meet its financial obligations to the State. However, the possibility of making investments from its own retained profits will be very limited. It will also be very difficult to take credit for potential investment since the company, being until the termination of the leasing contract not an owner of the property of the enterprise will not be able to use it as a collateral (mortgage). Thus in the present situation the company does not have chances for any radical development or expansion of activities (like, e.g. undertaking some production activity). It may only try to improve its commercial activities realized until now. The only way allowing for a major expansion would be to sell the whole company to some large external investor: it would allow to radically increase the initial equity capital of the company and to stregthen it from an external source.

3. Investments

Since the moment of transformation the company spent 2.4 bln zloties on investments. All these expenditures were covered from retained profits. The company opened three new retail outlets (including two in new cities) having an attractive, modern appearance. The shops used till now were also modernized and redecorated. To improve the level of services offered to customers and to rationalize the costs three new trucks were bought. The company has also acquired and installed computer hardware and software to fully computerize its activities.

4. Sales

The company does not change the profile of its activity, it only expands the area of its coverage (new cities included in the sales network) and enriches the assortment of goods sold. The wholesale turnover amounts to 75% of total activities. The company became a representative of several domestic and one foreign manufacturing companies. The marketing and promotional activities were largely strengthened. The product line of the company includes domestic and imported goods, the latter ones are imported by the company itself.

5. Employment

After group redundancies and rationalization of employment undertaken still before the privatization process was initiated, the present employment is stable with a slight increasing tendency related to starting of new commercial outlets. The total number of employees at the end of subsequent quarters of 1992 amounted to :

1st quarter - 124 persons
2nd quarter - 126 persons
3rd quarter - 130 persons

Thanks to the better use of time and internal transfers between jobs the working time of commercial outlets was extended without the need to employ more staff.

6. Wages and Salaries

The privatization process had a profound impact on wages. Within two months after the privatization had taken place the wages were increased by some 30-40%. At the same time the rules of remuneration of employees were changed. The wage system was largely simplified - instead of some 17 elements influencing the wage calculations only 6 were retained. Much importance is attached to motivational elements (so-called motivation award), related to current results of the company (in particular with the amount of profit earned) and individual achievements. Larger differentiation of wages can be noted. Pay increases for the management team were related to the organizational changes: assignment of larger competences and larger scope of responsibility. The basic salary of the CEO amounts to 400% of the average pay in the company. His motivational award amounts to 100% of that pay depending on the realization of financial ratios defined by the General Assembly of Shareholders. The CEO's remuneration has improved most remarkably thanks to the privatization. The remuneration of the members of the Supervisory Board is rather low and are not related to the financial results of the company.

The average net wage in the Company was the following:

- before privatization: 1st half 1991 - 2,700 thous.zl.
- after privatization: 1st quart.1992 - 3,500 thous.zl
  2nd quart.1992 - 4,403 thous zl
  3rd quart.1992 - 4,262 thous.zl

The level of earnings in the company is nearly two times higher than in average in the national economy, where, e.g. in the first half 1992 the net wage amounted to some 2,263 thous.zl.

Thanks to privatization - in spite of considerable pay increases the Company did not have to pay the so-called tax on excessive wage increases in 1992 - in 1990 it amounted to 1.6 bln zl and in 1991 (until September) - to 2.8 bln zl.

C.CONCLUSIONS

1.The example of the "Chemia" company shows how great, positive role plays - in particular in smaller enterprises - good, strong management. The enterprise was able to undertake the process of adaptation and rationalization of its activities still working as a state enterprise.

2.This example exposes the strength of motivational aspirations of the management and the employees (the "insiders" of the enterprise). Nearly 100% of the whole staff joined the Employees'Company.

3. The privatization leasing exposes, on the example of the "Chemia" company, its strengths and weaknesses. It is a formula for a relatively conflictless privatization divided into subsequent stages. This formula proves to be well suited only to enterprises which are in a relatively good condition, that do not need major modernization investments or expansion, that do not have large debts and which have good perspectives of survival in a market environment and to generate positive cash flows. The weakness of that formula is that it does not create favourable conditons for

expansion or major changes of production line. The employee companies have as a rule a weak capital base and have difficult access to the investment credit markets since they are not owners of the property that they use.

4.The analyzed case is, generally speaking, a sucess story. The activities of the company are being constantly improved. No social conflicts are identified in the company. The level of identification with the mission of the company among the employees shareholders has radically improved. The wages are nearly two times higher than in the national economy in general. The financial condition of the company is good. Leasing seems then to be an adequate form of privatization of the commercial sphere.

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PRIVATIZATION IN POLAND
CASE STUDY OF "TRANSBUD"

Method of privatization:
"Liquidation through bankruptcy"
Sales of assets

paper prepared for the project being financed by USAID
"Lessons Learned from Central European Privatization"

Warsaw, November 1992

"TRANSBUD"

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"Transbud", a state-owned enterprise, went into liquidation on April 1, 1992 (by force of the law on state-owned enterprises). Liquidation proceedings are to be completed by the end of 1992. The enterprise in question operated in the transport sector rendering transportation services for construction companies.

1. SITUATION PRIOR TO LIQUIDATION

The enterprise was established in the 1960s. Before 1991 it owned two subsidiaries in small towns near Olsztyn, two representation offices abroad (in the former USSR and Czecho-Slovakia) and three large repair-and-construction depots. During its hey-day (in the mid-1970s) it had an employment of some 2,500. It was one of biggest transportation companies in the region.

Until 1990 the firm fared relatively well and did not complain about its financial standing or lack of orders. At that time, however, it had to deal with problems posed by the equipment it operated. By the force of decisions made by central authorities, the enterprise was equipped mostly with Soviet- Czech- and Polish-made trucks. In 1990 most of them were already heavily used and uneconomical. Towards the end of the 1980s efforts were made to modernize the equipment, however, no sufficient financial means were raised.

At the moment of launching systemic changes in the economy (the beginning of 1990), the firm enjoyed a relatively favorable economic condition (see: Table 1). Its package of orders guaranteed its operation for at least half a year. Nevertheless, a decision was made to dismiss almost 20 percent of employees due to falling demand and gradual scrapping of the equipment. At the end of the first half of 1990 first financial difficulties became apparent (lack of means for payment of obligatory dividend, i.e. a specific tax on capital levied exclusively on state-owned enterprises).

It was not until autumn of 1990 that "Transbud" ran into real difficulties. Overall recession that also affected construction, led to a collapse of the transportation market (a decline in demand by almost 50 percent). Moreover, the market was entered by small, viable, private transport firms offering their services at substantially lower prices and successfully depriving state-owned giants of their customers. In view of all that "Transbud" was losing the market, ran into financial difficulties (an account loss was reported in the second half of 1990) and continued to lay off its employees. The enterprise's management did not go for any adjustment measures, hoping that the government would revise its economic policy or that the market situation would return to its former state. A number of "tensions" was reported between the employees pressing for a wage rise and the management pointing to a difficult situation of the firm. It seems that neither of them did realize how difficult the situation really was at that time.

In autumn 1990, in view of mounting economic troubles, the employees and the management attempted to start privatization of the firm. However, no coherent conception of an ownership transformation was prepared and due to a disastrously poor economic performance in the fourth quarter of 1990 all the activities in this field were discontinued.

In the late 1990 and early 1991 the firm virtually seized its operation (as a result of seasonal fluctuations in construction and further decline in demand for transportation services). At that time capacity utilization in the firm was not more than 10 percent and its financial revenues were quite marginal as they covered only some 20 percent of its operation costs. At the same time (January 1991), the company employment was reduced by some 20 percent. There were disputes between employees demanding job safety and implementation of better-pay promises and the management that clearly had no ideas of how to rescue the firm.

In view of the above, in February 1991 the enterprise director filed with the Ministry of Privatization (Ministry of Ownership Transformations) an application for starting liquidation proceedings "due to lack of opportunities for the enterprise's operation and lack of any development prospects". The application was consulted neither with trade unions not with the employee council. Those bodies were only notified about its filing and they did not oppose it.

2. LIQUIDATION PROCEEDINGS

In March 1991 the Ministry of Privatization gave its consent for the enterprise liquidation due to its bad financial standing (bankruptcy liquidation by force of the law on state-owned enterprises). A version of liquidation proceedings was chosen that provided for a sale of all or some of the firm's assets. The ultimate decision on liquidation was made by the Olsztyn province governor (the founding body) in April 1991. The liquidation was to be completed by the end of June 1992. At the same time, the province governor appointed the enterprise director its liquidator.

Hence, the "Transbud" enterprise in Olsztyn became one of the first companies to be liquidated due to their poor financial standing. It was the first transport enterprise to take up this liquidation formula. Many other enterprises (mostly in the transport sector) followed its example and learned from its experience.

Shortly after the governor had made his decision an appraisal of "Transbud's" assets began. A hired consulting company estimated their value at 27 billion zlotys, i.e. some $ 2.4 million (the book value of the firm amounted at that time to 30 billion zlotys, i.e. some $ 2.6 million). Consulting costs reached 80 million zlotys and preparation costs for the whole liquidation proceedings amounted to almost 200 zlotys, which means that the latter did not exceed 1 percent of the estimated value of the firm's assets.

Problems Encountered During the Liquidation Period

Liquidation proceedings started with preparing an inventory of the firm's assets. The main problem that emerged at that time concerned lack of clearly defined ownership rights to land and grounds used by "Transbud". This was a consequence of negligence made many years ago in a result of which the firm got no documents stating its right to this real estate. Following many many interventions and legal actions, taking up almost 3 months, appropriate certificates were finally issued. The problem of unspecified ownership status of land used by state-owned enterprises was at that time quite common and it delayed ownership transformation processes in most of them.

Anther problem that impaired liquidation proceedings in the enterprise was posed by poor financial liquidity of the firm (7 billion zlotys worth of overdue receivable amounts). This added to difficulties with employment reduction (lack of means for remuneration and severance pay) and increased the costs of this process. Severance pay (3 to 6 times worth of a monthly pay for dismissed employees) was paid out only after financial means had been acquired from the sale of assets.

A rather surprising difficulty was involved with inefficient work of the notary public institution. It took more than two months to get necessary acts and, consequently, delayed the preparatory stage of liquidation. This was a problem faced by a majority of liquidated firms. Notaries found themselves unprepared in terms of both their competence and organization for coping with new tasks arising from ownership transformations.

The last, but probably the most significant problem, concerned the appraisal of the firm's assets. It seems that the assets, especially in the conditions of high risk and recession, were seriously overvalued. It turned out that the demand for the firm's assets at offered prices is next to none. Application of "classical" methods of appraisal to collapsing companies proved wholly ineffective (this was confirmed by other cases of liquidation by bankruptcy). The liquidator decided to go on with sales at tender prices and it was only since then that an actual process of selling the firm's assets could begin.

Transfer of Ownership Rights

The sale of assets was initiated in June 1991 with putting on sale trucks (at prices estimated by their appraisal). In the first two rounds not a single vehicle was sold. The liquidator then made a decision to sell the assets according to their tender prices, offering employees a preemptive right of purchase. Besides, employees could make their payment in four installments. As a result of the above all trucks were sold within four months. Most of them (some 60 percent) were purchased by employees. Final prices (substantially lower than those suggested by the appraisal) set set by a commission summoned by the liquidator, that evaluated the technical condition of vehicles. The liquidator regarded the sale of vehicles as a big success. According to him the equipment was seriously used up (depreciation reaching 80 percent) and would not find buyers at "ceiling" prices set by the consulting company. So, he could either wait and not sell anything or lower the price and find buyers. It seems that the decision made by the liquidator was right, although this way of enterprise liquidation may give rise to accusations of corruption and uncontrolled sale of assets (the appraisal has no real meaning, decisions on prices and on the choice of buyers are made exclusively by the liquidator, while tenders only provide a formal guarantee).

Sales of the real estate and land involved much more difficulties. In his first attempt the liquidator wanted to find a buyer for the whole estate, however, there was no response at all to his offer. In view of the above he decided to sell the enterprise "piece by piece". During the first six months of liquidation, virtually no assets were sold (apart from trucks) at prices corresponding with the appraisal.

The situation changed only at the end of 1991 when the liquidator decided to lower the price for land and real estate. As a result of that decision practically the whole of assets were sold by September 1992. They were purchased by private firms or individuals.

Most of the land and real estate was sold below its appraised value, however, some of these assets reached the price above their book value, which was read as a success by the liquidator in view of unfavorable economic conditions (recession, expensive credits). Payments were to be made in interest-free installments contributed within several months (not more than half a year). Most of buyers met their commitments on time.

Operation of the Firm under Liquidation

Almost immediately after having been granted a liquidation permit the director (liquidator) decided to dismiss 50 percent of employees. The reason for that was the lack of any orders and a virtual discontinuation of service activities by "Transbud". Further lay-offs were averted by lack of financial means for severance pay for redundant employees. As financial means from sales of the firm's assets started to flow in, every new month saw a reduction of employment. At the end of 1991 there were only 50 people left. In April 1992 another 40 employees were dismissed. The remaining ones (caretakers, cleaners, accountants) were notified about termination of their employment contracts.

As a result of launching the liquidation proceedings the wages (salaries) of employees who were left in the firm increased substantially (by 50 percent on the average). This paradoxical situation can easily be explained by a rapid inflow of financial means from the sale of the firm's assets and by a radical decline in the number of employees. Besides, it was, in the first place, production workers who lost their jobs and who had been the worst paid prior to liquidation.

The process of liquidation did not give rise to internal conflicts or disputes. Employees managed to come to terms with their and the enterprise's fate, although, as the liquidator pointed out, they did not quite realize what liquidation by bankruptcy meant. At the beginning of 1991 trade unions made a resolution supporting the liquidation and at the moment of its start they dissolved their organization and so did the employee council.

III SITUATION AFTER LIQUIDATION

By the end of 1992 the liquidation of "Transbud" was practically completed. As a result, all enterprise's assets have been sold to private individuals or firms. Total liquidation costs amounted to some 3 billion zlotys. They consisted of costs involved with preparation of liquidation proceedings (200 million zlotys) and costs of the firm's operation during the liquidation period. According to estimates, the proceeds from the sale of assets amounted to some 15 billion zlotys. Hence, the liquidation cost accounted for some 20 percent of proceeds from the sale of the firm's assets.

Re-allocation of Capital Assets and Results of their New Application

In the case of "Transbud" all the assets were sold to private owners. Trucks have been purchased by employees or small private enterprises. They were still used for road haulage purposes. However, the costs of services offered by those firms and private individuals was by some 40-50 percent lower than that of "Transbud". Road haulage activities of those entities are profitable despite growing market competition. New employment created in this field (transportation services by the use of equipment formerly owned by "Transbud") is estimated at some 200.

The bulk of real estate of "Transbud" has been purchased for purposes other than transportation. The firm's structures and land provided a basis for e.g. a chemical laundry, a tailor's shop a commercial company, a wholesale warehouse, a gasoline station, a plastic production plant, an assembly plant for electronic components. So far, all those ventures have been profitable. New firms created jobs for almost 200 people. It is expected that as soon as all the relevant transactions are executed and economic activity begins in all the premises, total employment will reach some 400.

Thus, in the case of "Transbud" it turned out to be possible to sell within one year and a half its whole assets and to find for them a new application. The enterprise repaid its commitments vis-a-vis the state budget, other firms and its own employees. At the same time, the resources that were utilized at "Transbud" in an inefficient way, started to bring profits in new ventures. One may expect that the assets formerly owned by "Transbud" will soon offer a number of jobs comparable with that at the liquidated state-owned firm. From this point of view the liquidation of "Transbud" should be given a positive evaluation.

IV CONCLUSIONS

The basic aim of liquidation through bankruptcy is, on the one hand, an elimination from economic life of firms that are making permanent losses and, on the other hand, re-allocation of land, capital and labor resources to other, more efficient applications. Those resources, as assets of a state-owned company, are acquired by private firms or individuals and are still utilized in production processes. Some of the resources that are of poor quality, highly depreciated, etc. are eliminated from economic activity in the process of liquidation through bankruptcy. Therefore, although liquidation through bankruptcy is not a classical form of state property privatization, it provides for re-allocation of production assets from less to more effective applications and for transfer of short-supply resources of state-owned firms to private owners. Hence, this is a specific, although real transfer of ownership rights of all (or some) assets of a liquidated enterprise to private agents.

The liquidation of "Transbud" and of other firms undergoing such proceedings at that time due to their poor financial standing has allowed to determine the factors and phenomena hampering development of this very process and to formulate conclusions as to its improvement. The most significant ones are the following:

1. Appraisal of the firm's assets. In the case of liquidation through bankruptcy all market methods of appraisal become unreliable. Moreover, an appraisal of the firm's book value is also inaccurate (usually overestimated). In several early cases of liquidation sticking to the requirement of carrying out an appraisal and taking it as a basis for setting prices for its assets caused delays in the liquidation process. Lack of interest for relatively expensive assets made it impossible to carry out liquidation proceedings (e.g. cuts in employment, paying off outstanding amounts) and clearly added to the firm's operation costs (maintenance and remuneration). Introduction of "tender prices" and elimination of appraisals (unnecessary costs) turned out to be indispensable. They speed up the liquidation process, although they may also lead to corruption. In this case it is required to define precisely the conditions of sales of assets and the rights of a liquidator.

2. The problem of rights and duties of a liquidator. The role and the scope of a liquidator in a state-owned enterprise have not been clearly defined so far. In any case, he is neither motivated for a quick completion of proceedings nor for a possibly most profitable sale of assets. Cases are reported of a deliberate retardation of proceedings (liquidators are usually well-remunerated) and of obstructing sales of some assets. It seems necessary to modify this system by introduction of extra rewards for a liquidator depending on duration of the proceedings (or their cost) and on incomes gained from liquidation.

3. There is lack of appropriate information on assets of liquidated enterprises. Inadequate interest in those assets often results not only from their being inattractive or too expensive. In many cases lack of information is a decisive factor here, as it reaches only local entrepreneurs, private individuals and companies. Setting up a system of a regional (central) monitoring of liquidated assets could substantially increase the number of their potential buyers.

4. The problem of the legal status of land. This issue has hampered any ownership transformation from the very beginning. In the case of liquidation through bankruptcy it made it impossible to sell most of the

assets due to an unspecified status of land. It was only the simplified regulation by law of the end of 1991 that provided for "enfranchisement" of enterprises on their grounds, giving them a possibility of selling ownership rights (or the right of usufruct) also pertaining to land.

Table 1

Basic Indicators

Period Indicator (billions of zlotys)	Jan. 1990	Feb. 1990	Jan. 1991	Feb. 1991	Jan. to March 1992
Sales	11,741	13,868	11,940	5,460	2,000
Total costs	11,130	14,592	15,212	5,488	7,000
Gross profit	1,160	-0,239	-3,457	-0,311	-5,000
Net profit	0,034	-1,141	-5,719	-1,222	-5,540
Profitability (%)	10,4	-1,6	-22,7	-7,3	-75,5
Receivables	1,798	2,707	3,897	1,350	7,100
Payables	0,831	1,526	5,978	1,280	3,560

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PRIVATIZATION IN POLAND. CASE STUDY OF CEMENTOWNIA "STRZELCE OPOLSKIE"

Method of privatization:
commercialization
(corporatization)

Paper prepared for the project being financed by USAID
"Lessons Learned from Central European Privatization"

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The enterprise operates within the cement industry branch. Itmanufactures almost exclusively cement and clinker (semi-product of cement). Its share in the domestic market amounts to 8-10 percent, with employment amounting to some 1,000. The enterprise is located in a town with 21,000 inhabitants, which has only one other industrial plant ("Agromet" manufacturing farming machinery for former CMEA countries, now facing very serious difficulties after the collapse of trade with the former USSR). The cement plant is situated 40 kilometers from Opole and 60 kilometers from Katowice.

The plant's capacity amounts to 1,480,000 tons a year. The area occupied by the plant is 1.283 square kilometers. The enterprise has its own limestone and cement rock quarry.

In November 1991 the enterprise was commercialized, i.e. transformed into a joint-stock company owned by the State Treasury.

A. THE ENTERPRISE CONDITION PRIOR TO PRIVATIZATION (1990)

The **obsolete technology of cement production** has been the major strategic problem faced by the enterprise. The firm has been provided with Soviet technology and Soviet-made equipment for cement manufacturing by the means of the so-called **wet method**. This method is very material- and energy-intensive. The **dry method** applied by "GÓRAZDZE", another cement plant located nearby (30 km), allows for a 36 percent cut in energy consumption, a 50 percent reduction of demand for hard coal and, at the same time, it makes it possible to obtain 12.5 percent more finished product out of the same quantity of raw material.

Economic consequences of that structural defect of technology became apparent following the implementation, as of January 1, 1990 of a macroeconomic reform, known as the Balcerowicz Plan.

Elimination of a shortage economy and adoption of a more realistic price structure had a decisive impact on the enterprise position. On the one hand, for the first time in its history the enterprise was confronted with a demand barrier and on the other hand it faced a substantial rise in energy prices. Developments in the field of demand were under a considerable influence of recession and adjustment processes in the Polish economy, the first consequence of which was a decline in the activity of housebuilding and industrial construction. The new demand and price situation in contributed to a basic change in the economic and market situation in the whole cement production sector in Poland. Enterprises manufacturing cement by the dry method found themselves in a good situation, while those applying the wet method ran into strategic difficulties.

In the case of Cementownia "Strzelce Opolskie" the new situation was reflected in a **radical decline in cement sales**. While before the breakthrough those sales exceeded 1,400,000 tons (1,407,000 tons in 1988, 1,419,000 tons in 1989), in 1990 they fell to 1,174,000 tons. Exports accounted for 7 percent of those sales.

Financial standing of the cement plant in the first year of the reform was relatively good. Gross profits reached 72.3 billion zlotys and gross profitability (gross profit to costs ratio) amounted to 36.3 percent. Due to considerable contributions to the state budget (corporate income tax, dividend and excessive wage growth tax amounted to 28.9 billion, 28.0 billion and 2.5 billion zlotys, respectively) net profit totaled 12.8 billion zlotys and net profitability (net profit to costs ratio) amounted to 6.4 percent. At the end of 1990 the amounts receivable from customers (24.4 billion zlotys) were 2.4 times higher than the amounts payable to suppliers (10.5 billion zlotys). Indebtedness vis-a-vis banks was low and concerned only working-capital credits (6 billion zlotys).

The fact that in 1990, thanks to cartel-type agreements there was no price competition between cement plants in southern Poland had a significant impact on developments in the field of revenues and profitability of the enterprise in question. Breaches of price agreements and mutual underquoting started only in the middle of

1991.

Situation in the field of organization and management had all the features typical for a socialist enterprise. The formal structure of power was determined by the state enterprise formula. Hence, the organs of power were: the director, the employee council (electing the director) and the meeting of employee representatives. Trade unions: "Solidarity" and the post-communist union, were also influential.

The so-called engineering and technical staff, i.e. technicians and engineers represented in the top and middle-level management, formed the most influential and intellectually strongest group. This was in accordance with the organizational and functional structures in which only the "production" (production department) really mattered, and such departments as "sales" or "finance" employed almost no staff at all, since their functions, in fact, did not exist before. The formal body representing the interests of this group was the employee council, dominated in 80 percent by members of this group.

The main weak points of the enterprise in the analyzed scope were:

- wrong (too slim) organizational structure,
- complete lack of control over costs (wrong system of cost accounting),
- excessively developed (incoherent) and non-motivating wage system,
- complete lack of market research and marketing, very poor organization of sales,
- overemployment and wrong employment structure.

In terms of organization and staff the enterprise was unprepared for operation in the market economy conditions.

The existing formal and actual structure of power in the enterprise in a natural way blocked rationalization changes and, at the same time there was not a real pressure on such changes exerted by the formal owner - the state. In fact, the enterprise was not experiencing the owner's interest at all. Thus, it is not surprising that in 1990 despite a drop in production by 17.5 percent employment fell by only 5.5 percent. Rationalization (flattening) of organizational structures would have to impair the interests of this most influential middle class in the enterprise. Improvement of cost accounting and control would also be at variance with the interests of insiders. On the other hand, hiring qualitatively new employees that would be responsible for sales and marketing was made very difficult by the restrictive tax on excessive wage increases that regulated the wage level in state-owned enterprises.

B. COMMERCIALIZATION (1991)

Although in 1990 the enterprise was not troubled by any significant financial difficulties, it was already then realized that without a radical change of the production technology the enterprise's survival on the market was not possible. The awareness of that fact was particularly strong in the most influential group formed by the engineering and technical staff. That group quickly realized its new situation, defining it in the categories of a considerable threat to jobs of all its members. On the local labor market there was no other employment alternative for this group. This factor clearly defined the strategy applied by this group. In contrast to many other enterprises it resigned, at the very beginning, from participation in ownership rights. The reasoning here was simple: their professional future was connected with Cementownia "Strzelce Opolskie", the cement plant may only survive if a fundamental technological modernization is carried out, such a modernization may only be accomplished by a large, strategic investor[1] only a big, foreign firm may be such an investor as in Poland there are still no private investors representing such a sizable capital. Summing up the above it can be pointed out that as early as 1990 the enterprises elite abandoned the idea of surviving by its own means and approved the option of a buy-out by a wealthy foreign investor. Deterioration of financial results in the early months of 1991[2] could only

[1]Modernization costs are estimated at 1 trillion zlotys (some $ 66 million).

[2]In the first six months of the year the net profit reached only 766 million zlotys, i.e. merely 6 percent of the net profit obtained in the previous year.

strengthen that belief. Visits paid by representatives of several Western firms[3] and their declared interest in a buy-out of the enterprise also had an encouraging effect. A foreign investor was to be won through commercialization, i.e. transformation into a joint-stock company owned by the State Treasury.

Other reasons behind commercialization were:

- hope for the burden of dividend (tax on enterprise assets) being removed,
- hope for a wage increase (expressed by employees)
- hope for more freedom in taking up the decisions, expressed by the director (commercialization means automatically a liquidation of the employee council which had an authority over the director).

The employee council was the main instigator of commercialization. This was a very particular feature as it was exactly it that was to lose the power at the moment commercialization. Neither of its members was appointed to the Supervisory Board of the newly-established company. The employee council represented strategic interests of the engineering and technical staff. The initiative of ownership transformation was also supported by trade unions, which expected, for no obvious reasons, immediate wage rises. Those expectations were unjustified as after commercialization state-owned enterprises still have to pay the wage growth tax. Similarly, expectations concerning exemption from the so-called dividend contributed to the state budget, as in the joint-stock companies owned by the State Treasury dividend was replaced by interest on capital assets, which in this case was only slightly lower than dividend.

The Resolution on transformation of the enterprise into a joint stock company was made by the Employee Council in February 1991. In March the decision was approved by the General Meeting of Employee Representatives and by the Ministry of Industry (as the so-called founding body). That Resolution was the basis of an application for transformation submitted with the Ministry of Privatization. On July 24, 1991 the Ministry made a decision on transformation. In November a new Company was registered at a

[3] SA Cimenteries CBR (Belgium), F.L. Smidth (Denmark), Ciments Francais (France).

court under the name of "Cementownia Strzelce Opolskie S.A. Mr Jan Suchanek was appointed President of the Board. Until March 1991 he used to be vice-Director of the enterprise and since March 1991 he had been its caretaker Director. The former director was recalled by the Employee Council on the proposal of the "Solidarity" leader in connection with a typical personal conflict. Both directors, the old one and the new one were involved with the engineering and technical staff. The Employee Council did not defend the former director, as his successor represented even better its interests, being an even more outspoken proponent of commercialization and privatization with the participation of a strategic foreign investor.

The 6-men strong Supervisory Board consisted of two representatives of the Ministry, two "insiders" from the enterprise elected by the employees in an open ballot and two members from outside the enterprise and outside the ministry (economists).

C. AFTER COMMERCIALIZATION - PRIOR TO PRIVATIZATION (1991-1992)

The case of Cementownia "Strzelce Opolskie" S.A. is a very good example of fruitlessness of commercialization. Strengthening of the so-called ownership supervision or, in other words, restoration of an effective state control over enterprises is one of basic objectives of transformation into companies owned by the State Treasury. The state influence was seriously limited by the laws on state-owned enterprises and on employee self-government that were passed in 1991. Commercialization of Cementownia "Strzelce Opolskie" did not restore that influence as it maintained or even strengthened the former configuration of power in the enterprise.

First of all, the Supervisory Board proved to be weak. It was not in a position to monitor effectively the Board's activities, to discipline it or to guide its operation. There was not an effective pressure on rationalization of the enterprise activities. Moreover, the Supervisory Board was not an effective instrument of information transfer from the enterprise to the Ministry of Privatization (representative of the State Treasury), which could well be seen from delays in privatization decisions vis-a-vis the enterprise. That body performed a decorative function rather than an actual one. It was relatively weak in intellectual terms and poorly motivated: remuneration of the Council's members was not connected in any way with the cement plant's performance.

The position of the former Director, and presently the President of the Board was strengthened. The Employee Council through which trade unions (and in particular the "Solidarity") could exert their pressure was dissolved and, on the other hand, he still enjoyed the support of the engineering and technical staff, the interest of which he represented. In his interplay with trade unions and the staff the President of the Board, in fact being an autocratic ruler, was constantly winning on two occasions, First, the threat posed by the near-by "Górażdże" cement plant. The President kept repeating that the "Górażdże" plant had a clear competitive advantage resulting from a much cheaper "dry" technology, as well as from the aggressive and "unfair" attitude of the competitors who would break price agreements and constantly underquote. This way they should take over domestic and foreign customers of "Strzelce Opolskie". The President reiterated that systematically, in order to mobilize the employees and to find excuse for his own negligence. Another excuse made by the President for any difficulties was the "incompetent" Supervisory Board and "supine" Ministry. In both cases the information policy of the President was very effective. In the second case he even managed to be a go-between for trade unions and the Supervisory Board.

As regards the Management Board, the first 18 months of privatization can be described as a wait-and-see attitude, until actual privatization comes (buy-out by a large, foreign investor) without facing the risk of falling out of the game (losing the post). Neither the President nor the Board members had strong incentives and interests to undertake substantial steps towards rationalization of the enterprise. The President's salary was 400 percent of the average remuneration in the firm and was increased by a bonus payment amounting to 0.01 of the turnover value and 1.0 percent of the net profit. The President and other Board members had no interest in undertaking rationalization measures that might spark off some important internal conflict. Thus, the key problems of organization and management remained unsolved. The system of cost accounting has not been reformed, hence identification and control of costs in five major production departments is impossible. This refers, in particular, to costs of energy used, the reduction of which would be very much welcome in this technology. The core of organizational structure, inherited from the command system, also remained unchanged despite the common conviction about its malfunctioning. Two positive changes in this respect were only fractional. They concerned merging of the Railway Transport Department with the Cement Packaging Department into one Department of Commodity Turnover and merging the Sales Department with the Export Department into one Commercial Department. Despite a pronounced decline in production no rationalization of employment was made. There were no group layoffs. No staff changes were made, either.

The last development has its objective explanation. On the one hand, on the local labor market there is lack of qualified specialists (e.g. in the field of marketing), and on the other, the enterprise, limited by the wage-growth tax, was not in a position to pay enough the short-supply specialists. In the third quarter of 1992, i.e. three years after the reform implementation, the wage system was finally modified (simplified). However, due to the deficient cost accounting system the remuneration system still fails to provide motivating incentives.

The ineffectiveness of commercialization as a way towards the improvement of enterprise efficiency, is also reflected in the fact of existence of two trade union co-operatives rendering their services for the enterprise. This is a typical "unsound" parasite-type structure, containing elements of "transferpricing" and contributing to "getting rich" by the trade unionists at the expense of the enterprise and the state.

While the measures which would upset the configuration of interests inherited from the real socialism period were not undertaken, the reverse was the case with "neutral" adjustment measures. In the second half of 1992, four important, although small investment projects were realized:

- electronic scales for cement-cars weighing was purchased in order to diminish loses resulting from underweighing or overweighing,
- a complete line for packing, palletization and covering with film was purchased to meet the requirements of Western customers,
- plating of the furnace was replaced, to cut down the electricity consumption by 20 percent,
- an electro-filter was installed on the rotary furnace, to secure dust emissions reduction to some 99.66 percent.

All the four investment projects might be described as rudimentary steps towards adjustment to new conditions. The necessity of such steps was realized as far back as 1990. The fact that their implementation took almost three years reflects the extremely slow adjustment process. The total value of investment was not very imposing (less than 30 billion zlotys). The enterprise financed them entirely from its own assets (from profit).

The production, market and financial situation was subject to some fluctuations in 1991 and 1992. In the middle of 1991 the period of price agreements with other cement manufacturers was definitely over. Sharp price competition started. In 1991 966,000 tons of cement were sold, i.e. by 208,000 tons less than in 1990. Gross profitability in 1991 declined to 12.2 percent (as compared with 36.3 percent in 1990). Net profit was only 637 million zlotys in 1991 (12.849 billion zlotys in 1990). The first quarter of 1992 saw further deterioration of the situation: gross profitability declined to 4.3 percent, a net balance loss of 4.568 billion zlotys was recorded, there was a further decline in sales (by 52,000 tons). However, in the following three quarters of 1992 the situation in the field of cement sales recovered markedly, i.a. due to a pronounced rise in exports.

D. THE PROBLEM OF PRIVATIZATION

At first, one should note delays in actions undertaken by the Ministry of Privatization. The strategy of privatization applied to Cementownia "Strzelce Opolskie" was already obvious in 1990. However, the Ministry took up actual privatization steps only after the so-called sectoral studies concerning the whole cement industry had been completed. The outcome of those studies was the decision on combining the sale of the "Strzelce Opolskie" cement plant with that of "Gorażdże". On October 20, 1992 "Rzeczpospolita" published an advertisement on invitation to negotiations over the sales of 51 percent of shares of the "Góraż że" cement plant and 80 percent of "Strzelce Opolskie". The remaining 20 percent of shares was, in accordance with the Privatization Law, to be offered to employees and the rest of "Górażdże" shares was to be sold through public offering.

As a result of the invitation foreign investors emerged, ready to accept the conditions set by the Ministry, i.e. to buy both the "good" and the "bad" cement plant, involving the commitment to implementation of the proposed investment program and social package.

However, completion of negotiations was blocked in November by the employees of the "Górażdże" cement plant. This happened despite the agreement reached earlier in September between the Ministry and all-Poland and factory-level trade union organizations on matched sales and on trade union participation in negotiations with the strategic investor concerning the so-called social package included in the contract for sales of those enterprises. The Factory Commission of the "Solidarity" trade union in Cementownia "Górażdże" staged a referendum in which the employees voted against the foreign investor. At present, (December 1992) the Commission is ready to go on strike if the plant is sold to the foreign investor. It also made a counter proposal of "leverage sale", i.e. setting up an "Employee-owned Company".

This proposal is unrealistic, as at the market value of the cement plant estimated at 1.6-2.0 trillion zlotys the employees would have to invest several dozen million zlotys each, which is practically impossible. Moreover, the proposal does not take into account the fact that new investments worth some 500 billion zlotys are needed. At present, (December 1992) there is still a deadlock as the employees of "Górażdże" do not want to resign and the Ministry does not want to take radical steps that might result in a strike.

The attitude of the "Górażdże" cement plant may have changed under the impact of negotiations on "State Enterprise Pact" that leaves the choice of ownership transformation path to employees themselves (represented by trade unions).

E. CONCLUSIONS

Three general conclusions may be drawn from the analysis of the "Strzelce Opolskie" cement plant case. The first of them concerns objective difficulties with a quick transformation of old socialist enterprises from and "engineering - production"-oriented ones into "market" companies. The problem here is the **skills-and-mentality barrier**. The enterprise clearly lacks a minimum of managerial know-how. This refers to a whole gamut of skills involved with sales (market analyses, marketing, sales organization, etc.), accounting and finance as well as organization. Making up for those deficiencies possibly soon, through the local labor market was practically impossible. Apart from problems connected with hiring new men, there was also the problem of "old thinking" represented by the workers and the former establishment. That thinking results in wage demands and a generally passive approach - waiting until the state settles all the problems.

The second conclusion concerns **limited chances for a positive impact of commercialization alone on the operation of enterprises**. In this place one should take notice of two factors: first the relatively unfortunate composition of the Supervisory Board and the lack of a proper system of remunerating the members of that Board. The Board was motivated not by financial but by political reasons - its survival depended on avoiding problems and troubles. It seems, however, that even if better people were appointed to the Board and if their remuneration was linked with the enterprise's performance, the chances for enforcing an internal reform, bound to upset the main configuration of "insiders'" interests (engineers and technicians) would be small. Namely, the opportunities are big for making a deal with workers and forming a coalition of insiders (staff + workers) against the external and state-administration bodies like the Supervisory Board or the after the so-called sectoral studies concerning the whole cement industry had been completed. The outcome of those studies was the decision on combining the sale of the "Strzelce Opolskie" cement plant with that of "Górażdże". On October 20, 1992 "Rzeczpospolita" published an advertisement on invitation to negotiations over the sales of 51 percent of shares of the "Góraż że" cement plant and 80 percent of "Strzelce Opolskie". The remaining 20 percent of shares was, in accordance with the Privatization Law, to be offered to employees and the rest of "Górażdże" shares was to be sold through public offering.

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E. CONCLUSIONS

Three general conclusions may be drawn from the analysis of the "Strzelce Opolskie" cement plant case. The first of them concerns objective difficulties with a quick transformation of old socialist enterprises from and "engineering - production"-oriented ones into "market" companies. The problem here is the **skills-and-mentality barrier**. The enterprise clearly lacks a minimum of managerial know-how. This refers to a whole gamut of skills involved with sales (market analyses, marketing, sales organization, etc.), accounting and finance as well as organization. Making up for those deficiencies possibly soon, through the local labor market was practically impossible. Apart from problems connected with hiring new men, there was also the problem of "old thinking" represented by the workers and the former establishment. That thinking results in wage demands and a generally passive approach - waiting until the state settles all the problems.

The second conclusion concerns **limited chances for a positive impact of commercialization alone on the operation of enterprises**. In this place one should take notice of two factors: first the relatively unfortunate composition of the Supervisory Board and the lack of a proper system of remunerating the members of that Board. The Board was motivated not by financial but by political reasons - its survival depended on avoiding problems and troubles. It seems, however, that even if better people were appointed to the Board and if their remuneration was linked with the enterprise's performance, the chances for enforcing an internal reform, bound to upset the main configuration of "insiders'" interests (engineers and technicians) would be small. Namely, the opportunities are big for making a deal with workers and forming a coalition of insiders (staff + workers) against the external and state-administration bodies like the Supervisory Board or the

Ministry of Privatization (as the General Meeting of Shareholders). Through eliminating the formal body of employees - the Employee Council - commercialization strengthens the management's position vis-a-vis the employees, but it is unable to strengthen the state's position vis-a-vis the enterprise. Just the contrary, the state's position is in a way weakened as it formally becomes a party (employer), an addressee of various demands and hopes. In the state-owned enterprise formula almost all decisions are made by the enterprise itself. Employee self-government bodies are at the same time bodies of an enterprise. The "employee rule" is manifested in the decisive say of the Employee Council in appointing the enterprise's director. Thus, from the formal point of view the state is not a party in labor disputes and is not responsible for what is going on in an enterprise. Autonomous, self-governing and self-financing state-owned enterprises (according to provisions of the Law passed in 1981) are state-owned rather only from the verbal and not legal or practical point of view. Actually, in Polish terms commercialization is, in a way, an act of re-nationalization" - restoring enterprises to the state. This means a growing scope for politics in the economy. The state becomes formally "responsible for enterprises". Forming of offensively - defensive coalitions of insiders (workers and management) in order to intensify their competition with the state (instead of other companies on the market) becomes then easier.

The analyzed case shows that one should not expect too much from commercialization as an instrument that is to improve management of state-owned enterprises (non-privatization commercialization).

The third conclusion refers to the general **weakness of the Polish state in execution of its formal rights and privatization policy.** The example of Cementownia "Górażdże" indicates that the Ministry of Privatization is not strong enough to privatize enterprises against their employees' will, even if formally it has undeniable right to do so. This is a proof of a consensual nature of Polish privatization, which has an adverse effect on its pace, but probably allows to avoid excessive tensions and social conflicts.

Table 1.

Basic indicators in 1992

Period	1-3 92	4-6 92	7-9 92
Output (tonnes)	164.479	232.000	287.348
Sales (mln zł)	65.396	109.974	164.737
Total costs	69.483	79.789	112.532
Gross profit	2.720	19.352	22.919
Net profit	-4.568	1.185	5.095
Gross profitability (%)	4.3	14.8	20.4

THE GDAŃSK INSTITUTE FOR MARKET ECONOMICS

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PRIVATIZATION IN POLAND
CASE STUDY OF "PRÓCHNIK"

Method of privatization:
"Capital path"
Public offering

paper prepared for the project being financed by USAID
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"Prochnik", a state-owned enterprise, was transformed into a joint-stock company owned by the State Treasury on October 1, 1990. Distribution of shares through public offering was completed in the middle of January 1991. The enterprise operates within the framework of light industry and its scope of activities includes production and services in the field of men's and ladies' wear. Its employment amounts to some 2,200 (fourth quarter of 1992).

I. SITUATION PRIOR TO PRIVATIZATION

Before having been privatized "Próchnik" belonged to the group of the best Polish firms. Its name was renowned both in Poland and abroad. A major part of its output had been exported to developed market economies for many years. It was a firm making high profits and enjoying good development prospects. Those characteristics were decisive for putting Próchnik" into the group of five Polish enterprises to be privatized first through public offering. It was namely assumed that this form of privatization should involve exclusively the firms being in a good financial condition that would guarantee profitability of capital investment for potential buyers of shares.

Financial Standing

Prior to privatization (1990) the financial condition of Próchnik" was very good, especially when compared to that of other Polish firms at that time. With its annual turnover reaching $ 15 million the firm recorded profitability ranging from 30 to 40 percent (see: Table 1). Despite a serious rise in receivables in 1990 the enterprise had no liquidity problems. At that time it used credits (mostly working-capital ones) totaling $ 1 million.

Output and Sales

Since it very beginning "Próchnik" had been manufacturing mostly men's wear (jackets and overcoats) and ladies' wear (overcoats and suits), as well as children's wear, ladies' and men's underwear, etc. In the middle of 1990 the production of underwear and some other (marginal) items was discontinued because of insufficient profitability and small absorptivity of the domestic market.

Prior to its transformation the Company was believed to have operated in a competitive environment both on the Polish and on the foreign market. On the market for men's overcoats and jackets "Próchnik's" share amounted to 25-35 percent. On the market for ladies' winter overcoats for some 12 percent. The market shares of other products were not bigger than several percent.

"Próchnik's" major suppliers have been, and still are, Polish firms. Since January 1990 the Company has not been troubled by unreliable supplies of raw and base materials (as a result of implementation of the economic stabilization and equilibrium restoration program). However, at the same time, due to a substantial decline in consumer demand, the absroptivity of the Polish market, especially as regards light industry products, declined by almost 50 percent. The Company's real sales on the domestic market also declined by almost a half in 1990.

"Próchnik" had been conducting diversified export activities for many years, cooperating with regular customers in Western Europe and North America. Prior to privatization the share of exports in "Próchnik's sales amounted to some 60 percent, which was equal to approximately $ 10 million annually.

Organizational Structure and Management

The enterprise was established in 1945. From its start its activities were concentrated on clothes manufacturing. In the 1960s and 1970s four subsidiaries were set up in small towns near Łódź and in 1977 a new plant was constructed in Łodz. At the beginning of 1990 in view of insufficient profitability one of the subsidiaries was closed down.

Before starting the privatization process organizational structure of the Company was somewhat simplified (several departments were merged some managerial posts were liquidated, administrative operations were curtailed). A centralized, functional structure emerged, with four main main fields comprising accounting and finance, supply and sales, production and technology The Company consisted of a center and four plants organized as manufacturing units.

Prior to privatization of "Próchnik" following the provisions of the law of July 13, 1990 on privatization of state-owned enterprises a Supervisory Board and a Management Board were appointed, following a consent to privatization given by the old employee council and its subsequent dissolution.

The first Supervisory Board, appointed prior to privatization, was composed of six persons. Two of them, in accordance with the law, were representatives of employees elected in a ballot. The remaining four members were nominated by the Minister of Privatization.

The Management Board consisted of three members nominated by the Minister of Privatization. The hitherto director of the firm (occupying that post for 12 years) was appointed President of the Board. A qualified accountant (until 1990 working for another enterprise in Łódź) and the hitherto sales manager in "Próchnik" were appointed to be Vice-Presidents

Employment and Relations Inside the Company

Throughout several recent years preceding privatization the employment in "Próchnik" was subject to minor changes. At the end of September 1990 (shortly before the transformation) the number of employees was 2,479 of which 313 performed administrative functions, 1,601 worked in production departments and 565 performed auxiliary activities.

The relations between the firm's management and employees prior to privatization had been good and not conflicted. In recent years no striking actions were reported and cooperation among the firm's bodies was successful. Approximately 10 percent of employees were trade union ("Solidarity" and OPZZ) members, which in Polish terms was a relatively unimpressive figure (the average "unionization" rate being some 35 percent in 1990).

II PRIVATIZATION PROCESS

Motivation behind the Process

The motivation of participants of the privatization process seriously diversified. The Ministry of Privatization wanted to have "Próchnik" in the group of first enterprises privatized following the capital path, due to its favorable economic condition, stable selling outlets, high quality of goods manufactured. Another reason was the necessity of replacing those firms in the "top five" which failed to meet the formal conditions. (originally, "Prochnik" was not included in that group, despite being better prepared for privatization).

The enterprise director, acting as the main instigator and promoter of privatization, was interested in ownership transformation mostly for prestigious reasons. He wanted "Próchnik" to hit the headlines throughout the country and to be regarded as a leading firm. He also hoped for getting more breathing space in operating the Company.

On their part, the employees expected a substantial wage rise to follow privatization (as a result of lifting the wage-growth tax), although at the same time they were afraid of possible lay-offs, stricter work discipline, etc. Following many months of discussions and negotiations (i.a. those with the Company director, who promised that employment would not be impaired by privatization) they became pronounced adherents of the ownership transformation. Trade unions in their official statements declared themselves in favor of privatization.

Resistance to privatization was voiced only by the employee council. Until the very end it obstructed the implementation of privatization procedures (the law provides for privatization to be started only upon acceptance given by the employee council). The council members did not want to concede their considerable impact on enterprise management and their prominent posts in the council (privatization means an immediate liquidation of the employee council in the firm). It was only under a very strong persuasion of the director and employees that the council members gave their consent to privatization (a week after the deadline set by the Ministry).

Appraisal of Capital Assets

The equity capital of the Company has been estimated at 30 billion zlotys (some $ 3 million) and divided into 1.5 million bearer shares, each of them representing a nominal value of 20,000 zlotys (some $ 2 million). The selling price of a single share was set at 50,000 zlotys (some $ 5).

The remaining part of the Company capital was transformed into reserve capital. The own capital of "Próchnik", registered on September

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30, 1990, amounted to 68.303 billion zlotys (some $ 7 million). The real estate being property of the State Treasury was handed over under administration and use by the "Prochnik works". The Company has the right of a perpetual usufruct of grounds owned by the State Treasury, currently being administered by the Company, and has the ownership right over structures, premises and other establishments situated on those grounds.

Appraisal of the Company capital was prepared by two firms: a Polish and a British one. The Know-How Fund organized a tender that was to choose a foreign consulting company. Three methods of appraisal were applied, in line with recommendation made by the Ministry (differentials between the extreme outcomes did not exceed 25 percent). The job done by the Polish firm was given a very positive assessment, while its foreign counterpart was regarded as a "needless assister" contributing neither know-how nor skills, but receiving huge remuneration, totally incommensurate with services actually rendered.

Privatization Procedure

On October 1, 1990 the state-owned enterprise "Próchnik" was, by force of the privatization law, transformed into a Company owned solely by the State Treasury. At the end of October consulting companies prepared an issuing prospectus of "Próchnik" (the director ordered preparatory work on privatization to start several month earlier). On November 30, shares of the Company were put on sale in several divisions of Polish banks.

In accordance with the privatization law, 1.200,000 bearer shares, representing 80 percent of equity capital of the Company were offered for public sale. 300,000 shares representing the remaining 20 percent of the Company capital, were reserved for employees, who, according to the provisions of the law, have the right to purchase 20 percent of shares on preferential terms, i.e. 50 percent of their selling price (in the case of "Próchnik" the limitation concerning preferences per employee was not significant).

At first the employees showed a very limited interest for preferential shares (only 100 employees declared then their readiness to buy them), however, that interest rose over time. Internal regulations of preferential share purchase provided for the first installment worth 25 percent of share price to be paid in the first six months, and the remaining part to be paid in four installments during the next six months. Moreover, it was decided to pay out rewards from the Company's profits for 1990 by the means of state bonds (paying in bonds the buyer could buy shares with a 20 percent bonus, which in the case of employees allowed to buy shares at 40 percent of their original price).

The subscription of shares in a public offering began at the end of November, planning its completion by December 21, 1990. Orders for shares could be placed by Polish natural or legal persons without any limitations (state-owned agents had to receive a permit issued by the Ministry). Foreign agents or Polish agents directly controlled by foreign agents and placing an order for more than 10 percent of all shares had to apply for permit issued by the the President of the Foreign Investment Agency.

The State Treasury represented by the Ministry of Privatization decided, in the case of Próchnik", to put all the shares for public offering without leaving for itself a package of shares for negotiation with strategic investors.

The course of subscribing was not the expected one. Until December 21, it was not possible to find buyers for shares offered, and because of that the subscription period was extended by three weeks. The reason for this development was, first of all, the weakness of the distribution system (small number of outlets, inefficient information systems, subscription for shares connected with sales of bonds) and the necessity of making the payment at the moment of placing the order (money could be returned, interest free, only after distribution of all shares was completed). In this situation the management of "Próchnik" decided to set up its own share-distribution branch, which allowed for a slight acceleration of the process. On January 11, 1991 the subscription of shares was finally completed. It turned out that the orders were somewhat higher than the number of shares offered for sale. This could be attributed mainly to the fact that a strategic investor - a co-operative insurance company "Westa" - was found "in the last moment" by the Ministry. At first "Westa" intended to buy 20 percent of shares but the Ministry allowed only for the sale of 3 percent of them. In view of protracting sales of shares it was finally decided to sell 17 percent of "Próchnik" shares to "Westa"

Capital Structure

A principle of preferring small shareholders, having precedence in share purchases, was initially adopted. After the completion of the subscription, the first shares were sold to those who placed the smallest orders. Bigger orders were reduced to the actual capacities of share distribution. As a result of that, in January 1991 the ownership structure of "Próchnik" was the following: 17 percent of shares were owned by "Westa", 4.5 percent by Polish banks, 4.4 percent by foreign investors 2.6 percent by individual persons. The remaining 51.5 percent of shares were owned by small investors and shareholders, and 20 percent, potentially, by the employees (the sale of 300,000 shares for employees was completed in January 1992; all shares have been distributed). Approximately 30,000 persons have become the shareholders of "Próchnik", most of whom presently own not more than 5 shares.

Low level of participation of foreign investors may be surprising here. According to unofficial information they waited for another subscription of shares that would directly finance the Company instead of the State Treasury. The estimated privatization costs of "Próchnik" reached some 7 to 8 billion zlotys (some $ 600,000-700,000) with the proceeds totaling approximately 60 billion zlotys (some $ 6 million).

The First Conflict

The expectations of employees prior to privatization were obvious and understandable. They hoped that the privatized firm would be more efficient, but first of all, they hoped for their average wages (salaries) to rise substantially. Those expectations were based on the fact of lifting the wage-growth tax levied since the beginning of 1990 on all state-owned firms. The employees supposed that tax to be lifted immediately after transformation of the firm into a joint-stock company owned by the State Treasury. However, the tax may be lifted only when at least 50 percent of shares have been sold. When in December 1990 it turned out that wages in the firm are, on the average, by 30 percent lower than the all-Polish average, a conflict broke out between the employees and the management (the employees regarded themselves deceived). In view of a mounting conflict and even a strike the Management Board appealed on employees for keeping calm and being patient. The strike threat was eventually averted. In February 1991 the

Board decided to raise average wages (salaries) for more than a half. Since then, remuneration in the firm is close to the country average.

III SITUATION AFTER PRIVATIZATION

At the end of January 1991 the procedure of distribution of shares among the new owners of "Próchnik" was completed and the Company became a private enterprise.

Changes in Managing and Organization of the Firm

It was back in April 1991, that is two month since the completion of privatization that it was decided, on the request made by "Westa", to convene a General Meeting of Shareholders. Not more than 20 percent of the equity capital of "Próchnik" was represented then (the President of "Westa" alone held a 17 percent parcel of shares). Because of a considerably scattered structure of shares the parcel owned by "Westa" became wholly dominant.

During the General Meeting slight adjustments were introduced to the Company statute and the composition of the Supervisory Board was changed. It was decided to extend the composition of the Supervisory Board to 12 members (including 4 representatives of employees). At present the Board is composed of 11 members: four employee representatives, although such a requirement no more exists, three persons involved with "Westa" (being members of its Board), one person cooperating with "Westa" two persons representing banks, and one declaring himself as independent. According to members of the Board, not all the decisions made are dictated by "Westa", although it has a decisive say in deciding over strategic issues.

During the first General Meeting the Board was given a vote of acceptance. However, towards the end of 1991, because of the deteriorating financial standing of "Próchnik" and lack of sufficient adjustment measures one member of the Board was recalled. Shortly afterwards (February 1992) the President of the Board was dismissed. It was admitted that the hitherto activities of the Board did not guarantee right development of the firm and that it contributed to a collapse of its financial standing. A former employee of "Próchnik", later working for a competing clothing company in Łódź as a production manager (recommended and supported by "Westa") was appointed as a new President.

This was one of the first cases of exerting an influence by the new owner on the choice of managers and on management in the firm. Decisions taken in spring 1992 turned out to be very positive for "Prochnik", as the performance achieved by the firm after the first three quarters of 1992 indicates (see:Table 1).

Organizational changes were made that provided for creation of new jobs and employment of experts or employees representing appropriate skills needed in the new conditions of company operation (e.g. the number of salesmen was increased by 50 percent). The department of domestic sales and marketing was strengthened and a computer data processing department was set up. Since the beginning of 1992 internal business calculation is being introduced in selected parts of "Próchnik". The number of executive posts has been reduced to make the managerial structures more efficient.

Financial Standing

In 1991 the economic situation of Poland proved relatively difficult for most economic agents. The recession strengthened its grip, the profitability of exports declined (in the first half of the year) and average profitability indicators in companies fell considerably, while payment arrears rose markedly. In "Próchnik", despite the deteriorating collapse of the domestic market, market and financial problems were not as acute as those of other Polish enterprises (mainly due to stable exports). Nevertheless, 1991 closed with rather poor economic performance (see: Table 1). This was the first indication of lack of essential and necessary changes in the Company's operation.

In 1992 the firm's financial standing showed a marked improvement. In the first half of the year profitability increased, receivables and payables stabilized at the level of 1.5-2 times the value of monthly sales. The early, still unofficial results covering the three quarters of the year point to a clear upward trend in basic indicators (see: Table 1). The new Board of "Próchnik" seems to be leading the Company out of its temporary financial troubles.

Market Adjustment

Neither the commodity nor the geographical structure of sales has changed as a result of privatization. Namely, the privatization itself has not provided access to new selling outlets and has not contributed know-how concerning techniques and forms of sales. Lack of an active investor involved with the production pattern of the firm hampered significant changes in the market strategy. Despite of that, in 1991 and 1992 "Próchnik" introduced some important modifications in this field. First of all, as a result of insolvency of customers from the former USSR "Próchnik" backed out almost completely from that market. In 1991 the strategy provided for intensified exports to Western markets (even at lower profitability than that achieved on the domestic market). In the following year (1992) a strategy was adopted of non-differentiation between the domestic and the foreign market due to a comparable level of prices got on both of them. However, exports were kept on the level of some 30 percent (the bulk of them to Germany, the United Kingdom and France). In this case, however, the problem is posed by the falling profitability of Próchnik" on those markets (due to relatively rising production costs).

In 1991 no noticeable changes were introduced to sales methods and techniques. Old formulas were applied, with an adverse effect on, first of all, a decline in domestic turnover. It was only after the change of management that a decision was made to develop the network of local dealers, to enter cooperation with a network of wholesale warehouses and to increase the number of company-operated shops. Intensive advertising campaigns were launched, participation in fairs as well as in meetings of manufacturers and customers, etc. were intensified. These measures profited in the form of turnover growth recorded since April 1992.

In 1992 a decision was also made to try and enter new segments of the market. A market analysis was carried out and a strategy was prepared. The project involves high quality products sold in large cities at prices lower that those for foreign goods. Another field of strategic changes is an attempt of getting orders for cheap mass production (e.g. uniforms for guards, policemen, etc.). At present it is still difficult to evaluate the results of those measures.

Assortment Restructuring

During the first months following the privatization no decisions on a possible change of an assortment of manufactured products were made despite falling sales. It was only at the end of 1991 that the production offer was enriched by new items (ladies' wear) the demand for which was higher than for those manufactured so far. In 1992 orders were negotiated for the so-called service sewing of materials supplied mostly by German firms. This made it possible for a substantially higher capacity utilization (rise by 10 percent). Further rise in production was due to lack of manpower (despite very high unemployment in the Łódź region).

More ambitious production plans are limited by modest financial means owned by the Company. For a long time "Próchnik" has been troubled by excessive production costs. The solution of problem requires however, substantial financial outlays (modernization of equipment, new technologies). Only in 1992 it was decided to launch modest replacement investments (replacement of outdated machinery) and modernization investments (introduction of computers). Nevertheless, the needs in this field are much stronger. The price of an investment credit still limits its accessibility (the firm uses, mainly, working capital credit). On the other hand, privatization has brought the firm no capital support. Investors are not willing to invest in it more and the whole gain from privatization has been received by the State Treasury. The introduction of new technologies was not possible because of privatization having been carried out this way. On the other hand the firm has no financial means that would enable it to face technology challenges.

Stock Market Value of the Firm

The shares of "Próchnik entered the newly launched Warsaw Stock Exchange in the middle of April 1991. Although more than one year and a half have already passed since its opening, the stock exchange market is still shallow (shares of 16 companies are traded on it).

In the first week the quotation of "Próchik" shares exceeded by 12 percent the selling price registered in November and by almost 40 percent the real purchase price used for payments in bonds. Starting with the following week, the quotation of "Próchnik" shares, like those for shares of many other firms, started to fall systematically. In the middle of the year, the quotation for "Próchnik" shares ranged between 25,000 and 30,000 zlotys (at that time poor financial performance was announced, together with a decision on spending the whole 1991 profit on investments). In 1992 the quotation of "Próchnik" shares showed a slight, but sustained growth ("Próchnik" was seen as a "risky" firm facing serious troubles). In October 1992 the quotation recorded its lowest ever level of 17,500 zlotys (with the original selling price amounting to 50,000 zlotys). In November, following the announcement of financial results of the Company after three quarters of the year, the quotation started to rise and quickly reached the level of 30,000 zlotys. This resulted both from speculative demand for "cheap shares" and from information confirming an exceptionally good condition of the firm.

One may venture to say that the rapid and protracted decline in stock exchange quotations of "Próchnik" in the first months following the start of the stock exchange resulted from speculative turnover in shares (many people bought shares only to resell them immediately) and from low profitability of this form of savings (small shareholders realized that their dividend, even when available, will not compensate for the loss they are bound to suffer as a result of inflation and, apart of that, they will also lose due to the falling quotation of their shares). Another important reason for that were the reports about the relatively poor economic condition of the Company.

Generally, it should be said that value of "Próchnik" appraised in the privatization process was somewhat exaggerated. This remark also refers to many firms privatized following the capital path. Political and social pressures surely had their impact. The idea was not to sell firms for a "rock-bottom price" and to maximize budgetary revenues. The common practice was to adopt the possibly highest appraisal of the privatized Company value.

Consequently, after a year and a half of the operation of "Próchnik" as a company represented at the stock exchange its quotations dropped almost four times (at nominal prices). This means that in October 1992 the value of the shares of "Próchnik" represented in the real terms 17 percent of their issuance price. Moreover, in October 1992 the stock exchange value of the firm was not higher than 25 percent of its book value at the moment of privatization. All these figures suggest that the purchase of shares (not only of "Próchnik") turned out to be a very bad business for investors.

Despite the occasionally large transactions concerning the Company's shares, its capital structure remained, in fact, unchanged. Shares were mainly sold by small shareholders and employees concerned about their constantly falling quotations. Their parcels were rarely bought by the main investors of "Próchnik".

Results of Privatization

The results of the ownership transformation of "Próchnik" cannot be given an unequivocal evaluation. On the one hand, new owners facing a deteriorating economic condition of the firm and lack of proper means to avert it decided to use their powers and to re-shuffle the Management Board after having changed the Supervisory Board. Those changes turned turned out to be beneficial for the Company. Adjustment measures initiated by the new Board (market and product restructuring) relatively quickly brought about favorable effects (largely financial ones). These developments led to a substantial rise of the firm's stock market value (it increased almost twice between October and November).

On the other hand, the privatization of Próchnik" did not bring about either a better access to selling outlets or changes in sales strategies. It was only the collapse of the domestic market in 1991 that brought about a modification of sales acquisition methods and a search for new selling outlets. The ownership transformation did not mean, either, a capital support providing for new modernization and technology investments). The investments, falling short of actual requirements, engaged the Company's own means. They did not allow for a reduction of production costs, which for some time have been the major threat to "Próchnik's" competitiveness on both the Polish and foreign markets.

IV. CONCLUSIONS

The privatization of "Próchnik" and other firms transformed through public offering in 1990 revealed the scale and the complexity of the problem faced by the Polish way to privatization. It also laid bare the drawbacks and deficiencies of methods, instruments and provisions actually used. In the light of previous analyses and remarks concerning the privatization of Próchnik" it may be concluded that:

1. The capital path privatization, based on a public offering method, encountered two substantial barriers. First, it requires a long time for privatization of selected firms. Secondly, due to insufficient capital resources in hands of the population it is inefficient. This method makes it possible only to privatize only some 10-15 enterprises a year

(approximately 40 firms have been privatized this way within two years and a half). Therefore, it was decided to accelerate this process substantially through, first of all, liquidative privatization (still, it concerns only small and medium-size firms), introduction of the idea of quick sales (simplified tenders for small firms) and improvement of the mass privatization project, providing a chance for quick privatization of a considerable number of large and very large enterprises.

2. The simultaneous sale of shares owned by several firms proved ineffective due, first of all, to inefficiency of Polish banks and to organizational problems (insufficient number of issuing prospectes, comprehensive and credible information, lack of flexibility in the decision making process) as well as to the poor promotion campaign. As a result of that experience it was decided to go in for sale of other enterprises thorough public offering by the means of the "case by case" method. The sale was preceded by a developed, well-organized advertising campaign. The problem of information flows was better solved. As a result of those modifications, sales of any of other privatized enterprises took several hours to several days (the sale of shares of the first five firms took some six weeks).

3. As a result of the early experience it was also decided to look for active investors even prior to announcing the public offer of sales (the method of "invitation for negotiations" was sometimes applied). This was aimed at attracting private firms or institutions able to carry out indispensable changes in the firm and to secure its proper development. Besides, active investors also had to be able to introduce the firm to new markets or to import for it modern technologies.

4. The case of "Próchnik" revealed serious problems concerning the appraisal of privatized firms. Most firms privatized following the capital path have been slightly or seriously overvalued. As a result of this operation, their real stock market value (less the rate of inflation) ranged between 8 and 40 percent of their issuance value after a year or two years since their privatization. This is of much significance for building the capital market in Poland, creation of the so-called middle class and convincing the society about the need for privatization. The early experience with investment into securities was very discouraging. Anyway, other firms to be privatized were appraised

much more cautiously than the "top five" and they went under a much weaker social and political pressure.

5. As a result of the privatization experience of the first five firms an option providing for some revenues from privatization to be left in the company was examined. This, of course, meant a departure from the privatization doctrine reserving all gains for the state budget. However, it was decided that such solutions would be allowed in some special cases, and the decision on that would be made each time by the Minister of Privatization. In the two-year practice of privatization processes such a procedure was applied only once (in the case of "Swarzędz"). It was decided to allow that Company to spend some gains from privatization on repayment of its obligations (otherwise, the firm would, on the very outset of its operation, face serious difficulties due to sharp changes in the economic activity). It seems that a permanent change of philosophy behind privatization is clearly indicated here.

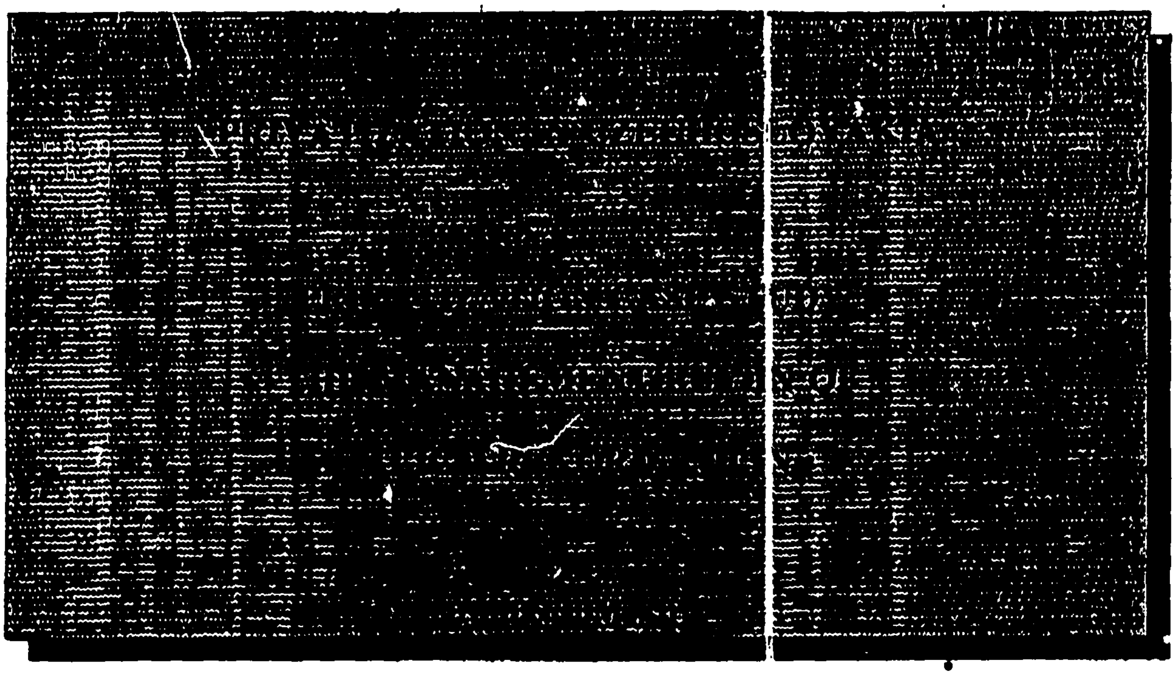
6. The early privatization experience also revealed the extent to which this issue has been misunderstood by the society and, first of all, employees of privatized enterprises. A necessity emerged of privatization principles and its possible advantages to be explained to employees beforehand. Because of lack of sufficient information and know-how disputes and conflicts were reported in several firms (including "Próchnik"). In most cases employees expected an immediate rise in wages (salaries) that would come even before the completion of privatization procedures. As a result, training schemes for employees and employee council members were organized under the auspices of trade union organizations, governmental institutions, universities, scientific institutes and other establishments.

Table 1

Basic Indicators

Period Indicator (billions of zlotys)	Jan. 1990	Feb. 1990	Jan. 1991	Feb. 1991	Jan. to Sept. 1992
Sales	**53.948**	**103,044**	**67,865**	**107,488**	201,600
Total costs	36.074	83.179	62.403	100.075	172.300
Gross profit	25.104	27.062	5.357	5.831	25.576
Net profit	14.720	8.632	3.486	2.843	14.264
Profitability (%)	**69.5**	32.5	**8.8**	**5.8**	**15.0**
Receivables	9.739	24.644	16.307	28.161	32.359
Payables	10.479	5.957	31.617	18.622	24.924

CZECH AND SLOVAK REPUBLICS



PRAGUE, DECEMBER 1992

A. BACKGROUND

Founded in 1919 by J.L. Bayer, Rekord-Kolín began as a manufacturer of coated abrasives for the paper and printing industries. In 1958 Rekord-Kolín became one of the two subsidiaries of the state owned producer of abrasive materials, Carborundum Electrite-Benatky and Tiberon.

The new era of privatization has seen the break up of many state owned enterprises including Carborundum-Electrite. In 1991 Rekord-Kolín gained its independence from its parent corporation and now functions as a wholly autonomous entity. Today, Rekord-Kolín is one of the three Czechoslovakian producers of abrasive materials. The other producers are Carborundum Electrite-Benatky, the former parent corporation, and Carborundum-Moravit the other subsidiary.

Rekord-Kolín manufactures over 3,500 different types and sizes of coated abrasive materials. The firm's primary products include the production of flex wheels, endless abrasive belts, water proof abrasives and abrasive cloths. Rekord-Kolín distributes all products directly to end-users with the exception of some export merchandise that goes through a foreign trade firm.

Rekord-Kolín has its offices in the industrial city of Kolín, a mid-size city of 35,000 inhabitants about 60 km. from Prague. The factory is within 2 km of the Kolín railroad station and near the main highway to Prague.

The company is located on approximately 64,847 sq. m. of land on three separate plots. Two of the plots are across the street from each other and the third is on the other side of town.

B. COMPANY PROFILE

As of Sept. 30, 1992, Rekord-Kolin's balance sheet showed assets totalling 130.6 million Kcs. Equity amounted to 59.1 mil. Kcs. Sales declined from 142 mil. Kcs in 1989 to 132 mil. Kcs in 1990. For 1991, this number increased to 192 mil. Kcs, but the increase in sales was mainly due to the price liberalization which took place in early 1991. Exports fell from 61 mil. Kcs in 1989 to 37 mil. Kcs in 1990, and then increased to roughly 45 mil. Kcs in 1991. Export activity had been oriented mainly toward Eastern (CMEA) markets. Generally, profits were not strong during this period, at about 6-7 mil. Kcs annually.

Pre-Privatization Balance Sheet of Rekord-Kolin (9/30/1991)			
Assets (thousand Kcs)		Liabilities and Equity	
Fixed Assets	40,320	Equity Capital	59,085
Accounts Receivable	36,335	Bank Loans	37,629
Inventories	52,962	Accounts Payable	30,590
Cash	1,032	Other Liabilities	3,345
Total	130,649	Total	130,649

1. Products

Rekord-Kolín manufactures 3,500 different kinds of coated abrasive products and more than 50 types of flex-wheels. The different products include:

- flex wheels - hardened with glass textile for grinding metals and stones
- endless abrasive belts (ROLLS) - for machine surface adjustment
- abrasive paper
- abrasive combination - for machine grinding of synthetic materials
- abrasive cloths
- waterproof abrasive paper

Products are manufactured in various grades of quality and dimensions. Specific customer requests can usually be met without difficulty.

Rekord-Kolín products are used for the grinding of wood, metals, fabrics, lacquers, stones, rubber, ceramic materials and leather. They specialize in the production of FLEX snagging wheels used on hand angular grinding machines, and abrasive papers, cloths and combinations. Their trade brands GLOBUS, CIDOR and REKORD are well-known all over the world.

Exact technical parameters are used in the selection of raw materials for the production of abrasive materials. The grit size for the abrasives correspond to the FEPA (Federation Europenne des Fabricants des Produits Abrasifs) international standard. The abrasive grain usually used is artificial aluminium oxide or silicon carbide. The bond base used for the FLEX wheels is a henolic resin mixture. For higher resistance the wheels are strengthened with glass fibre inserts.

For the backing of the abrasive materials Rekord-Kolín uses special papers of high strength and weight of 120, 130, 170, 200 and 220 grams per meter squared. Rekord-Kolín normally uses animal glue combined with an artificial bond for its sealants.

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The quality of Rekord-Kolin's product is equal or above its domestic competitors but behind its Western competition. However, the price is substantially lower than its Western counterparts. Prices are approximately four times higher in the West, but management estimates that the quality of similar products are only twice as high. However, management realizes that to survive, exports must increase and in order attain this the products must meet western quality standards.

In order to meet western quality standards, the company started the construction of a new factory for abrasive papers and FLEX wheels. Thus, the quality of the products will greatly improve. Prices will also increase, but will remain lower than the western competition. The new plant will also meet all environmental regulations. The factory is scheduled for completion by the end of 1992.

2. Facilities, Technology, and Manufacturing Processes

The FLEX wheel production is contained completely in one building. A basic three step process is required for the production of the FLEX wheels. Abrasives purchased by the company are pressed to glass fibre wheels creating several layers. The glass fibre wheels are then connected to the metal wheels. Stacks of the unfinished wheels are placed in hardening ovens for 48 hours.

The final FLEX baking step releases pollution directly into the air. In order to meet future environmental regulations this production facility will be closed and replaced by the new facility which is expected to be completed in late 1992.

Quality is checked throughout the production process and at the final stage of production before the product is shipped to the end user.

A separate production facility on this part of the plant is responsible for the production of the water proof abrasive paper. The process begins as a large roll of paper is slowly unrolled at one end of the production process. The company logo is printed on the back side of the paper while on the front an electrostatic coater applies the abrasive. The coating is then glued to ensure durability. Large strips of this paper are hardened during an 11 hour steaming process. Unfortunately, this process also creates toxic emissions. However, the new production capacity will eventually replace this facility. From the finished roll of abrasive paper various shapes and sizes are cut out for final sale.

The first two production facilities produce a significant amount of pollution including phenol, formaldehyde, xylene and lacquer petrol emissions during the drying process. The total quantity of toxins released amount to 60 t/year. This problem will be solved by the investment in the new production line which utilizes tunnel drying rooms that liquidate toxic emissions.

The newest production facility produces the same abrasive paper as the previous facility. However, the production process uses a high technology one step machine. In one step the printing, electrostatic coating, and drying occurs. The drying process uses hot air rather than steam and the total production time is only 8 hours. The maximum production capacity is 3500-4000 meters per shift for abrasive papers with a grit of 60.

For a listing of some of the major equipment please see Appendix 1.

Rekord-Kolín is currently constructing a new factory space that will replace obsolete and environmentally unsafe production processes. The new factory will be located on the main premises in Kolín. Construction has almost been completed.

3. Marketing and Distribution

For the year 1991, total sales of Rekord's products were 192 million kcs.. Flex wheels represented 36 million kcs. of sales and the rest was divided among the other abrasive products. Management believes that in order for the company to survive it must focus on exports since the economic conditions in Czechoslovakia have caused much of the domestic market to be insolvent and have made payments uncertain. Thus, in the short term to ensure payment, Rekord-Kolín will focus on the exportation of their products.

Rekord-Kolín's international market includes exports to Syria, Lebanon, Philippines, Yugoslavia, Poland, Germany, France, England, and Central and South America.

Rekord-Kolín distributes its products to more than 1,000 clients in the domestic market through direct sales. This number is quickly growing due to tremendous industry restructuring. Smaller customers receive their products through REMPO-Praha and REMPO-Bratislava. This distribution company also provides Rekord-Kolín products to foreign customers. Eventually, Rekord-Kolín plans on eliminating the trade company completely in order to keep Rekord-Kolín's prices down by avoiding any markup pricing by the trade companies.

Rekord-Kolín has not traditionally actively marketed its products domestically. Instead, it has relied on name recognition and affordable prices. Rekord-Kolín does not have a direct sales force.

Internationally, Rekord-Kolín's product line is marketed through various trade magazines and foreign trade companies. Currently, Rekord-Kolín exports 50% of its sales of abrasive papers and combinations and 30% of the FLEX wheel sales. Approximately one-half of these products are exported through the foreign trade company Oesroslo-venska Keramika. The remainder are sold through direct sales.

4. Management and Personnel

Rekord-Kolín currently employs 193 people. Of the total 137 are production workers and 56 are white collar workers. This number is significantly lower than the 258 who were employed there in 1989, but has not changed significantly since the company gained its independence.

Ing. Josef Tvrdik became the Managing Director of the firm starting in January 1992. Prior to becoming Managing Director, Mr. Tvrdik headed the Economic department of Rekord-Kolín since 1982. With another former director, Mr. Tvrdik presented a plan for privatization of the firm by conversion of the enterprise into a joint-stock company with a partial management buy-out.

C. PRIVATIZATION OF REKORD-KOLIN

The firm's management, headed by Ing. Tvrdik, presented its own privatization project, as required by the privatization process. However, a separate group of interested buyers outside of the firm teamed with two members of junior management and two former members of the firm's junior management to write up a competing privatization proposal. Their project was presented by the end of December 1991 and was prepared with the outside assistance of the Czech consulting firm Equity Expansion International, Prague. The authors of the project joined to create a limited liability company, ALICO, in order to purchase Rekord-Kolin, as well as one other firm in which they were interested in gaining a share.

The business plan in ALICO's competitive privatization project was mainly written by members of junior management who had good knowledge of the firm and had actively contributed to earlier restructuring efforts. Their plan suggested an aggressive strategy to attract more attention to the products manufactured by Rekord-Kolin, because they felt that there was good potential for the firm's future operations.

The following structure of privatization was submitted by ALICO as of December 30, 1991:

Rekord-Kolin's Structure of Privatization	Total Property	Property not in project (restitution)	Unuseable property	Direct Sale
Total Assets	130,424	970	0	129,454
Liabilities	72,651	0	0	72,651
Book Value Equity	57,773	970	0	56,803
Assets not in books	7,930	3,668	0	4,262
of which: land	4,004	3,668	0	336
other	3,926	0	0	3,926
Total value of property	65,703	4,638	0	61,065

Part of the firm's property was to be returned to its original owner in order to satisfy a restitution claim, but the original owner confirmed that he was not interested in obtaining the physical property of the firm and negotiated another form of compensation. The original book value designated for direct sale according to Czechoslovak accounting standards was 56.8 mil. Kcs, but in accordance with western standards this amount had to be adjusted upwards by 4.3 mil. Kcs due to the value of assets not included in the book value (336,000 Kcs due to revaluation of land). Under the submitted plan, none of the property was to be written off as unuseable.

In July, 1992, the Ministry of Privatization of the Czech Republic approved the competitive project which had been submitted by ALICO. This project then had to gain government approval, which was obtained by October, 1992. The Fund of National Property sold Rekord-Kolin to ALICO after some further small adjustments, for a final adjusted book value of 55.5 mil. Kcs on December 1, 1992.

As part of the agreement, ALICO must pay half of the agreed upon sum to the National Property Fund by the end of January, 1992, and half will be paid over three years in annual payments of about 9 mil. Kcs. These payments will be interest free, quite advantageous conditions in comparison with those offered by commercial banks. In addition, the new firm must pay off bank debt inherited from the old firm. The privatization has had a negative effect on Rekord-Kolin's capital structure.

D. FUTURE PLANS

Rekord-Kolin is the largest producer in its branch. Its main competitor is producing only 43% as much. The company cannot cover demand for its products while working only in one shift. In fact, goods are being imported to cover excess demand of domestic producers. ALICO has suggested that Rekord-Kolin widen its manufacture of competitive products, working in two or three shifts with better organization of the manufacturing process. The firm's comparative cost advantage should allow for an expansion of exports. Therefore, ALICO and the firm's new post-privatization management have established contact with several foreign trade partners, which has already led to the preparation of several trade contracts.

The business plan anticipates the following cash flow developments in the next few years:

Sales	201.8	207.3	209.6
Costs	170.9	174.6	176.8
After tax profits	17.0	18.0	18.0
Depreciation	4.5	5.0	6.0
Cash Flow	21.5	23.0	24.0
Installment payments to FNP	(9.0)	(9.0)	(9.0)
Payment on Bank Debts	(11.5)	(12.0)	(13.0)

Data on anticipated profits are created from existing contracts, past performance, and expert assessments of the future of the firm. Data on expected depreciation come from the existing structure of assets, assumed investment, and constant rates of depreciation.

Over the next few years, the required payments to the FNP and banks, including inherited debts, will squeeze remaining profits, but over time Rekord-Kolin's profits should increase to cover these obligations more comfortably.

E. CONCLUSIONS

Rekord-Kolín is making plans for the future. Construction has nearly been completed for the new production facility that will improve quality, upgrade efficiency, improve working conditions, and adhere to environmental concerns. Rekord-Kolin intends to work to increase production for the domestic market, where there is excess demand, and to increase emphasis on its export market, as well, due to its comparative cost advantages. The new post-privatization management is trying to meet this challenges by increasing production through use of multiple shifts, cutting costs, and establishing new trade contacts.

The domestic market is extremely important to Rekord's survival. Rekord-Kolín's domestic competitors could easily be a serious threat. The firm needs to more aggresively market its products and hire a committed sales force. In comparison with the former management, the new managers are placing increasing emphasis on marketing and new product designs.

APPENDIX 1

TYPE OF MACHINE	NUMBER	AVG. AGE	MAKE
FLEX WHEELS			
mixture	2	15	domestic
pressing	4	7 - 18	Ryple/Germany
[illegible] products	[illegible]	[illegible]	[illegible]
ovens	10	10	
flex machine	1	4	Anacker Schmidt/Switz.
ABRASIVE PAPERS			
drying chamber	2	25	
sheet cutting	1	14	Hoffman Schwabe/German
sheet cutting	1	4	Anacker Schmidt/Switz.
sheet cutting	3		in-house
ROLLS			
cutting	1	20	Anacker Schmidt/Switz.
cutting	1	40	U.S.A.
cutting	4	10 - 15	in-house
ENDLESS BELTS			
cutting	1	20	Anacker Schmidt/Switz.
cutting/100mm-450mm	1	20	Sandt/West Germany
pressing/100mm-450mm			in-house
circle cut/500-900 mm diameter	1		in-house

segment of the market, within 3 months the new original design of car jacks was produced through an external designer. Within a further 6 months, the production of these jacks was fully implemented and delivered to Skoda-Volkswagen. By now, this has become the main product manufactured by Pistol Hlinsko and it continues to be promising for the future. In fact, Skoda-Volkswagen sent quality inspectors to check the quality of production processes at Hlinsko, and these inspectors were fully satisfied and recommended the company to further potential clients. Since then, a new car jack design is being developed in cooperation with another large foreign car manufacturer for an order which should be implemented in 1994. The increasing returns which this production should bring can be seen from the following table on anticipated future cash flow.

[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
After tax profits (including interest payments for privatization loan)	7.2	11.5	11.3	14.5
Depreciation	3.0	3.0	3.[illegible]	3.2
Cash Flow	10.2	14.5	14.[illegible]	17.7
Payment of Privatization Loan	(7.2)	(7.2)	(7.[illegible])	(7.2)
Payment on Bank Debts	(1.2)	(1.2)	(1.[illegible])	(1.2)

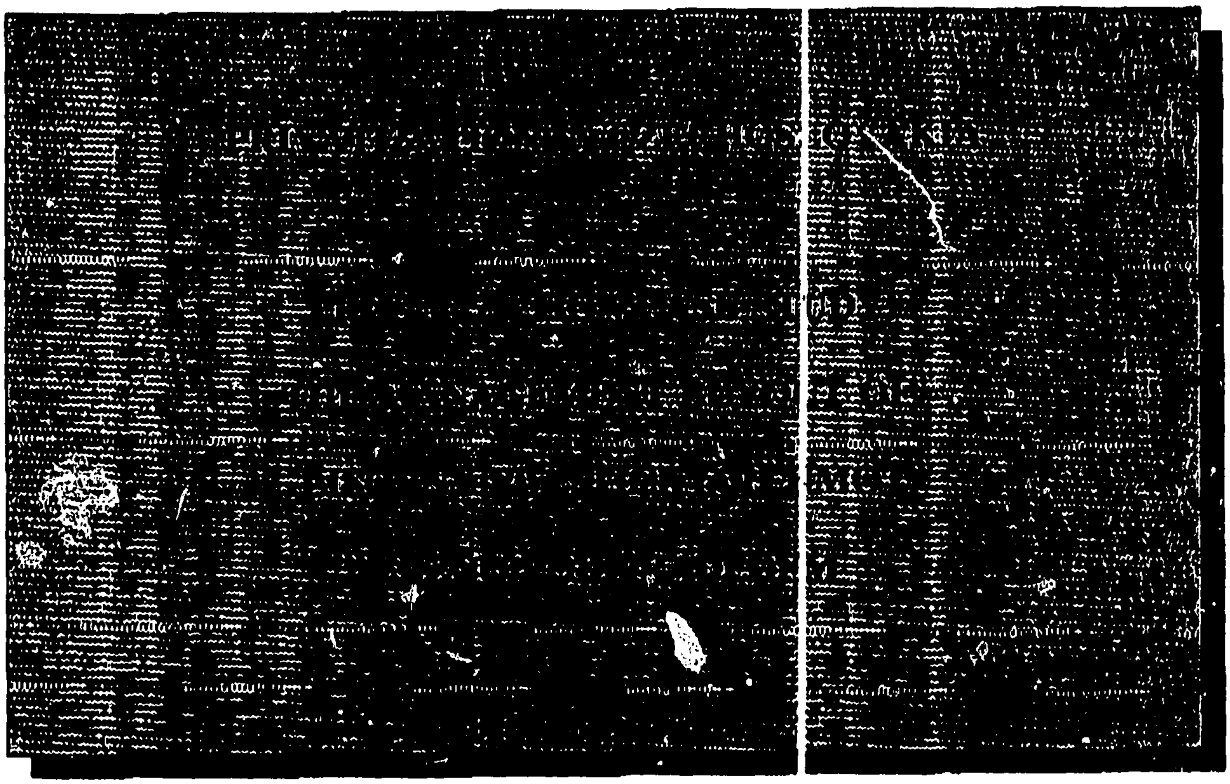
See Appendix A for more details of the three scenarios. Data on anticipated profits are created from existing contracts, past performance, and expert assessments of the future of the firm. Data on expected depreciation come from the existing structure of assets, assumed investment, and constant rates of depreciation.

As can be seen from the above table, in the early stages after privatization, the required loan payments will squeeze remaining profits, but over time profits should increase to cover these obligations more comfortably.

E. CONCLUSIONS

The successful restructuring of Pistol Hlinsko is a good case of the activity of management acting to increase the profitability of a firm which they are acquiring. Assuming that no major changes occur, HTN Pistol Hlinsko should be able to cover their liabilities and prosper, especially once the four year privatization loan is successfully paid off.

An especially striking point is the flexibility of this small company. A clear drawback is the firm's reliance on one large customer, Skoda-Volkswagen. In fact, currently other customers are showing interest in Pistol's products, which could allow the enterprise to diversify its clientele and further solidify its future development.



PRAGUE, DECEMBER 1992

A. BACKGROUND

Lisovny Plastických Hmot--Vrbno pod Pradědem (LPH) was founded in 1955 as a maker of bakelite products used in electrical applications. As new materials and production technologies became available, LPH incorporated them into the making of its products. **Today, the company is the most technologically advanced producer of injection-molded plastic products in Czechoslovakia, and the second largest producer of its kind in the nation.**

Before 1990, LPH was the largest of the eight manufacturing divisions of the firm Lisovny Nových Hmot (LNH). In 1990 a ministerial decree split up LNH giving each of its eight factories autonomy (Please see Appendix A for a complete description of the eight units). As part of the breakup, LPH received a large portion of the assets of its former parent company. Certain marketing, design, and investment services are still provided to LPH by LNH management under contract; however, LPH is rapidly becoming completely self-sufficient.

LPH is located in Vrbno pod Pradědem, a northern Moravian town 100 km west of Ostrava and 350 km east of Prague. The factory is accessible by road, rail and through Ostrava by air. All the company's buildings occupy 122,800 m^2, of which 47,700 m^2 are used directly for production and another 13,000 m^2 are used for storage. The company currently employs 750 people.

85% of LPH plastic moldings consist of technical products and are made according to customer specifications. The remainder of the company's output consists of household products sold in retail outlets throughout Czechoslovakia.

B. COMPANY PROFILE

LPH's Sales in 1990 were almost 300 million Kcs, but increased sharply in 1991 to roughly 500 million Kcs. Before tax profits in 1990 were about 19 mil. Kcs, in 1991 they amounted to roughly 41 million Kcs ($1=28 Kcs). Due to the efforts of the new management, before-tax profits nearly doubled. After-tax profits increased from 6.5 mil. Kcs to 18 mil. Exports increased from 7 mil. Kcs to over 23 mil. Kcs. This improvement created a rather favorable capital structure for the firm, as well (see balance sheet below). This capital structure remained favorable even though fixed assets in 1991 were depreciated by 50.5%. The gross labor productivity increased also, while the labor force decreased from 811 in 1989 to 800 in 1990 and 790 in 1991. During the last five years, the firm has never relied upon any subsidies from the government, an unusual condition among Czechoslovak firms.

Part of the enterprise's strong performance can be attributed to the fact that management had already submitted a privatization project proposing management buy-out in

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September 1991, which motivated them to improve the enterprise's performance over the long term.

Pre-Privatization Balance Sheet of LPH (3/31/1992)			
Assets		Liabilities and Equity	
Fixed Assets	155,810	Equity Capital	203,107
Accounts Receivable	130,954	Bank Loans	46,229
Inventories	96,762	Accounts Payable	127,889
Cash	12,358	Other Liabilities	18,659
Total	395,884	Total	395,884

1. **Products**

LPH currently makes 4,000 different products which range from simple plastic bottle tops to intricate housings for electrical appliances. Two major strengths of LPH are the high level of technical development of its products, both molds and final plastic products, and its low prices, which allow it to be competitive on global markets. Some of the firms larger product lines are:

- housings for home appliances
- insulated casings for electrical switches, circuit breakers, and sockets
- household products
- automotive parts

LPH products meet all necessary Czechoslovak and international certifications. See *Appendix B* for a complete listing of the top 9 products for different customers, including costs of raw material, total costs, selling prices and yearly volume.

The company possesses the technology to produce injection-molded pieces from a variety of raw materials, including polyolefines, polystyrene, ABS SAN, polyamides, polycarbonates, polyesters, special thermoplastics and many modifications of theses polymers. The only plastic that they do not use is PVC. These materials are easily available from suppliers in both Czechoslovakia and the West and **approximately 50% of the raw materials are imported.**

The strength of LPH's products lies in the company's ability to design and manufacture all of its own molds. This in-house capability, which utilizes state-of-art Western equipment, allows the company to produce molds for virtually any injection-molded piece. The use of these molds in automated injection machinery ensures that product quality compares to that of Western manufacturers.

2. Manufacturing Process

Once LPH receives an order for a new product, the company begins work on the mold. For new mold designs, LPH employs sixteen designers who use computer-aided design tools. If the customer provides the design, it takes between two and thirty weeks to produce a new mold depending on the size, the complexity, and the urgency of the order. If the customer provides the mold or the mold is in stock from a previous production run, production can begin within one week.

LPH's in-house mold workshop includes two new West German Deckel computer-controlled copying/cutting machines, and three Swiss Charmilles electron cutting machines for detailed work. MAS precision grinding machines and the workers' expertise ensure an average precision of 1/100 of a millimeter. If needed, they are able to match specifications to 1/1,000 of a millimeter. Finally, the molds are tempered for durability.

Unlike other Czechoslovak firms, LPH has consistent raw material supplies. This is important because LPH uses twenty tons of raw plastics per day. Due to its size and timely payments, the company is able to command competitive prices and frequent deliveries. Roughly half of LPH's raw materials are sourced from Western firms and the rest from domestic firms. The materials sourced through domestic firms are comparable to those from the West, but can cost 30 percent less. This price differential is important because raw materials account for 70 to 80 percent of costs.

The injection molding process uses 120 machines (5 additional machines are used for testing new molds). The fifty largest machines of 160, 250, 320, 400, 500, 800, 1,000, and 1,200 tons of pressure use as much as 9 kg of plastic per piece. (Please see *Appendix C* for a more detailed description of the machines). Most of these machines were made by Engel of Austria and KuAsy of Germany. These machines are popular because of their reliability and familiarity. All the large machines employ robotics to handle the newly formed products which reduces human error. The large machines can produce one piece per minute and account for roughly two thirds of annual sales.

The 70 smaller machines account for one third of sales. These 36, 48, 50, 88, and 100 ton pressure machines produce 40 pieces per minute. Most of the smaller machines are made by Engel, KuAsy, MAG of Czechoslovakia, [illegible] of Germany and MIR of Italy. These machines produce products under 150 grams such as switches, sockets, and audio cassette boxes.

24% of LPH's machines are less than five years old and 43% are between six and fifteen years old. The remainder range in age from 16 to 25 years.

The company ordinarily employs statistical quality control techniques, but is willing to inspect 100 percent of output if requested by a customer. In the end, two percent of the products are found defective. These plastic pieces are recycled on-site and used in future injection molding. **Only one-hundredth of one percent of the goods are returned by the end customer.** In such a case, LPH will credit the customer or replace the defective products.

3. **Capacity**

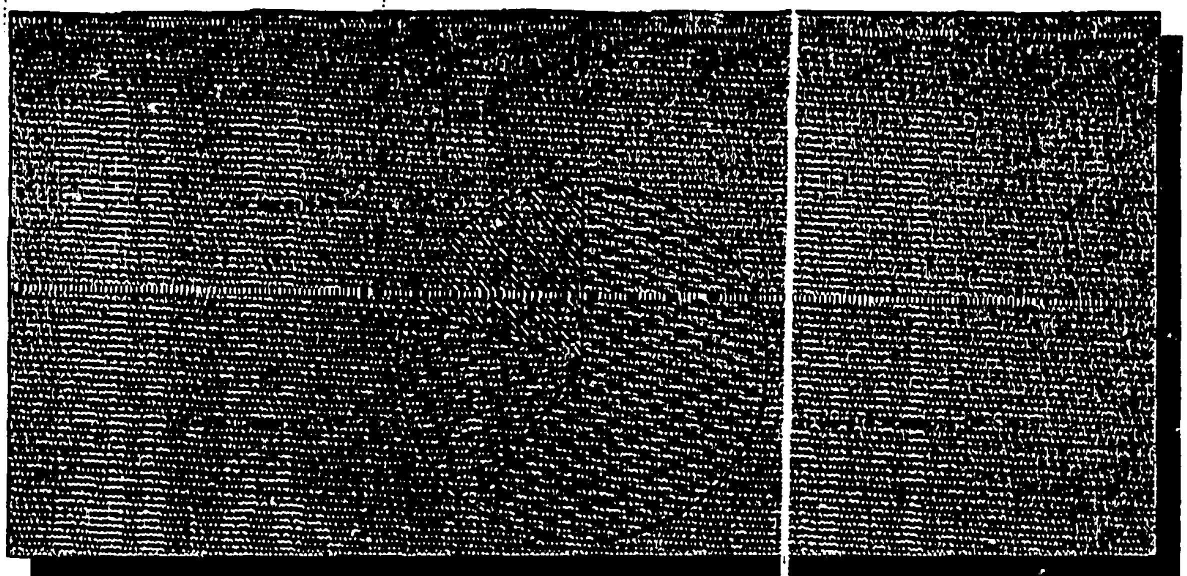
LPH is an uncommon Czechoslovak manufacturing company. **Even during the turmoil of the last year, LPH has continued to operate at near full capacity.** The company operates three eight-hour shifts a day, from 22.30 on Sunday until 22.30 the following Friday.

During any shift, approximately ten machines are cleaned and the molds changed. LPH needs up to three hours to change a mold and a similar amount of time to clean a chamber. Except when there are exceptional demands for production, LPH uses the weekends for preventive maintenance.

One benefit of operating at near full capacity is that LPH is able to choose which orders to fill. When there is little room in the production schedule for smaller, lower margin products, LPH is able to pass the smaller orders on to its affiliates from the old LNH firm. This allows LPH to pick up new, more demanding projects while retaining their old customers who need simpler products.

Even though LPH is operating at near capacity, there are possibilities for increasing its current output. 20% of the production is for low margin products, which LPH can easily pass along to its former affiliates. In addition, the managers estimate that there is an additional 15 to 20% of "Reserve Capacity:" the ability to shift priorities in order to make room for more important projects. There are two places within the existing facilities where new machines could be placed: a storeroom in the main building with 1,200 m^2 and an expedition room with 324 m^2 free. **Potentially, almost 40% of production capacity could be devoted to an additional long term commitment.** (see chart, following page)

Furthermore, there is space for additional capacity expansion. Some of the contracts are up for renegotiation within the next six months. This means that LPH could target additional capacity for outside firms if it is given some advanced notice. Finally, there is a large, 300 person yarn factory across the street that is in the process of being shut down. It easily could be purchased to increase LPH's capacity



CAPACITY AVAILABLE FOR EXPANSION

4. Distribution

To ship its products, LPH has a three-bay loading dock. The company ships 30 percent of its products by truck and the rest by rail. In addition to its two trucks and full-time drivers; the firm hires outside trucking concerns to meet demand. A railhead is located only two km away from the factory. Management hopes to build a direct connection to the rail line. Regardless of the method of transportation, it takes less than 48 hours to clear any border; most borders are accessible within 24 hours.

During the recession of Czech industry during 1991, LPH permeated the Czechoslovak marketplace with its household products in order to diversify distribution channels. Besides selling its products to other manufacturers (like Hlinsko) the company sells its products directly to 30 of the largest retail organizations and to some of the state wholesale organizations. Two of the largest customers for LPH's household products are Domaci Potreby and Drobne Zbozi who operate both wholesale networks and their own retail chains with thousands of shops all over the country.

During the present small and large privatizations, many of the retail and wholesale networks are beginning to collapse. To fill the voids, LPH is establishing relationships with new, private wholesalers throughout the nation, for example in Prague, where LPH extends 90 days credit on its goods.

5. Marketing

Forty years of central planning have left the company with no Western marketing skills. LPH makes inexpensive, high quality products that used to sell themselves. However, the Czechoslovak immersion in a free market has made it necessary for the company to take an active approach to marketing in order to sell its goods. Management realizes the need for active marketing efforts and is doing everything possible to rectify the problem.

LPH has established a new marketing/trade department to concentrate on active sales promotion. Furthermore, two employees will be sent to England to improve their language skills and business acumen. Frequent participation in regional trade shows has begun to yield positive results.

LPH's strongest marketing attributes are price and quality. These are especially attractive to the company's more price-sensitive customers. The firm offers volume discounts from its cost-based pricing system to maintain near full capacity. In addition, the company must offer its largest customers favorable credit terms to help them weather their current economic difficulties.

6. Management and Personnel

LPH employs approximately 750 people. LPH Managing Director, Ing. Petr Gross was chosen for the top position in June 1990. He is extremely knowledgeable about the production process; he has a degree in macrochemical engineering and has been with the firm for fifteen years. Unlike many other Czechoslovak managers, Ing. Gross has a general knowledge of Western marketing and business techniques. He has worked to focus the company on injection molding and has contracted non-essential services, such as the company hotel, employee housing and the company's recreation facilities to outside firms. More work needs to be done in this area, but Ing. Gross has a clear vision for the firm and the energy to succeed.

The first line management team under Ing. Gross consists of the Production Manager (Ladislav Kubalek), Economics Manager (Svatoplur Maj), Technical Manager (Jan Czernin) and the new Trade Manager (Jiri Simunek). Ing. Kubalek was the previous Production Manager for entire LNH corporation and he still has key customer connections from that position. Mr. Maj is young and quickly grasps Western business concepts. Mr. Czernin has a university education and is responsible for the tool work shop. Finally, Mr. Simunek, the Trade Manager will be responsible for developing the new Marketing Department.

The next line of management includes the Maintenance Supervisor (Jaromir Malec), Computer Manager (Otto Plachy), and the Personnel Director (Margit Placha). These three middle managers have been with the company for many years and have served in other administrative capacities.

These managers will play a critical role in LPH's transition to the private sector. **The real challenge for creating a more efficient firm depend on Ing. Gross's ability to encourage these managers to exercise more responsibility,**

authority and initiative.

The workforce is well educated and highly skilled. This is particularly evident in the mold making department where the attention to detail and advanced skills result in quality products. All machine operators have a vocational education as well as three years apprenticeship experience. LPH pays its workers a base salary, personal bonuses and a premium tied to the company's overall performance. For a more detailed description of the work force, please see *Appendix D*.

C. MARKETS

1. Description

The domestic market represents 95 percent of LPH sales. As the Czechoslovak economy liberalizes, the demand for plastic products is increasing, allowing LPH to start once more to concentrate on wholesale production rather than retail markets. In the event of either an economic recession or upturn, LPH is flexible enough to meet changes in demand.

LPH has the potential to grow faster than the increase in the Czechoslovak plastic consumption, but only if its efforts are directed towards the vast international market. Currently, the company's direct exports constitute five percent of total sales, half of which go to Poland with the remainder going to Western Europe. These figures however, do not include indirect exports. The firm's largest domestic customer, which accounts for 45 percent of total sales, uses LPH plastic components in appliances exported to the West.

2. Customers

A positive sign for LPH is that its top five customers represent some of the major manufacturing industries within Czechoslovakia. The following is a list of LPH's major customers:

- Electro-Praga Hlinsko (45% of sales) is a manufacturer of electric appliances incorporating LPH products. As part of long term cooperation agreements with two major Western appliance firms (Phillips and Rowenta), many Electro-Praga products are exported under the Western firms' tradename.

- Slovenske Electrotechnicke Zavody (15%) makes switches and sockets using plastic [illegible] LPH.

- Electro Pristroje--Pisek (10%) makes electro-technical components including plastic switches, knobs and "on-off" buttons produced by LPH.

- Electrotechnicke Zavody--Bystrany (5%) uses LPH plastics in its fuseboxes.

Other important customers of the firm are Tatramat (washing machine maker), Calex Zlate Moravce (refrigerators), Skoda (automobiles), Avia (trucks), and CSD (Czechoslovak national railroad).

As for international customers, Poland has proven to be a lucrative market among former COMECON members. LPH hopes to expand further into Poland since the Poles have no competitive producer of plastic injection-molded pieces. Polish customers are attractive because they pay for their orders in advance and in hard currency.

3. Competition

The primary considerations when discussing LPH competitors are (1) the ability to produce top-quality injection molds and (2) the ability to use the molds efficiently.

Within the Czechoslovak plastics industry, LPH is a leader in technology and in controlling overhead costs. In addition, LPH employs 130 highly skilled mold makers--more than any other firm in Czechoslovakia. The firm's largest Czechoslovak competitor is Plastimat Liberec, the only other domestic plastics producer to operate at near full capacity. Plastimat produces wide range of products for Skoda Mlada Boleslav.

Outside Czechoslovakia, LPH is competitive with other European firms. Since LPH is able to purchase materials from the same sources as their Western competitors, the firm derives its competitive advantage from lower labor and overhead costs.

D. PRIVATIZATION OF LPH

LPH management presented [illegible] proposing a management buyout. The project was prepared with the outside assistance of the Czech consulting firm Equity Expansion International, Prague. The proposal was based on the fact that management was ready to start restructuring of the whole company and to secure its future development in a region suffering from generally depressed economic conditions. Eight members of the firm's management joined to create a limited liability company, Plast Vrbno, in order to purchase the firm LPH.

By the end of September 1991, and finally in October 1991 the proposal was submitted to the Ministry of Privatization, which approved this direct sale only after [illegible] months of deliberation. The Fund of National Property of the Czech Republic, the temporary owner of the firm, implemented the project by August 1, 1992, when the firm was sold to Plast Vrbno as they had proposed. The new company took over ownership of LPH, as well as the firm name.

Between submission of the proposal and its implementation, the privatization plan was updated five times in order to comply with changing rules and developing conditions. The following structure of privatization was finally submitted as of March 31, 1992:

LPH's Structure of Privatization	Total Property	Property not in project (restitution)	Unuseable property	Direct Sale to Plast Vrbno	Unpaid transfer to municipality
Total Assets	395884	983	23209	341804	29888
Liabilities	192777	0	0	192777	0
Book Value Equity	203107	983	23209	149027	29888
Assets not in books	10447	0	0	10018	429
of which: land	57	0	0	57	0
other	10390	0	0	9961	429
Unuseable assets	x	x	7681	7681	0
Proceeds from sales of unuseable assets	x	x	0	0	0
Total value of property	213554	983	15528	166726	30317

From the table above, it can be seen that some of the original property of LPH (983 thousand Kcs) was returned to the original property owner, a share of the enterprise (30.3 mil. Kcs) was transferred at no cost to the municipality. Property given to the municipality included the enterprise's nursery school, employee's flats, dormitory, the enterprise laundry building and parks. The original book value designated for direct sale according to Czechoslovak accounting standards was 149 mil. Kcs, but in accordance with western standards this amount had to be adjusted upwards by 10 mil. Kcs due to the value of assets not included in the book value (57,000 Kcs due to revaluation of land). Under the submitted plan, part of the property (15.5 mil. Kcs) was to be written off as unuseable, however in the final approval this figure was not accepted and was added to the value of the equity of the firm. After some further small adjustments, the final adjusted book value agreed upon as of Aug. 1, 1992, was 183.5 mil. Kcs.

As part of the agreement, LPH must pay the National Property Fund 183.5 mil. Kcs (the equity value) by the end of 1996 in five yearly payments of 36.7 mil Kcs. These payments will be interest free, quite advantageous conditions in comparison with those offered by banks. In addition, the new firm must pay off bank debt inherited from the old firm LPH totalling 41.[illegible] mil. Kcs by the end of 199[illegible]. As a condition of the purchase, the Fund of National Property also required installation of equipment to moderate the plant's emission of pollutants. The investment in new machinery will total 18.6 million Kcs from 1993 to 1995. The privatization has changed LPH's capital structure in quite a detrimental way.

Post-Privatization Balance Sheet of LPH (8/1/1992)			
Assets		Liabilities and Equity	
Fixed Assets	130,411	Equity Capital	180
Accounts Receivable	121,808	Loan from Fund of National Property	183,500
Inventories	102,527	Inherited Bank Loans	46,200
Cash	9,775	Accounts Payable	??
Total	364,521	Total	364,521

D. FUTURE PLANS

The new management has very ambitious plans for the upcoming two years. LPH has prospered in the recent past and has strong prospects for the upcoming years. The enterprise expects cash flow in 1993 to total over 60 mil. Kcs, reaching roughly 70 mil. Kcs by 1996. By operating at full capacity (when other plants in the plastics industry are encountering slowdowns) they are in an excellent financial position to receive favorable loan terms from commercial banks.

[illegible]	[illegible]	[illegible]	[illegible]
After tax profits	45.0	49.5	58.5
Depreciation	17.0	17.0	18.0
Cash Flow	62.0	66.5	76.5
Installment payments to FNP	(36.7)	(36.7)	(36.7)
Payment on Bank Debts	(24.6)	(14.9)	(11.4)
Data on anticipated profits are created from existing contracts, past performance, and expert assessments of the future of the firm. Data on expected depreciation come from the existing structure of assets, assumed investment, and constant rates of depreciation.			

In the early stages after privatization, the required payments to the FNP and banks will squeeze remaining profits, but over time profits should increase to cover these obligations more comfortably.

In the near future, LPH plans to scrap its current IBM 3880 style computer system to make way for a new mainframe computer system with a large PC network. The system will be used for everything from accounting to inventory control. The "clean" room used for the old computer will be used for production of medical equipment. LPH also plans to build a new covered storage area and to use existing stores in the main building for production purposes.

Future marketing plans include a reorientation towards the more lucrative wholesale production and Western European markets. Demand for LPH's products is extremely high now due to LPH's good reputation and management efforts. In fact, orders have reached a level where some production must be sub-contracted to the formerly affiliated firms of LNH.

E. CONCLUSIONS

As a Czechoslovak company, LPH possesses many strengths. Its management has a good sense of how the company will survive this difficult transition period. LPH is competitive in the international marketplace on the basis of quality, cost, technology, and proximity to Western markets. The firm enjoys a strong customer base with no foreseeable shortage of orders. Real growth in the domestic markets appears to be assured especially as Czechoslovakia becomes more developed. Finally, LPH has a good position to weather a recession since there will always be a need for quality plastic products.

Several areas pose problems for LPH:

a. Forty years of central planning have left LPH with very few marketing skills and little experience in dealing with Western markets. However, management efforts have had positive results and the firm seems to be successfully overcoming this past difficulty.

b. The company has limited funds available to expand capacity to meet potential excess demand.

c. With 45 percent of sales concentrated in Electro-Praga Hlinsko, the health of Electro-Praga can determine LPH's future. LPH's increased marketing efforts and expanding customer base should decrease its reliance on orders from Electro-Praga Hlinsko, however.

d. Financially, if LPH can survive immediate cash flow problems it will be well placed to weather the Czechoslovak economic problems ahead. Prognostications suggest that there is a high probability that LPH will be able to successfully confront its cash flow problems in the near future.

If LPH relies on its many strengths and works to improve its few areas of weakness, the company will be in a good position to survive the privatization process. LPH has the potential to be a major plastics producer in both domestic and international markets.

APPENDIX A:
The Eight Independent Companies Which Emerged From the Breakup of Lisovny Novýdh Hmot

1. Lisovny nových hmot Vrbno (150 employees, providing different services to the companies - technical development, production of forms, engineering, projects, marketing, etc.)

2. Lisovny plastických hmot Vrbno

3. Alfaplastic Bruntál (600 employees, producing large plastic products - crates, etc.)

4. LNH Lutín (160 employees, producing forms)

5. Formy a plasty Chuchelná (500 employees, manufacturing many products for Autopal Novy Jičín - e.g., rear automobile tail lights) - **most advanced of the other LNH companies**

6. Linaset Budišov (350 employees, wide range of products for households: pots and pans, for automobiles: plastic covers for ignition coils and distributors for Pal Magneton Kroměříž)

7. Vyškovan Vyškov (250 employees, uses both thermoset and thermoplast technology)

8. Formplast Mikulovice (250 employees, both thermoset and thermoplast products with emphasis on households and construction items) The company was purchased by former LPH managers during the small privatization wave.

APPENDIX B:
Products Description

Product description	Material crowns	Total Costs	Selling price	Volume 1,000 Kčs
Case for vacuum cleaner (Elektro-Praga Hlinsko)	67,5	77,4	84,6	9.300
Vacuum cleaner cover (Elektro-Praga Hlinsko)	24,6	28,5	32,9	5.300
Case for lamp	33,1	39,9	43,6	9.600
Crate (medium size)	32,40	41,6	48,5	9.700
Garbage containers	35,1	62,2	79,0	4.700
Toy box (Ikea)	37,90	51,70	60,0	6.000
Case	0,54	0,[illegible]3	0,65	2.600
Electrical socket	1,7	2,[illegible]	2,4	720
Bottle cap	0,042	0,[illegible]91	0,2	2.200

These 9 products, out of 3,000 they make represent 10% of total production.

The profit margins vary from product to product. The top rate is 19%.

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APPENDIX C: Description of Machinery

DATA ON SMALL INJECTION MOLDING MACHINES

Machine type (by material/item)	Quantity	Age (yrs)	Origin of Machines
Up to 30g	11	8	Czechoslovakia, Germany, Austria
Up to 60g	21	12	Czechoslovakia, Germany
Up to 100g	25	15	Czechoslovakia, Germany, Austria, Italy
Up to 200g	33	12	Czechoslovakia, Germany, Austria
Up to 1000g	16	10	Czechoslovakia, Germany
Clean weight 1000g	9	7	Germany
Above 1000g	10	12	Germany, Austria
TOTAL	**125**	**11.[illegible] (avg)**	

APPENDIX C (continued)

SELECTED LARGE INJECTION MOLDING MACHINES

Make/Model	Year Acquired	Price (Kcs)
ENGEL ES 9000/1200	1976	8,766,000
ENGEL ES 4400/650	1989	8,259,000
ENGEL ES 4500/800	1981	3,436,000
ENGEL ES 1000/6000	1965 (rebuilt in 1990)	2,017,000
MAS CSE 4000-3	1978	2,250,000
KuASY 2500/400	1989	1,137,000
KuASY 1800/400	1984	1,366,000
KuASY 1800/400	1984	1,363,000
KuASY 1800/400	1984	1,363,000
KuASY 1800/400	1991	5,500,000
KuASY 1800/400	1991	5,500,000
MAS CS 1025/320 N3	1987	578,000
MAS CS 1025/320 N3	1988	600,000
MAS CS 1025/320 N3	1988	568,000
STUBBE S 852/2000 VE	1965	1,032,000
STUBBE S 852/2000 VE	1964	961,000
MIR RMP-135/360	1989	1,696,000
ENGEL ES 700/150	1989	2,131,000

BEST AVAILABLE DOCUMENT

APPENDIX C (continued)

SELECTED SMALL INJECTION MOLDING MACHINES

Make/Model	Year Acquired	Price (Kcs)
MIR RMP-95/150	1989	1,199,000
MIR RMP-95/150	1989	1,199,000
MIR RMP-95/150	1989	1,201,000
MIR RMP-45/70	1989	979,000
MAS CS 195/100 E1	1988	269,000
MAS CS 195/100 E1	1988	269,000
MAS CS 185/100 E1	1988	269,000
MAS CS 88/63 E1	1987	239,000
MAS CS 88/63 E1	1987	239,000
ENGEL ES 240/75	1986	858,000
ENGEL ES 240/75	1986	858,000
ENGEL ES 80/35	1986	610,000

APPENDIX C (continued)

SELECTED MOLD MAKING MACHINES*

Machine Type	Make/Model	Year Acquired	Price (Kcs)
Center lathe	SV 18RA	1974	39,000
Perpendicular lathe	SKJ 12A	1982	1,105,000
Milling machine	FGS 32/40	1990	536,000
Overhead milling machine	FCV 63SCA	1991	924,000
Milling table	FNGJ 20 NS115	1991	500,000
Tool-making milling machine	DECKEL FP3A	1988	1,800,000
Computer-controlled planing machine	DECKEL FP4NC	1991	5,586,000
Horizontal boring machine	W 100A	1982	543,000
Coordinated boring machine	WKV 100	1963	639,000
Coordinated boring machine	32 M83 SF10	1990	847,000
Horizontal grinding machine	BRH 20 A/N	1983	130,000
Vertical grinding machine	BPV 700/2000	1957	172,000
Apex grinding machine	2UQ 750	1969	96,000
Electrostatic hollowing machine	CHARMILLES D420	1982	2,596,000
Electrostatic hollowing machine	CHARMILLES ROBOFORM 200	1988	7,132,000
Electrostatic cutting machine	EIR 005A	1987	1,099,000
Electrostatic hollowing machine	CHARMILLES ELERODA 110	1987	1,386,000

* Machine descriptions are direct translations from the Czech.

APPENDIX D:
Composition of the work Force

TOTAL NUMBER OF EMPLOYEES		770
Managerial Clerical and Administrative Staff		156
among them:		
top management	10	
computer dept.	25	
foremen+assist.	40	
construction	12	
book keeping	20	
financial planning	6	
technology	28	
prod. supervisors	5	
sales+mark. dept.	10	
Production		416
machine tools	133	
maintenance of forms	26	
moulding sector	257	
Support Staff		198
maintenance	70	
recycling of waste	10	
store and shipping	30	
quality control	20	
transportation	12	
security, telephone, post	14	
cleaning, heating	40	
retail shop	2	

PRAGUE, DECEMBER 1992

A. BACKGROUND

Pistol's original factory was built in 1908 by the company Tlusty Loewy in Hlinsko. The firm's first product lines were a wide assortment of files and rasps. In 1976, the firm switched its focus to hand tools and tighteners. This production continued through the "Velvet Revolution" until late 1991. Today, the firm concentrates on the production of high quality car jacks, electrician's tool sets, wire strippers, and plumber's pipe vices with stands.

Prior to World War II, Pistol's business was conducted by the firm Ajax, which had acquired Tlusty Loewy. In 1946, Ajax was taken over by Dratovny a Sroubarny Bohumin (DASB), a state-owned enterprise. As a result of the nationalization of Ajax, Pistol's business and property were nationalized as well. In 1960, DASB was merged into TONA Pecky, another tool making firm. Until 1990, the business of Pistol and three other factories was conducted under the TONA tradename. In November 1990, each of the TONA factories was given autonomy. The Hlinsko plant took the registered name HTN Pistol in April 1991.

Hlinsko is located 150 km east of Prague along well-maintained roads. Pistol's present 9,650 m² facility is less than 12 years old, and the company owns an additional 2,000 m² of surrounding land suitable for expansion.

After the change in government in 1989, the firm HTD (later HTN) Pistol saw two major changes that significantly affected domestic demand. First, state owned construction companies could no longer continue ordering new hand tools when they had to make actual payment for them. Hand tools of the quality level of those produced by HTN Pistol do not have to be replaced with regularity, and thus struggling companies were able to delay purchases. Second, the distribution network for the firm was dependent on state-owned retailers. Under a free market system, many retailers were closed or privatized. Many retailers also started carrying other brand names for the first time. Finally, the depressed economic conditions of the country have dramatically decreased demand.

B. COMPANY PROFILE

HTN Hlinsko's assets totalled over 45 mil. Kcs as of Dec. 31, 1991, with book value of over 26 mil. Kcs ($1 mil.). Sales for 1991 totalled over 37 mil. Kcs, with pre-tax profits of 2.1 mil. Kcs. As can be seen from the balance sheet on the following page, the firm's capital structure was rather solid, especially compared to other Czechoslovak firms in this period of recession.

Pre-Privatization Balance Sheet of LPH (12/31/1991)			
Assets (thousand Kcs)		Liabilities and Equity	
Fixed Assets	26,658	Equity Capital	26,325
Accounts Receivable	8,175	Bank Loans	10,242
Inventories	9,065	Accounts Payable	8,40[illegible]
Cash	1,551	Other Liabilities	481
Total	45,449	Total	45,449

1. Products

After 1989, Pistol found itself in a highly competitive hand tool market. In order to remain competitive with Western products, they developed a new finish and a lighter design for their tools. Very quickly, they were able to produce a higher quality product than their South East Asian competitors and meet Western European standards, which are more stringent than in the United States. However, the Stanley Corporation of America merged with HTD Pistol's old parent company to produce many of the same products. The parent company's new scale of production and their access to western capital forced Pistol to reevaluate their future competitiveness and survival.

Today, the firm concentrates on the production of high quality car jacks, electrician's tool sets, wire strippers, and plumber's pipe vices with stands. The production of car jacks began with a new contract awarded by Skoda-Volkswagen. A limited number of profitable tool sets will be continued while the production of others will be slowly phased out. HTN Pistol is also developing the capability to produce two new products: brake fluid pipes and hand brake handles for automobiles. Both new products will be produced for the Skoda market. In all, HTN Pistol will reduce their number of products from 18 to about 6.

Most of Pistol's products use chromium vanadium coated steel (Czechoslovak regulation N. 152 6C), and all products correspond to ISO and DIN regulations. The following products are listed in the order of their production volume.

Primary Products:

AZN 600/2: Car Jack for Skoda 781, 785, 1000MB, 100. 600 kg with load increase during the hoisting operation in accordance with the characteristics of the S 781 and S 785. Maximum lifting height from base 375 mm, mass 2.3 kg, dimensions in folded condition 63x115x330 mm. Current production is 20,000 a month which represents 70-80% of total factory production. Management believes that car jack output can be doubled in the near future.

Pipe Vice with Stand: A 20 kg stand with vice used by plumbers. Second best product produced. 99% of production is exported to Germany. Production capacity is 1,300 per month.

K2: Electrician's Tool Set in which Pistol supplies the sockets and extensions with handles for the 24-piece set. Pistol contributes 4, 4.5, 5, 5.5, 6, 7, 8, 9, 10, 11, and 12 mm sockets and three extensions with handles to the set, which also includes four pairs of pliers and six screwdrivers. HTN Pistol is currently the monopoly producer of this product in Czechoslovakia.

Stripping Pliers and Front Stripping Pliers: Unsheathing (stripping) pliers for electricians. Wire diameter: .15, 0.5, 0.75, 1 mm, 1.5, 2.5, 4, 6 mm. Front stripping pliers handle wire diameter of 0.15-6 mm. Weight is 0.3 kg. Production has been at about 100 a month. HTN is the only producer of this item in Czechoslovakia.

SN 1: Socket Wrench Set for use with a 6.3mm (1/4") square drive shaft. The set includes 4, 4.5, 5, 6, 7, 8, 9, 10, 11, and 12mm sockets, one ratchet wrench, one extension bar, three extensions with handles, and a metal case.

SN 2: Socket Wrench Set for use with a 6.3mm (1/4") square drive shaft. The set includes 4, 4.5, 5, 6, 7, 8, 10, 11, 12, and 13mm sockets, one ratchet wrench, one extension bar, three extensions with handles, and a metal case.

SN 4: Socket Wrench, Screw Driver and Hex-Key Socket Wrench Set for use with a 6.3mm (1/4") square shaft. The set includes 4, 5, 5.5, 7, 8, 9, 10, 11, 12, and 13mm sockets, three phillips head screwdrivers, three flat-head screwdrivers, 3, 4, 5, and 6mm hex-key sockets, one extension bar, two extensions with handles, and a metal case.

SN 3: Socket and Hex-Key Socket Wrench Set for use with a 6.3mm (1/4") square shaft. The set includes 4, 4.5, 5, 5.5, 6, 7, 8, 9, 10, 11, 12, and 13mm sockets, 2, 3, 4, 5, and 6mm hex-key sockets, one ratchet wrench, one extension bar, one extension with a handle, and a metal case.

SN 7: Hex-Key Socket Wrench Set with a 12.5mm (1/2") square drive shaft. The set includes 5, 6, 8, 10, 12, and 14mm hex-key sockets, one extension with a handle, and a metal case.

S 2: Socket and Hex-Key Socket Wrench Set for a 6.3mm (1/4") square drive shaft. The set includes 5.5, 7, 8, 10, 11, and 12mm sockets, 2.5, 3, 4, 5, and 6mm hex-key sockets, one extension with a handle, and a metal case.

SN 5: Socket Set for a 6.3mm (1/4") square drive shaft with long execution. The set includes 3.2. 4, 5, 5.5, 6, 7, 8, 9, 10, 11, 12, and 13mm sockets, one extension bar, two extensions with handles, and a metal case.

TMK 05: Spring-Loaded Torque Wrench Set (0-5 Nm of torque) containing 4, 4.5, 5, 5.5, 6, 7, 8, 9, 10, 11, and 12mm sockets, and a vinyl case.

OMK 3: Ratchet Torque Wrench Set (0-30 Nm of torque) containing 4, 4.5, 5, 5.5, 6, 7, 8, 9. 10, 11, 12, and 13mm sockets and 2.5, 3, 4, 5, and 6mm hex-key sockets, one extension bar, one extension with handle, and a metal case.

As a result of flexibility in Pistol's production processes, the firm is able to make changes in products according to customers' specific requirements. Presently, almost half of Pistol's production is custom designed. One hundred percent of Pistol's products undergo a quality inspection before leaving the factory.

An example of Pistol's flexibility is seen in its newly designed car jack. By incorporating techniques used to manufacture vices, Pistol developed a compact, heavy-duty jack which conveniently fits inside the spare tire. The jack has passed strenuous certification tests and Pistol has won the contract to produce the car jack for the new Skoda automobile, which is being built as part of the joint venture with Volkswagen of Germany. By now, these jacks have become the main item of manufacture for Pistol.

2. Facilities, Technology, and Manufacturing Processes

Pistol's tool-making and prototype shop contains some of the company's most technologically advanced milling machines, drills, presses, and lathes. Factory-based research and development permits Pistol to incorporate manufacturing concerns into the designs for new products As a result, Pistol can quickly move new products from the design phase to full-scale production.

A profile of the remaining technology used at Pistol reveals an eclectic collection of metal working machines from the last three decades. Most of the machines were made in Czechoslovakia. The average machine in Pistol's factory is 13.6 years old. The machines have been well maintained; the reason behind most new machine purchases has been to increase capacity and to take advantage of newer technologies rather than to replace worn out machines.

The following table summarizes the age of Pistol's 199 machines:

Age of Machine	Number of Machines	Percent of Total
0-5 years	72	36.2%
6-10 years	40	20.1%
11-15 years	16	8.1%
16-30 years	53	26.6%
Over 30 years	18	9.0%

The factory is divided into nine areas, roughly according to the factory's different manufacturing processes: main hall, socket pressing room, painting area, hardening shop, waste neutralizing station, loading dock, storage area and tool room. This report reviews the different technologies in the first five areas.

The first and largest is the main hall where most of the activity takes place. There are two groups of machines: the automatic lathes and all the other manual tools. In the main hall are 28 automatic lathes whose age is between 34 and 2 years old. Most were made by MAS/Kovosvit, a Czechoslovak manufacturer. Other tools in the main hall are center lathes, turret lathes, universal milling machines, grinding machines, drilling machines, roll forming machines, and some of the factory's presses.

The remaining presses, which range from 10 to 600 tons in size, are in the socket pressing room. In addition, the socket pressing room holds a new copying lathe controlled by an Erfurt Electronic computer acquired in 1990.

The painting room contains a spraying booth and a degreasing machine, both of which are six years old. The factory uses latex paints that have been specially formulated to be environmentally safe. The paints are cured by heating.

Many of the factory's products are processed in the hardening shop to improve their durability. Pistol uses a three-stage hardening process. At the first stage, the products are immersed in an 850 degree (Celsius) hardening furnace. Next, the products are placed in a 250 degree tempering furnace. Finally, the products are cooled in a liquid bath. The hardening shop is also where some tools are chemically treated before being sent for chromium-vanadium plating by TONA Pecky, another former division of TONA.

Pistol recycles all scrap metal and lubricating oils used in its production processes. Using two state-of-the-art machines located in Pistol's waste neutralizing station, the company treats the chemicals used in the hardening shop. After neutralization, these chemicals are then shipped to approved disposal sites. As a result, Pistol's operations have almost no negative impact on the environment.

One of Pistol's strengths is the quality of the workers operating its equipment. Approximately 80 percent of Pistol's production workers have completed at least three years of vocational training.

3. Capacity

Prior to the recent economic and political changes in Czechoslovakia, accounting by Czechoslovak businesses was concerned more with labor utilization than with production costs. In the absence of other substantive data, labor content was used to determine the utilization of plant capacity. Based on labor content calculations, management has calculated that Pistol is operating at approximately 59 percent of its existing plant capacity. By adding a third shift, Pistol could increase its available capacity by another 50 percent. In the short term, this excess capacity will permit the firm to increase production without expanding its facilities.

4. Markets, Marketing and Distribution

Approximately seventy percent of Pistol's current production is made for the domestic market. Within Czechoslovakia, Pistol's hand tools are sold through two distribution networks. First, Pistol is a party to an agreement which created a consortium of four Czechoslovak manufacturers of socket wrenches and other hand tools. Pursuant to this agreement, a network of 300 sales agents was created. This sales network offers Pistol's products to institutions, retail outlets, and individual consumers. In addition, the consortium has established a network of 8-12 shops dedicated to their products.

Independently, Pistol also cooperates with several other businesses, including Sargas, Merkuria and Sedlak. Both Merkuria and Sargas distribute Pistol's products in Czechoslovakia and internationally. In the near future, Pistol's products will also be distributed domestically through a private wholesale/retail network that is currently being developed.

In the past, approximately 10 to 15 percent of Pistol's production was targeted for export to Yugoslavia, Germany, England, France, and Canada. Pistol's exports are expected to rise significantly in the future, as high quality and low prices make Pistol's products competitive around the world.

Pistol is represented in Prague by the export agency 3PH, which manages Pistol's foreign trade affairs and demand for the company's products. Moreover, Pistol uses the services of the foreign trade organizations Merkuria, IMEX, and Keramika, and a number of other export/import firms such as Kamo, Ocean, Schuter, Stackfine, and Wesstling. The firm Czechoslovak Trade Link UK has recently agreed to serve as a sales agent for Pistol in Great Britain, Australia, and New Zealand.

5. Management and Personnel

Pistol employs approximately 200 people, including 120 production workers, 50 designers and tool makers, and 30 managers and support staff. The number of workers has remained fairly constant over the past four years because none of TONA's headquarters staff was added to Pistol's payroll after Pistol was granted autonomy. Pistol's location in Hlinsko gives the company access to a skilled labor pool that permits the company to add a third production shift if needed.

Relative to other Czechoslovak firms the number of managers at Pistol is very low. The top managers are young, well-educated engineers with no ties to the old regime. Hence, they are very open to Western business ideas.

C. THE PRIVATIZATION OF HTN PISTOL HLINSKO

In the second half of 1991, Hlinsko's management prepared its own privatization project, proposing a management buyout. This project was changed after some hesitation into a direct sale to a foreign buyer from the USA. The project was prepared with the outside assistance of the Czech consulting firm Equity Expansion International, Prague. After some time, the consulting firm reviewed the financial position of the foreign investor and found that it was in a poor financial situation.

After some negotiation with the U.S. investor, during which he was not able to provide evidence of his ability to meet his financial promises, the project was finally changed back to a version proposing direct sale to the management. Five members of the firm's management, including the General Manager, and three other interested investors joined to create a limited liability company, ALFA Hlinsko, in order to purchase the firm.

The following structure of privatization was finally submitted as of March 31, 1992:

HTN Pistol's Structure of Privatization	Total Property	Property not in project (restitution)	Unuseable property	Direct Sale to ALFA Hlinsko
Total Assets	44,832	0	158	44,674
Liabilities	16,382	0	0	16,382
Book Value Equity	28,450	0	158	28,292
Assets not in books	350	0	0	350
of which:				
land	350	0	0	350
other	0	0	0	0
Total value of property	28,800	0	158	28,642

From the table on the preceeding page, it can be seen that no restitution claims were met on the property of Pistol Hlinsko. The original book value designated for direct sale according to Czechoslovak accounting standards was 28.3 mil. Kcs, but in accordance with western standards this amount had to be adjusted upwards by .35 mil. Kcs due to the value of assets not included in the book value (due to revaluation of land). Under the submitted plan, part of the property (158,000 Kcs) was to be written off as unuseable, however in the final approval this figure was not accepted and was added to the value of the equity of the firm.

The proposal for direct sale was finally approved by the Ministry of Privatization of the Czech Republic in November, 1992, a full year after it was submitted. The final sale will be closed on December 31, 1992. After some further small adjustments, the final adjusted book value agreed upon for the sale will be the actual book value of the firm (based on year end financial statements).

As part of the agreement, ALFA Hlinsko must pay the National Property Fund the equity value by the end of February, 1993. This payment will be based on a 4-year privatization loan from a major Czech commercial bank, with interest amounting to 14% annually. In addition, the new firm must pay off debts inherited from the old firm. The privatization has changed HTN Pistol Hlinsko's capital structure in quite a detrimental way.

Post-Privatization Balance Sheet of LPH (anticipated 12/31/1992)			
Assets (thousand Kcs)		Liabilities and Equity	
Fixed Assets	23,998	Equity Capital	5,659
Accounts Receivable	7,230	Privatization Bank Loan	28,800
Inventories	9,100	Inherited Bank Loans	6,108
Cash	1,640	Accounts Payable	1,401
Total	41,968	Total	41,968

After it takes over, ALFA Hlinsko will use all potential sources to improve the financial situation of the company. Due to increased management activity, several new contracts have been signed or prepared for future orders. The most important one is a contract with Skoda-Volkswagen on delivery of 200,000 car jacks for 1993 and 100,000 for the first half of 1994. This means that the company should provide jacks, which are legally required, for the majority of Skoda cars produced during that period.

The 1993-4 contract should cement Hlinsko's cooperation with Skoda, which was started only in mid-1992 as a part of the management's restructuring plan accompanying the firm's privatization. After the decision to enter the promising new segment of the market, within 3 months the new original design of car jacks was produced through an external designer. Within a further 6 months, the production of these jacks was fully implemented and delivered to Skoda-Volkswagen. By now, this has become the main product manufactured by Pistol Hlinsko and it continues to be promising for the future. In fact, Skoda-Volkswagen sent quality inspectors to check the quality of production processes at Hlinsko and these inspectors were fully satisfied and recommended the company to further potential clients. Since then, a new car jack design is being developed in cooperation with another large foreign car manufacturer for an order which should be implemented in 1994. The increasing returns which this production should bring can be seen from the following table on anticipated future cash flow.

[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
After tax profits (including interest payments for privatization loan)	7.2	11.5	11.3	14.5
Depreciation	3.0	3.0	3.0	3.2
Cash Flow	10.2	14.5	14.3	17.7
Payment of Privatization Loan	(7.2)	(7.2)	(7.2)	(7.2)
Payment on Bank Debts	(1.2)	(1.2)	(1.2)	(1.2)

See Appendix A for more details of the three scenarios. Data on anticipated profits are created from existing contracts, past performance, and expert assessments of the future of the firm. Data on expected depreciation come from the existing structure of assets, assumed investment, and constant rates of depreciation.

As can be seen from the above table, in the early stages after privatization, the required loan payments will squeeze remaining profits, but over time profits should increase to cover these obligations more comfortably.

E. CONCLUSIONS

The successful restructuring of Pistol Hlinsko is a good case of the activity of management acting to increase the profitability of a firm which they are acquiring. Assuming that no major changes occur, HTN Pistol Hlinsko should be able to cover their liabilities and prosper, especially once the four year privatization loan is successfully paid off.

An especially striking point is the flexibility of this small company. A clear drawback is the firm's reliance on one large customer, Skoda-Volkswagen. In fact, currently other customers are showing interest in Pistol's products, which could allow the enterprise to diversify its clientele and further solidify its future development.

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PRAGUE, DECEMBER 1992

BEST AVAILABLE DOCUMENT

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A. BACKGROUND

Poldi Kladno, an enterprise devoted to the production of specialized steel, is one of the Czech Republic's largest enterprises and the largest metallurgical concern in Czechoslovakia. Poldi dominates the industrial town of Kladno (pop. 80,000), where it is located. In 1990, the firm employed 20,000 workers and recorded 8 billion Kcs of annual turnover.

At one time the enterprise had reached a level of one million tons of steel production yearly and 60% of its production was exported, mainly to CMEA and Middle Eastern markets. However, in response to the economic changes which have taken place since the onset of economic reform, as well as crises within CMEA and the Middle East, demand for Poldi's refined steel products has declined dramatically. In recent months the firm has been forced to make radical changes in order to meet the reality of declining global dependence on metallurgy and heavy industry. As a result, Poldi has laid off almost half of its work force, drastically cut costs, and reduced inventories.

Nonetheless, the firm's financial future continues to look grim. Although it is scheduled to be privatized through the second wave of privatization in 1993, it appears that a large share of the enterprise will remain in state hands until further restructuring can be achieved. In order to ease restructuring and privatization, Poldi has been broken up into 13 separate operating units, as well as one unit concerned exclusively with enterprise conversion and restructuring, all held by one holding concern, Poldi a.s. During the near future, some of these units will be privatized almost completely while others will remain held by Poldi a.s., 80% of which will be owned by the Fund of National Property (FNP). All units will be expected to be economically self-sufficient.

B. COMPANY PROFILE

As a whole, Poldi Kladno has over 8 bil. Kcs ($300 mil.) of equity on its balance sheet. Poldi is burdened by illiquidity and a large amount of outstanding debt. Debts due by the end of 1994 include 820 mil. Kcs to banks, 360 mil. Kcs to the government, and 2.16 bil. Kcs to trade partners. In addition, Poldi is burdened by a large number of late accounts receivable, totalling 2.3 billion Kcs, many of which may be unobtainable. Among the largest firms in debt to Poldi are major Czech metallurgy enterprises, such as Valcovny trub Chomutov (325 mil. Kcs) and Zelezarny Chomutov (180 mil. Kcs), and major Slovak armaments firms such as ZTS Dubnica (67 mil. Kcs) and Turcianske strojarne (66 mil. Kcs). In 1991, Poldi recorded a loss of 1.1 bil. Kcs.

1. Production

Until 1992, Poldi was one massive enterprise, one of the largest in Czechoslovakia. Its various production units were run centrally and profit-making parts of the firm subsidized other parts which otherwise might not have been viable.

Its production units have included the following:

Poldi 1: The older of the two steel mills, employing roughly 5,000 workers. It concentrates on special shapes and is seen as economically viable. Potentially interested foreign investors have been contacted (see below).

Poldi 2: Turns out commodity sheet steel, employs about 2,500 workers. It seems unlikely that this part of the enterprise will be viable. Included in Poldi 2 is, for example, the sheet metal workshop Dříň, which is over a mile long. Half of this area is a workshop which was projected to produce up to 450,000 metric tons of alloyed steel annually. It would be economically viable to operate this workshop at production levels as low as 250,000 tons, but the maximum level reached in 1989 was 215,000. From July 1991, losses from this mill grew by 150 mil. Kcs monthly until production was stopped in January. This workshop has the largest capacity of any steel producing unit in the CSFR, but it currently stands idle. A maintenance crew performs routine maintenance and runs the lines occasionally to keep the machinery in working order. These operations alone cost 3 mil. Kcs monthly.

Mechanical: This unit encompasses six shops creating crankshafts and formed or welded products. Among these are three mechanical shops, a tool shop, a shop making ingot thermometers, and Antikorro, a separate unit using steel products to produce artificial limbs and medical supplies. As a whole, the mechanical shops employ about 2,500 workers.

Energy: This division supplies energy to Poldi's other operations.

2. Corporatisation of the Enterprise

In January of 1992, Poldi was "corporatized" ("commercialized"), i.e. transformed into a joint-stock company. As a joint-stock corporation, Poldi, although still state-owned, attained much more autonomy but it has not been allowed to rely on subsidies from the state budget. Corporatization in the CSFR is usually performed simultaneously with privatization. In this case, however, it was done as a preliminary measure which could create pressure to allow some restructuring before the actual privatization.

2.1 Board and Management Changes

Corporatization meant that a new Board of Directors had to be created. The Board presently includes three internal members and seven external members, and is chaired by a representative of the Ministry of Industry. Other members are as follows: Poldi's General Manager and Economics Manager (financial officer); a labor representative elected from the labor union; a representative of the FNP; a commercial banker; the Deputy Minister of Economic Development; two further representatives of the Ministry of Industry; and one representative of the Labor Exchange.

There is also a six-member Supervisory Board, which has authority for labor and community affairs. This Board is chaired by a trade union representative and includes two other union members, the Economics Manager, a Ministry of Industry Representative, and the Mayor of the town of Kladno.

One of the first moves of the new Board of Directors was to appoint a new General Manager. The previous Manager, who was retired, had been seen as an obstacle to successful enterprise restructuring.

The new management of Poldi Kladno also adopted a new overall adjustment strategy in order to improve the firm's financial results, to stabilize its capital structure, and to decentralize operations, limit internal redistribution of profits, and to prepare for privatization.

2.2 Organizational Changes

The next step, taken in May 1992, was the restructuring of the enterprise into 13 individual operating divisions and the creation of the Conversion Division (crested in April). These divisions were autonomous and expected to be self-financing. These reorganizational steps were taken in order to decentralize and rationalize operations and to facilitate Poldi's privatization.

Poldi's production is thus currently divided into thirteen separate divisions plus one new "conversion" unit. These divisions include a number of the different production units described above, as well as several units devoted to servicing the production units (i.e. transport, design engineering and technical support, computers, finance and business planning). The conversion unit is a newly created division, which was created to search for new business opportunities and create new products. A secondary purpose was to employ personnel laid off from other divisions at lower pay in order to mitigate the overall effects of worker layoffs (see below).

A further measure taken by the new management was to stop production at the money-losing Dříň steel workshop in Poldi 2. Production was partly resumed in October when the management secured orders, 90% of them export orders, which allowed partial production to resume. Management foresees losses in the near future but expects that this production should be profitable in the longer run. Banks, unfortunately, have not been convinced of this likelihood and thus have not provided financial support to this endeavor.

2.3 Employees

In 1990 Poldi had 20,000 employees. Since then, this number has declined steadily as the program for enterprise restructuring has progressed, dropping to 16,000 in May 1992 and then gradually to 10,200 in October. For the most recent decrease, layoffs were staggered over a period of time to lessen the impact on employees and on the town of Kladno. Also, 36% of workers laid off from May to October were able to find employment in Prague, sometimes after being retrained at the company's expense through the conversion division.

The conversion division was specially created to search for new business opportunities and to employ and retrain laid off workers. Workers in this division were paid only 60% of their former wages. Since October 1, 1992, the conversion division has become a separate operating unit, although still 100% owned by Poldi.

2.4 Markets

As mentioned above, Poldi has suffered in the recent past from a severe drop in orders. Poldi's traditional customers included heavy industrial markets (CMEA) and traditional weapons markets (CMEA, Arab Middle Eastern Nations). Since 1989 both of these markets have declined drastically. By now it is quite clear that Poldi's productive capacity greatly exceeds the natural domestic demand for refined steel products and the opportunities for export without dumping. The decline of orders from domestic customers declined by 35%, a change which is recognized as a permanent decline resulting from lower consumption needs. Poldi is expected to produce only 280,000 tons of steel in 1993. With 10,000 workers, productivity is less than half of that in comparative Western producers. An independent study by the consulting firm Roland Berger found that, assuming that unit consumption of refined steel in the CSFR in the year 2000 will be the same as in West Germany in 1991, Poldi should produce at most 530,000 tons of steel and have annual sales of 7.2 bil. Kcs.

In spite of the recent activities of Poldi's new management, orders remain small in comparison with the firm's optimal capacity. Poldi's production is not competitive with respect to the resulting costs and prices. Another danger to which Poldi is particularly vulnerable is that customers will place orders that they are unable to pay, due to the widespread illiquidity in this sector of the economy.

2.5 Early Financial Results of Restructuring

As mentioned above, the new management of Poldi Kladno has embarked upon a new **adjustment strategy** in order to stabilize the firm and avert the threat of possible proceedings from the expected new bankruptcy law.

Part of the strategy is the reorganization of the firm, in order to decentralize management and financing, and to end the subsidizing of loss-making parts of the firm by profitable divisions. The end goal is to privatize Poldi's individual divisions.

A major part of the adjustment strategy is financial restructuring, a narrowly oriented scheme for the settlement of all liabilities which are due by the end of 1994. Among these liabilities are 2.16 bil. Kcs of accounts payable to trading partners, 360 mil. Kcs owed to the government budget, and 820 mil. Kcs owed to banks.

According to the financial restructuring plan, creditors have been divided into three groups:

a) **priority creditors** -- the government budget and bank mortgages -- should be paid in full within two years. These payments total 1.18 bil. Kcs.

b) **small creditors** -- private and state-owned firms to whom Poldi owes less than 500,000 Kcs ($18,000), which numerically represent the majority of Poldi's creditors, but to whom Poldi owes only a total of 90 mil. Kcs. These suppliers did not influence Poldi's production and efficiency, and should be repaid in full under the condition that the third group of creditors agrees.

c) **200 major suppliers of Poldi**, who Poldi owes in total 2.07 bil. Kcs. These suppliers' prices had an important influence on Poldi's low efficiency and high costs and full payment would mean that these suppliers benefited directly from Poldi's economic difficulties. Poldi will offer this group a settlement totalling 80% of the money owed, an adjusted total of 1.66 bil. Kcs.

The changes which the new management has been able to enact so far have already succeeded in significantly improving the firm's economic results. Although the firm had recorded a loss of 1.1 bil. Kcs in 1991, for the first three quarters of 1992 losses amounted to only 670 mil. Kcs. In fact, losses have declined from 430 mil. Kcs in the first quarter of 1992 to only

80 mil. Kcs in the third quarter, and **in September the firm even showed a slight profit.** After restructuring of the enterprise, it appears that economic results are becoming more promising and operating losses are no longer being accumulated, although clearly there are still many problems ahead.

The anticipated debt settlement, however, clearly cannot be fulfilled from operating profits. In order to pay off creditors, Poldi expects to implement privatization and to use proceeds from privatization sales of daughter companies. The privatization proceeds of daughter companies thus will not be directed to the Fund of National Property of the Czech Republic (as is usually the case), but will be used to eliminate the existing debt of Poldi a.s. (the parent company) This does not cover the case of the parent company Poldi, a.s., whose privatization will be handled in a different way (see below).

C. THE PRIVATIZATION OF POLDI KLADNO

Based on negotiations with various European firms, it became clear that one partner could not be found for the Poldi concern as a whole in its current state. Thus, the proposal for privatization of the enterprise Poldi Kladno involves the partial privatization of the parent joint-stock company, Poldi a.s., as well as establishment and privatization of the 13 individual daughter companies mentioned above.

1. Privatization of Daughter Companies

The daughter companies have the following expected plans:

Anticorro, Ltd.: Stainless steel production of bone replacements and medical supplies, 400 employees. Sale of 58% ownership at book value is expected to the Czech firm International Product Trading (IPT), a trading company that is a major supplier of stainless steel and is involved in important recycling operations. A further 8% of shares will be sold the the Poldi trade union for book value. The remaining 34% of shares will be kept by Poldi a.s. This transaction was the first privatization transaction undertaken by Poldi, and it is nearly completed. While small, this was a pioneer case, and the other privatization sales in which Poldi is currently involved are being conducted in a manner based on this model.

Poldi 1, Ltd.: A joint venture is expected with the Italian firm FALCK, which will gain an initial ownership share of 36%. Up to 5% of shares will be sold to the trade union of Poldi for book value. The majority will be kept by the holding company Poldi a.s.

Strojirny Poldi, Ltd.: A joint venture in mechanical engineering with the French firm MAVILOR L'Horme is expected. Up to 10% of shares will be sold to the Poldi trade union for book value. The majority will be kept by the holding company Poldi a.s.

Termosondy, Ltd.: Sale of 34% of shares to the firm TERM, Ltd.. 10% of shares to be sold for book value to the Poldi trade union. The remainder of shares to be held by Poldi a.s.

Energeticke Centrum, Ltd.: This is the division providing energy supplies. A joint venture is expected with a foreign partner selected on the basis of a public tender Up to 5% of shares will be sold for book value to the Poldi trade union. At least 34% of shares will remain under the ownership of Poldi a.s.

Ferrokov, Ltd.: This division engages in metal supplies, storage, and sales (not refining). Sale of 34% share to the firm BAHAS, Ltd. for book value. BAHAS is a company founded by employees of the firm. 10% of shares will be sold for book value to the Poldi trade union. Remaining shares will be held by Poldi a.s.

Projekce a Konstrukce, Ltd.: Technical design and other technical support of operations. Sale of 34% of shares for book value to a firm founded by employees. 10% of shares will be sold to the Poldi trade union for book value. Remaining shares will be held by Poldi a.s.

Auttech, Ltd.: Automation division. 40% of shares to be sold to the firm Sara. 10% of shares will be sold to the Poldi trade union for book value. Remaining shares will be held by Poldi a.s.

P - Invest, Ltd.: Sale of 34% of shares for book value to a firm founded by employees. 10% of shares will be sold to the Poldi trade union for book value. Remaining shares will be held by Poldi a.s.

KND, Ltd.: Sale of a minority holding for book value to as yet undetermined buyers. 5% of shares will be sold to the Poldi trade union for book value. Remaining shares will be held by Poldi a.s.

SID Kladno, Ltd.: Sale of a majority holding to as yet undetermined buyers for at least book value. 10% of shares will be sold to the Poldi trade union for book value. Remaining shares will be held by Poldi a.s.

Zeolit, Ltd.: Sale of 34% of shares to the firm KERBET, Ltd. for book value. Remaining shares will be held by Poldi a.s.

Ekofin, Ltd.: Financial and information systems of Poldi. This division will be held 100% by Poldi a.s. because it is necessary in order to maintain Poldi's accounting and information systems.

Veso, Ltd.: Sale of a minority share on the basis of a public tender. Up to 10% of shares to be sold for book value to the

Poldi trade union. Remaining shares will be held by Poldi a.s.

Generally, the holding company Poldi a.s. should keep at least 34% of the shares of each daughter company. This is the "golden share" which allows vetoing of certain structural changes. In important cases, Poldi will keep at least 51% owership.

According to the updated project, groups of employees are allowed options to buy up to 34% of the book value of daughter companies in installments over 10 years. If there is a public tender, this amount may be paid interest free, otherwise interest will be paid at a rate equalling at least the discount rate plus one percent.

2. Privatization of the Parent Company Poldi, a.s.

The basic privatization project of Poldi a.s. was submitted at a time when prospects seemed promising. Nonetheless, it has become clear during the first half of 1992 that the current system of corporate planning cannot flexibly respond to market changes and adjust expenditures in accordance with sales. For this reason, Poldi a.s. will be transformed, starting on January 1, 1993, into a financial holding with up to 50 employees.

Poldi's property will be divided into three groups:

- property predetermined for direct sale in order to settle debts
- securities (100% share in daughter companies), part of which will be sold in order to cover outstanding debts
- property rented to daughter companies, which will be privatized according to an approved updated project.

The updated privatization project of the company Poldi a.s. proposes the following distribution of shares:

11.8 %	Voucher privatization
5.0 %	Unpaid transfer to the municipality of Kladno and surrounding areas
3.0 %	National restitution fund
0.2 %	Employee shares (15,000 shares at 1,000Kcs/share)
1.0 %	Unpaid transfer to charitable foundations
79.0 %	To remain owned by the Czech Republic Fund of National Property

E. CONCLUSIONS

The corporatization of Poldi has clearly had some positive results on the firm's overall performance. As mentioned above, losses have declined from 430 mil. Kcs in the first quarter of 1992 to only 80 mil. Kcs in the third quarter, and in September the firm even showed a profit. The cost-cutting and decentralizing adjustment strategy measures which have been taken so far appear to have yielded some results. Nonetheless, these results are still limited.

The updated privatization plan suggests partial sales of most of Poldi's daughter companies, where Poldi will always maintain a share of at least 34%. The proceeds of these sales should be used to cover Poldi's debts as a crucial part of the firm's financial restructuring.

The potential of excessive interference by Poldi a.s. into the daughter companies is further accentuated by the problem that it is proposed that the majority of the holding company should remain in state hands. The suggested 79% of shares kept in the Fund of National Property is more than suggested by other metallurgy works in the Czech Republic -- 75% in Vitkovice, 66.5% in Trinecke Zelezarny, 60% in Nova Hut.

The government is currently involved in some metallurgy restructuring studies. According to the Minister of Industry and Trade, Vladimir Dlouhy, the government cannot support the proposed privatization plan with a 79% share held by the FNP and with daughter companies whose accounts receivable are taken over by the holding company. He has suggested a counter-proposal, that Czech metallurgy be privatized rapidly including a sale for a symbolic price, even if it were to mean the closure of some works. State subsidies and government guarantees of further loans cannot be expected. On the other hand, it is possible that debts may be alleviated through debt-equity swaps with domestic commercial banks.

Post-Privatisation Balance Sheet of LPH (8/1/1992)			
Assets (thousand Kcs)		**Liabilities and Equity**	
Fixed Assets	130,411	Equity Capital	180
Accounts Receivable	121,808	Loan from Fund of National Property	183,500
Inventories	102,527	Inherited Bank Loans	46,200
Cash	9,775	Accounts Payable	134,641
Total	364,521	Total	364,521

D. FUTURE PLANS

The new management has very ambitious plans for the upcoming two years. LPH has prospered in the recent past and has strong prospects for the upcoming years. The enterprise expects cash flow in 1993 to total over 60 mil. Kcs, reaching roughly 70 mil. Kcs by 1996. By operating at full capacity (when other plants in the plastics industry are encountering slowdowns) they are in an excellent financial position to receive favorable loan terms from commercial banks.

Expected Cash Flow (million Kcs)	[illegible]	1994	[illegible]
After tax profits	45.0	49.5	58.5
Depreciation	17.0	17.0	18.0
Cash Flow	62.0	66.5	76.5
Installment payments to FNP	(36.7)	(36.7)	(36.7)
Payment on Bank Debts	(24.6)	(14.9)	(11.4)

Data on anticipated profits are created from existing contracts, past performance, and expert assessments of the future of the firm. Data on expected depreciation come from the existing structure of assets, assumed investment, and constant rates of depreciation.

In the early stages after privatization, the required payments to the FNP and banks will squeeze remaining profits, but over time profits should increase to cover these obligations more comfortably.

In the near future, LPH plans to scrap its current IBM 3880 style computer system to make way for a new mainframe computer system with a large PC network. The system will be used for everything from accounting to inventory control. The "clean" room used for the old computer will be used for production of medical equipment. LPH also plans to build a new covered storage area and to use existing stores in the main building for production purposes.