Progress Ostrava, a.s. (A)*

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

Progress Ostrava, a.s.: Background

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

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

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

Privatization History

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

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

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

The Construction Industry

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

The Czech Construction Industry

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

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

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

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

Worldwide Prospects for the Construction Industry

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

<u>Progress Ostrava, a.s.: Internal Operations</u>

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

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

Ostrava Facilities

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

Turnkey Construction

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

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

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

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

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

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

Aluminum Products and Assembly Operations

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

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

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

Other Activities at Ostrava

Besides the two main construction and manufacturing activities, Progress had also registered itself as a provider of several services. These included trading, shipping and import services, and rental services for machinery, buildings and technology. These services contributed less than 10% of the revenues.

Valasske Mezirici Facilities

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

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

Classic steel structures

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

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

Liebherr Steel Tower Cranes

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

According to Konecny, the emphasis on quality was the key competitive advantage of Progress versus its competitors. Although Progress was producing only one type of crane for Liebherr (a static load crane arm), Konecny predicted that if Progress could maintain its quality, Liebherr would come to trust Progress with more technically demanding (and potentially, in his view, more profitable) crane arm designs.

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

Other activities at Valasske Mezirici

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

Management Board

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

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

Agenda for the General Meeting

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

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

<u>Exercise:</u>

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

Exhibit 1: Supervisory Board

Progress Ostrava, a.s.

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

Exhibit 2: Board Members

Progress Ostrava, a.s.

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

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

Progress Ostrava, a.s.

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

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

Progress Ostrava, a.s.

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

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

Exhibit 5:
Construction Investment by Region, Czech Republic 1992

Progress Ostrava, a.s.

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

Exhibit 6
Major Investment Fund Shareholders

Progress Ostrava, a.s.

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

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

Management

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

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

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

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

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

Mutual Fund

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

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

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

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

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

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

Mutual Fund

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

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

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

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

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

Individual Shareholder

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

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

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

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

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

Progress Ostrava, a.s. (B)*

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

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

Structural Changes in the Construction Industry

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

Construction in the Czech Republic

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

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

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

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

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

Construction in Europe

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

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

Progress Performance and the Stock Market

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

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

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

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

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

Organizational Changes

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

Ostrava Business Unit

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

Ostrava Turnkey Construction Projects

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

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

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

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

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

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

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

Ostrava Reynaers Building Products

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

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

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

Valasske Mezirici Business Unit

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

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

Classic Steel Construction

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

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

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

Valasske Mezirici Liebherr Tower Cranes

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

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

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

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

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

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

Company Investments

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

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

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

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

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

Key financing Issues

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

- Debt capital. Short and medium-term bank loans were available, but most of these loans required at least 100% security in the form of real estate. In addition, prime lending rates ranged from 9 to 15%, and banks often charged up to double the prime rates, depending on the level of risk. The longest term on a commercial loan was seven years, and a five-year loan was considered a long-term loan. Most loans were still in the two to three-year range. Petr Polak wondered whether Progress would be able to meet payment terms. What was the company's cash position and how was this cash position likely to change over the coming months? What were the cash flow implications of this option?

- A bond issue or a share issue was also being considered. There were several aspects of this option that worried Polak. A share issue would dilute ownership, among other things. There were other potential costs involved in finalizing the prospectus. Finally, given the condition of the Czech capital market, it was not clear to what extent the company would be able to raise this capital.

- Another option being considered was financial or operating leases. These were quite widely available, and the only major requirement was an initial deposit of 25-35% of the lease amount. The only major drawback to leases was the cost. For example, a typical three-year financial lease might be computed at a "leasing coefficient" of 1.30, e.g., a 100,000 Kc piece of equipment would be leased at 130,000 Kc, with 30% of the leased amount (30% x 130,000 Kc) as a deposit.

Agenda For the General Meeting

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

- What areas should Progress invest in? How were they connected to the long-term goals? How much should be invested?

- How would Progress finance these investments?

- What needed to be done in terms of general shareholder approval, supervisory board approval, regulatory approvals, etc.?

Exhibit 1

Sources of Revenue, July 1993 versus January 1994

Progress Ostrava, a.s.

	July 1993		January 1994	
Business Activity	% of total revenues	Revenues (000 Kc)	% of total revenues	Revenues (000 Kc)
Classic steel structures includes Liebherr	60%		40%	
assembly work (including ·minum building materials production and assembly)	?		20%	
Classis construction activities-	?		30%	
other	?		10%	
Export markets	80%		20%	
Domestic Market	20%		80%	

Progress Ostrava a.s.
Exhibit 2. Income Statement
For the year ended December 31, 1993
(In thousands of Czech Crowns)

Revenues from merchandise	405
Cost of goods sold	424
Sale margin	-19
Production	204 296
Revenues from own products and services	165 780
Change in inventory of own production	28 916
Capitalization	9 600
Production consumption	152 368
Materials and energy consumption	87 067
Services	65 301
Added value	51 909
Personnel expenses	41 208
Wages and salaries	30 640
Remuneration of board members	166
Social security expenses	10 399
Social expenses	3
Taxes and fees	316
Depreciation of fixed assets	6 792
Revenues from disposals of fixed assets and mateerial	10 542
Net book value of fixed assets and materials sold	7 307
Additions to reserves and accruals to operating expenses	205
Other operating revenues	184
Other operating expenses	506
Operating profit	6 301
Additions to reserves (financial)	315
Interest received	92
Interest paid	4 334
Other financial revenues	2 322
Other financial expenses	3 482
Loss from financial operations	-5 717
Income tax due on ordinary income	168
Ordinary income	416
Extraordinary revenues	229
Extraordinary expenses	287
Income tax on extraordinary income	-2
Extraordinary loss	-56
Profit of current accounting period	360

PROGRESS OSTRAVA a.s.

Exhibit 3. Balance Sheets

For the years ended December 31

(In thousands of Czech Crowns)

	1992	1993
Total assets	181 615	211 009
Fixed assets	87 136	92 590
Intangible fixed assets	215	191
Tangible fixed assets	86 721	92 199
Financial investments	200	200
Current assets	94 342	118 055
Inventory	40 831	55 685
Long-term receivables	1 580	1 041
Short-term receivables	41 475	55 337
Financial assets	10 456	5 992
Other assets	137	364
Miscellaneous	137	364
Total liabilities	181 615	211 009
Equity	118 050	118 325
Registered capital	102 223	102 223
Funds created from net profit	10 843	10 758
Profit from previous years	4 984	4 984
Profit of current period		360
Not-own capital	63 565	92 684
Reserves		520
Short-term payables	51 191	67 900
Bank loans	7 000	20 000
Other liabilities	5 374	4 264

PROGRESS OSTRAVA a.s.

Statement of Changes in Financial Position

Year ended December 31, 1993

(In thousands of Czech Crowns "Kč")

Cash balance beginning of year		5 592
Net cash flow from ordinary and extraordinary activity		-4 288
Accounting profit		360
Non-cash transactions:		3 122
Depreciation of fixed assets	6 792	
Increase in reserve balances	205	
Change in deferred costs balances, accruals, and estimated accounts	-1 110	
Gain on sale of fixed assets	-2 765	
Current assets and liabilities		-7 770
Increase in receivables	-13 862	
Increase in short-term payalbes	16 709	
Increase in accruals	-227	
Increase in inventory	-14 854	
Decrease in short-term financial assets	4 464	
Investment activity		-4 387
Aquisition of tangible fixed assets		-14 929
Revenue from sales of tangible fixed assets		10 542
Financial activity		13 539
Changes in long-term liabilities		13 539
Decrease in long-term receivables	539	
Increase in bank loans	13 000	
Change in cash position during the year		4 864
Cash, end of period		10 456

Exhibit 4 Top traded stocks, June to Dec 1993

Stock		Volume		Min.		Max.	
		BCPP	RM-S	BCPP	RM-S	BCPP	RM-S
Hotel Forum Praha		518	2026	1400	1360	4000	3640
Barum Holding Otrokovice		1619	947	580	550	1600	1029
Ceska Zbrojovka		1103	1440	950	900	2160	1462
Sellier & Bellot		750	1169	650	785	1580	12266
Ceskomoravsky len		18	2818	630	450	701	800
Setuza		1227	492	520	480	1035	912
CEZ		75898	26934	645	585	1655	978
Bio[illegible] Paskov		836	1198	300	284	560	661
IPS		715	2230	424	302	700	538
Vodni stavby Temelin		180	6470	660	615	860	801
Vodni stavby Praha		2168	419	256	1666	910	454
CZ Strakonice		2712	6593	180	195	414	306
Trinecke zelezarny		1336	1293	240	134	309	241
Zbrojovka		1531	2442	190	160	424	240
Skoda koncern Plzen		12992	13332	1887	220	572	395
Transporta		956	2191	130	141	400	250
CKD Praha		5146	6423	86	122	428	218
Brno Diesel		686	2122	170	107	375	200
E[illegible]oaqua		348	1097	70	86	173	140

Exhibit 5
Detail of Trading Volume for Key Stocks:
22 June to 4 December 1993

Progress Ostrava, a.s. (B)

Stock	BCPP	RM-S
CEZ	42.3%	11.0%
Skoda koncern Praha	7.3%	5.4%
CKD Praha	2.9%	-
CZ Strakonice	1.5%	2.7%
Vodni stavby Temelin	-	2.6%
All other shares	46.0%	78.3%
Total all shares	100.0%	100.0%

Progress Ostrava, a.s.

Company Charter (Extracts)

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

~~(The full version is available in Czech, English version contains abstracts, translated by Sandy Chen and Tomáš Černohorský)~~

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

~~Article 2: Company name and seat~~

~~Article 3: Period of operations (indefinite)~~

~~Article 4: Company activities~~

~~Testing of electrical equipm~~ent

~~Testing of operating stoves and pressure cookers~~

~~Project activities~~

~~Industrial construction~~

~~Residential construction~~

~~Civil construction~~

~~Production of steel structures and their~~ parts

~~Purchase of goods for later selling~~ (retail?)

~~Trade intermediary~~

~~Renting of equipment and attachm~~ents

~~Technical and engineering activit~~ies

~~Assembly operations~~

Article 5: Basic capital of the company

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

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

Article 6: Shares

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

Shares for owners are registered according to law.

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

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

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

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

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

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

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

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

~~Article 7: Registration of the company~~

II. Organization of the company

Article 8: Organs of the company

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

Article 9: The general meeting

The position and sphere of influence of the general meeting

The general meeting is the highest organ of the company. It consists from all presented shareholders.

The rights of the general meeting include:

Approving changes in the articles of incorporation

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

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

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

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

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

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

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

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

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

Article 10: Participation in the general shareholders meeting

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

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

The general meeting is attended by the members of the management board and the members of the supervisory board and the prokurist of the company.

Article 11: Calling the general meeting

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

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

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

the company is illiquid for longer than three months

if there are any other serious concerns of the company

if the supervisory board requests it by its vote

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

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

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

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

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

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

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

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

Article 12: Operations of the general meeting

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

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

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

All required parts of the list of present shareholders, content and way of takinkg minutes, verifying minutes are regulated by the law

Article 13: Decisionmaking of the general meeting

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

If the general meeting is not empowered within one hour after the biginning another general meetin g can be called for the same day or within next three days. Another general meeting is empowered even if present shareholders doesn't represent more than one half of paid in capital. There has to be note about this fact on the invitation card for trhe original general meeting.

Items that were not on the program can be decided on only if all shareholders are present and have 100% agreement to consider the item.

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

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

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

A qualified majority is needed for deciding the following:

Changes in the articles of incorporation

Increasing or decreasing the basic capital

Changing the rights of individual classes of shares

Stopping the company

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

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

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

B. Management board

Article 14: The management board

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

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

The management board is empowered to at least:

realize business operations and supervise the operations of the company

uphold employer's rights

declare a general meeting

supervise the preparation and presentation of the general meeting

make suggestions for changing articles of incorporation

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

closing year-end accounts

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

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

suggesting policies concerning losses, including drawing from reserve funds

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

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

suggesting the winding-up of the company

(e) conduct/manage the general shareholders meetings

(f) supervise the preparation of quarterly balance sheets

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

(h) hold the list of shareholders

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

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

(k) empower and vote out the prokurist

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

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

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

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

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

(1) The management board has five members.

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

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

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

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

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

Article 16: Management board meetings

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

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

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

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

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

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

Article 17: Seating (sessions) of the management board

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

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

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

Article 18: Decisionmaking of the management board

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

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

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

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

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

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

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

Article 20: Responsibilities of the members of the management board

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

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

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

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

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

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

C. Supervisory Board

Article 22: Establishment and powers of the supervisory board

(1) The supervisory board is the control organ of the company

(2) The supervisory board evaluates the performance of the activities of the management board, and realizes the business activities of the company.

(3) The supervisory board evaluates for example:

- (a) verifying that the articles of incorporation, decrees of the general meeting, and general regulations are followed.
- (b) testing the annual financial statements and recommendations for dividends and royalties, including amount of the dividend and the means of payment.
- (c) testing the simple quarterly balances
- (d) calling extraordinary general meeting, if it is in the interest of the company
- (e) present to the general meeting and to the management board its opinions, proposals and recommendations.
- (f) verifying company documentation, accounting, trading bookds and other company documents anytime.

(4) The supervisory board as part of its activities directs the seating and approval of general meetings.

(5) The supervisory board can vote out a member of the management board who is currently performing the function of prokurist only with the recommendation of the management board.

Article 23: Composition and functions of the supervisory board

(1) The supervisory board has three members

(2) During the founding of the company, the founder names the first members of the supervisory board in the founding documents. Later two-thirds of the members are elected and voted out by the general meeting, and one third of the members is elected and voted out by company employees. A member of the supervisory board can not be at the same time a member of the management board.

(3) A member of the supervisory board is elected for 5 years, unless the member is voted out by the new supervisory board. Reelection to the board is possible.

~~(4) Members of the supervisory board can leave their function by submitting a written declaration to the supervisory board. In this case, the rights and responsibilities of the board member end on the day that his departure is discussed by the general meeting.~~

~~(5) The members of the supervisory board elect from among themselves their chairman.~~

Article 24: Declaring a meeting of the supervisory board

(1) The supervisory board has a meeting at least twice yearly.

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

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

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

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

Article 25: Holding the supervisory board meeting

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

(2) Minutes from the meeting have to be taken and signed by chairman of the supervisory board and one who took minutes

~~(3) Expenses related to this meeting are covered by company.~~

Article 26: Decisionmaking power of supervisory board

(1) Supervisory board can make a dicision if there is more than half of the members of the board at the meeting. Nobody can send sombody for this meeting on his behalf

(2) Decision can be made if more than one half of all members of the board (not only of those present ones) vote for it.

(3) If there is voting in or voting out of the chairman of the supervisory board that person (who should be or who is a chairman) doesn't vote.

Article 27: Responsibilities of the members of the supervisory board

(1) Members of the management board are required while carrying out their functions to exercise extreme care to keep all sensitive company information confidential. If this information is given to a third party, it may damage the company. However, these considerations do not affect the right of the board to monitor and supervise the activities of the

company.

(2) Members of the board have to follow regulations relating to prohibitions on competitive behavior which are given by the law.

(3) Penalties for breaking regulations given in paragraphs 1 and 2 are regulated by the law.

(4) Members of the board are legally responsible for demages caused to the company by breaking their responsibilities. If this demage is caused by several members they will be held equally responsible.

Article 28: Royalties for the members of the supervisory board

Members of the supervisory board are entitled to get royalties/compensation as decided by the general meeting.

D. Procurist

~~*Article 29: Position and rights of the procurist*~~

~~Rights and responsibilities of the procurist are given by the Commercial Code~~

III. Negotiation on behalf of the company

Article 30: Negotiation and signature power on behalf of the company

The power to negotiate or sign on behalf of the company is given to (1) the entire assembly of the management board, or (2) the chairman or deputy chairman and one member of the management board, or (3) only one member of the management board who is empowered to do this by the written decision of the management board. For documentation, the name and stamp of the company must be accompanied by with signature of the relevant person or persons.

IV. Business and operational issues of the company

~~*Article 31: Sales year*~~

~~Sales year of the company begins from the date of registration in Company Register and ends on December 31 of that year. Every other year is the same with the calendar year.~~

~~*Article 32: Bookkeeping and accounting of the company*~~

~~Bookkeeping and accounting is provided according to the law.~~

~~*Article 33: Yearly closing of the accounts*~~

~~(1) Yearly closing of the accounts and the suggestion for division of profits, including the amount and the manner of payment for dividends and bonuses or the way of financing losses is supervised by the management board. These documents are given for approval to auditors (choosen by management board) and to the supervisory board according to the terms given by the law. After approval given by the auditor and the supervisory boardm the management board will send the main data from those documents plus an invitation for the general meeting to the company shareholders. The general meeting must take place by June 30 and has to approve the yearly closing of the accounts. The supervisory board will provide their opinion on the yearly closing of the accounts.~~

~~(2) The yearly closing of accounts has to be provided according to the law and has to give complete information about the company's assets and financial situation, profits or losses.~~

~~*Article 34: Simplified quarterly balance sheet*~~

~~Besides the yearly closing of accounts, the management board must provide simplified quarterly balance sheets giving basic information about the current status of company property, the financial situation of the company, the efficiency of its operations and profits or losses. This balance sheet must be reviewed by the supervisory board.~~

Article 35: Company's distribution of profits

(1) Distribution of profits is decided by the general meeting, is recommended by the management board and reviewed by the supervisory board

(2) Company profits, after subtracting amounts for taxes, contributions to reserve funds, and other uses approved by the general meeting, are allocated for dividends and bonuses (board compensation).

(3) The general meeting decides whether part of the profits will be used to increase paid in capital.

~~*Article 36: Reserve fund*~~

~~(1) The reserve fund is prepered for financing losses of the company and as a bridge over difficult moments in the company's operating history.~~

~~(2) At the time of registration of the company there was put into the reserve fund 10% of the paid in capital. The reserve fund is increased every year by 5% of net profit until the total amount in the reserve fund represents 20% of paid in capital.~~

~~(3) Use of the reserve fund is decided by management. Every use of reserve fund must be declared to the supervisory board.~~

~~*Article 37: Social fund*~~

~~A company can establish according to the law a social fund. Rules for establishment, sources and uses of the social fund are given by the management baord. The total amount of the social fund is recommended by the management board and is approved by the general meeting.~~

~~*Article 38: Other funds*~~

~~The management board has the legal right to establish other funds.~~

~~*Article 39: Covering of company's losses*~~

~~(1) The manner of covering losses is recommended by the management board and decided by the general meeting.~~

~~(2) If there are any losses, they will be covered by the reserve fund. The manner of use and process of approval for the use of the reserve fund is described in Article 36.~~

Article 40: Increase or decrease of paid in capital

(1) Increase or decrease of paid in capital is decided by the general meeting under the conditions given by law. To increase or decrease paid in capital there must be the decision of a qualified majority of the general meeting. Notarized minutes of this decision must be made.

(2) If the increase of paid in capital is done by the issue of new shares, the general meeting will decide the manner of issuing and paying for new shares. If shares are not paid for in time penalties are given by law.

(3) If the increase of paid in capital is done by transferring part of the profit to paid in capital and issuing new shares those new shares will be offered to existing shareholders. Facts about the possibility of getting new shares must be anounced on the invitation for the next general meeting. Those shares not be taken by existing shareholders no later than the end of the general meeting will be offered for sale to third persons in the manner decided by the management board. If the general meeting is thinking about a decrease of paid in capital this amount cannot be lower than is allowed by law.

V. Cancellation and the end of the company.

~~*Article 41: Ways of cancellation of a company*~~

~~(a) decision of the general meeting about cancellation of company or its transformation into other form of company or cooperative, or merging or dividing of a company~~

~~(b) decision of the general meeting about cancellation of the company with its liquidation~~

~~(c) decision of the court about cancellation of the company~~

~~(d) announcement about a competition for the property of the company or cancellation of an offer of announcement of the competition for lack of property.~~

~~*Article 42: Decision of the general meeting regarding cancellation of the company*~~

~~The general meeting decides in matters in article 41 paragraphs 1 and 2 by a qualified majority. Notarized minutes must be made of the decision.~~

~~*Article 43: Liqidation of the company*~~

~~(1) The liquidation process of the company is given by the law~~

~~(2) The manner of distribution of the assets left after liqidation is decided by the general meeting. The liqidation balance is distributed among existing shareholders.~~

~~*Article 44: The end of the company*~~

~~The end of the company is at that time when the record of the company is taken out from the Company register~~

VII. Final articles

~~*Article 45: Announcements*~~

~~(1) Facts given by the law or by these articles of incorporation or by the decision of the general meeting are announced in Obchodní věstník (Business Bulletin) or in Hospodářské noviny (Business newspapers – daily) or in another daily with the exception of the invitation for the general meeting.~~

~~(2) Written documents are delivered to named shareholders according to owner's name and address which is on the list of shareholders.~~

~~(3) Written documents to other people are delivered to addresses given to the company~~

~~*Article 46: Legal relations and resolving disputes*~~

~~(1) The establishment, legal relations and end of the company as well as all legal relations coming from the articles of incorporation and all other legal relations inside of the company including relations of health and social insurance of company employees are regulated by the law of the Czech Republic~~

~~(2) If there are any disagreements between shareholders and a company as well as disagreements between shareholders related to their presence in the company, these will be resolved be mutual agreement. If the contention cannot be resolved by mutual agreement then it must be decided by the relevant court in the region of the company's legal seat.~~

Article 47: Changes in the articles of incorporation

Changes of articles of incorporation are recommended by the management board and decided by the general meeting. For this decision a qualified majority is needed and notary-verified minutes have to be taken.

~~Article 48: Explanation clausule~~

~~In the case that some article of these articles of incorporation is invalid, or if there are some differences in it because of changes in the legal framework, other articles are still valid without any changes. In this case, the invalid article is replaced by the related article from the law or if there is not such a law then the invalid article is replaced by the manner of resolving such an issue which is common in business relations.~~

~~Article 49: Effectiveness of articles of incorporation~~

~~These articles of incorpoartion are effective by the decision of general meeting of July 28, 1993.~~