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THE SECTOR APPROACH TO PRIVATIZATION:
The Example of Poland's Glass Sector

Final

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Executive Summary

By the end of 1990, Poland led privatization efforts worldwide. In a year's time the reformers had sold to the public five major companies through the new stock exchange - the first share offering in Poland since the beginning of World War II. The new officials passed a law allowing managers and employees to own companies they worked in, opening the door for a tidal wave of applications for ownership of thousands of small and medium companies. Cities across the country began to auction countless shops and businesses. An intellectual in Gdansk named Janusz Lewandowski published papers advocating a radical "mass" privatization plan. For the first time in the post-war era Poland allowed foreign ownership of state-owned companies. Curious investors (all with some degree of gold rush fever) streamed across the borders from Europe, Scandinavia and the United States, while lawyers dusted off the 1937 bankruptcy law.

The Ministry of Privatization (MOP) was created and opened its doors to officiate over the transactions. It scrambled to design coherent policy, increase the momentum of reform and, somehow, accommodate the flood of workers, their bosses, the public and the Western investors who all stood impatiently in the hallways.

Uncertainty abounded as various schemes for privatization were established. Every day a new delegation of bankers from London, lawyers from New York and consultants from around the globe descended upon the MOP, each representing wealthy Western firms seeking investments. Inevitably, these "buyers" possessed the best information and had often negotiated some sort of tacit agreement with the management of the target company well before approaching the MOP. The MOP, on the other hand, had little understanding of what it was selling and worse yet, it did not know the best way to sell since the new privatization law allowed several options.

Officials at the MOP were, no doubt, overwhelmed and had no established procedures for dealing with the rapid transformation and the subsequent demands of these various constituencies. Given these circumstances, the MOP officials needed help and they knew it. The sector approach grew out of this need to develop transparent and consistent procedures for privatization while leveraging scarce resources.

The MOP also knew, though, what it did not want: studies. For the two years prior to the reforms, a variety of international agencies lurked around Poland spending time and money producing elaborate "studies" of how and why businesses did not work. Newly appointed privatization leaders resolved to demand work from advisors that would lead directly to the transformation of SOEs into private companies.

Co-authors for this case study are Charles Krakoff of Abt Associates, Inc., Jay Madigan and B. Tina Pham of Price Waterhouse LLP-International Privatization Group. This case is to serve as the basis for class discussion rather than to illustrate either the effective or ineffective handling of an administrative situation. The authors wish to thank Tessie San Martin, Ph.D., Ms. Mariann Kurtz, Mr. Johnny Butt and Mr. Tomasz Pyrich of Price Waterhouse LLP for editorial and research assistance and Andrew Berg, Ph.D. for editorial contributions. The case study was undertaken as part of the Privatization and Development Project funded by the United States Agency for International Development. September 1994.

The idea for a sector approach formed with the sale of a food processing plant to Unilever. "Wasn't it true," MOP officials asked one another, "that to determine an appropriate privatization path for one company it was necessary to understand the sector as a whole?" And if that was so, "Does it not follow that if you know the suppliers, competitors and customers of one Polish food processing plant you are at least well on your way to knowing the same for them all?" So, having hired a consultant to analyze and negotiate the sale of one plant, the MOP decided to pay them a little more to leverage their efforts and prepare the remaining food processing firms for privatization as well. This compelling economy of scale launched the first sector project.

Over the next three years, 600 companies in 35 industrial sectors eventually adopted the sector approach. Of that number the MOP sold 85 companies through trade sales with another 50 companies remaining in the negotiation process. Officials have estimated that before the end of 1994 a total of 130 enterprises will have been privatized through sector-based trade sales.

In achieving these accomplishments the MOP spent approximately $50 million for advisory services. Phases I and II (Sector Analysis and Company Analysis) cost an average of less than $1 million per sector, while an estimated $20 million to $30 million were paid in success fees for Phase III (Implementation) activities.

By 1993, privatization revenues amounted to about $225 million, presumably increasing to $560 million in 1994, or about 2% of total government revenues. MOP officials have estimated that capital privatization could generate up to $200 million in 1994 alone. Total receipts for all methods of privatization since 1991 amounted to more than $700 million. Additional investment commitments, attained largely through the sector approach may total an additional $1 billion or more.

Today the sector approach in Poland draws criticism or indifference from former supporters. Polish authorities now expend resources on mass privatization, regional privatization and a variety of restructuring programs. The MOP no longer requests donor assistance for what was once its largest program. Why?

In part, the sector approach experienced some problems which were purely political and commonly shared with all methods of privatization. For instance, privatization in general operated under the legacy of the Solidarity worker's union. The Solidarity movement created the political conditions necessary to enact laws which enabled the Workers' Councils to fire their bosses with a vote.[1] Regardless of the free market intentions of the reformers, the labor unions effectively held veto power over the privatization process thus, unlike the Treuhand, the MOP could not force privatization.

[1] Lawrence Weschler, "Reporter At Large - Shock", New Yorker, December 10, 1990, pgs. 97-98.

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Moreover, Poland's distinguished history of resisting foreign control recently manifested itself in a suspicion of privatization. What if the Germans bought all the companies? Not an idle question to thousands of Poles in the west of the country, many of whom worked in former German owned factories, built on former German soil.[2] Would not foreign advisors give advice to the advantage of their own country? Members of parliament debated this question publicly. These questions placed the sector approach in double jeopardy by proposing to hire foreign advisors to sell Polish firms to foreign companies. To some, the concept itself was a scandal.

Initially, the sector approach aspired to inform a wide range of policy makers on all privatization related issues, including restructuring. However, as events unfolded the Ministry of Industry separately and without the informed advice of the sector approach advisors attempted to conduct restructuring projects. In the meantime the sector approach became very useful only for selling high performing companies through international tenders. In addition to other points mentioned below, this left unfulfilled the MOP's original ambition for the sector approach -- using it as a tool for facilitating the use of a multi-track privatization program.

But political problems aside, there remained a number of flaws in the design and implementation of the sector approach which, in hindsight, limited the ability of the sector approach to withstand changes in political leadership, scandals and investigations, and to produce more impressive results. These flaws included:

- human resource constraints;
- a lack of political support for this approach;
- limited effectiveness of the program due to a focus on trade sales;
- and a contracting process which favored trade sales.

The program, however, warranted some remarkable merits which ought to have outweighed any negative judgements. Considering the outcome of the sector approach makes the current inactivity of the projects somewhat mysterious if not regrettable. The merits included (i) generating revenue for the treasury, (ii) increasing the competitiveness of Polish industry by creating a clear picture of the marketplace and focusing on customer demands, and (iii) improving the efficiency of several industrial sectors through the infusion of investment capital, skills and technology.

This research case aims to shed light on the reasons for the growth, flourishing and eventual retraction of the sector approach in the Polish reforms. To illuminate these circumstances, the glass sector is used as an example throughout the text, including in Annex I, an explanation of how the sector approach affected directly and indirectly the fate of three glass manufacturing enterprises.

[2] Ibid, p. 117.

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The Sector Approach

The Ministry of Privatization (MOP) undertook the sector approach based on the belief that technical assistance organized and coordinated by industrial sector optimized the government's negotiation position in regards to privatization. The concept of the sector approach emerged in reaction to the sluggishness of the public offerings, the frustrations of foreign investors wishing to participate in the privatization process and the hope of using scarce resources to efficiently deal with the large number of companies in dire need of privatization. Klaus Hermann, a former official in the MOP's Capital Privatization Department and one of the principal architects of the sector approach, remarked, "It was in the interest of both Poland and the foreign investors to develop a more systematic approach - an approach to privatization which looks beyond the individual transaction."[3]

To make the monumental task of sector privatization more manageable, the sector project was divided into three phases: **Phase I - Sector Analysis** - an overall analysis of the sector domestically, regionally (i.e. Europe) and internationally; **Phase II - Company Analysis** - a detailed evaluation of each company and company-specific privatization recommendations; and **Phase III - Implementation** - in which advisors aimed to put in practice the recommendations for selected companies (see exhibit 2-sector project development).

The principle goal of the program aimed to privatize in a manner that would enhance the competitiveness of Polish industry. Attacking privatization sector by sector, it was presumed, utilized scarce resources most efficiently. Further, considered in sectors, firms could choose between one of several means of privatization in Poland's multi-track approach (see exhibit 1-privatization options). The sector approach was to be a tool for selecting the correct path. As such, the sector approach in many ways fulfilled the expectations of its designers but in others it failed to live up to its potential.

Background

Poland set a precedent

No where in Eastern Europe were the reforms more dramatic than in Poland. The historic "round-table" discussions forced upon the communists in 1989 by a runaway troika of Solidarity, hyper-inflation and $27 billion in external debt[4] paved the way for reform.[5] In the aftermath of

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[3] Hermann, Klaus, Michael Rusiecki, and Tom Kolaja, "Sector Approach to Privatization: Concept, Objectives, Operational Details," Ministry of Privatization, Warsaw, July, 1991.

[4] Norman Davies, Heart of Europe: A Short History of Poland (Oxford: Oxford University Press, 1989), pp. 15, 418-419.

compromise, the communists retained the Presidency while Tadeusz Mazowiecki, the editor of the Solidarity weekly paper, became Prime Minister. Perhaps most importantly, a forty-two-year-old American educated researcher affiliated with Warsaw's Central School of Planning and Statistics was awarded the post of Minister of Finance. His name was Leszek Balcerowicz. He authored the market reform now popularly known as "shock therapy."[6]

Within the wider context of the reforms, the Polish privatization law passed in mid-1990. The law, which established a multi-track program in privatization, was crafted by Krzysztof Lis[7], with the help of outside advisors from the International Finance Corporation, the Wharton School of Business, Harvard University and consultants sponsored by the British Know-How Fund.

Roughly 8,000 nationally-owned firms fell under the jurisdiction of the newly created MOP - all experiencing various states of decline. Approximately 500 firms were considered major, highly valuable firms or large employers with some element of national and strategic importance.[8]

Up to that time, only the Thatcher administration's privatization program in the U.K. had attempted such an ambitious privatization program. The British, experienced in privatization and

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[5] Lawrence Weschler, "A Reporter at Large - A Grand Experiment", The New Yorker, November 13, 1989, pp. 60-62.

[6] "Shock therapy" had two primary goals - macroeconomic stabilization and restructuring of the economy using and creating market mechanisms. On January 1, 1990 steps were immediately taken on five fronts: (i) *balance the budget* - consumer, enterprise and energy subsidies were greatly reduced; (ii) *tighten credit policy* - subsidized low interest rate loans to state enterprises were eliminated; (iii) *decontrol prices* - price controls were largely eliminated; (iv) *liberalize and promote foreign trade* - the zloty was devalued and became legally convertible at the same time most import restrictions (and export subsidies) were eliminated); (v) *control wage growth* - a penalty in the form of a heavy tax on wages of employees of state owned enterprises paid in excess of standards set by the Ministry of Finance. Additionally the government announced plans for privatization and restructuring of state owned firms as well as the creation of social assistance programs. Several sources provide detailed descriptions of the reform process in Poland, one of the best is "Creating a Market Economy in Eastern Europe: The Case of Poland," Brookings Papers on Economic Activity by David Lipton and Jeffrey Sachs.

[7] While Lis was never formally appointed Minister, he is recognized as the founder of the Ministry, which started as a Plenitpotentery in the Ministry of Finance. The Ministers of Privatization have been: Waldemar Kuczynski (September '90 to January '91); Janusz Lewandowski (January '91 to December '91); Tomasz Gruszecki - acting Minister (December '91 to July '92); once again Lewandowski (July '92 to October '93); and presently Wieslaw Kaczmarek.

[8] These numbers are estimates. Several sources quote contradictory numbers, though it is generally agreed that the MOP was ultimately responsible for the privatization of 6,000 to 8,000 firms. The figure of 500 large companies was also a figure that varied. In fact, the reformers discovered that the communists were very poor record keepers. A great deal of time at the beginning of privatization was spent on sorting out which government body was responsible for which firms.

first on the scene with funding, held tremendous sway with Lis and his team. Groups of investment bankers flew to Warsaw from London to advocate the method of privatization most familiar to them. Thus, the first privatizations occurred with British assistance. Not surprisingly they conformed to the British model of public offerings transplanted into the Polish environment. Paradoxically, the results were both stunning and inadequate.

As in other former communist countries, Poland's privatization program began with the widespread assumption that enterprises belonged to their workers. Compounding this conviction was the fact that Solidarity played a key role in overthrowing communist rule, and that the union held particularly strong political clout. The privatization law primarily sought to resolve the conflict over ownership of state enterprises, rejecting the claim that the workers themselves owned the firms that employed them. After all, workers in industrial enterprises represented only 30% of the work force and 15% of the population.

In granting the government powers to initiate privatization, the Act on Privatization of 1990 allowed the Minister of Privatization to petition the Council of Ministers to order the transformation of a SOEs into a joint stock companies.[9] However, this right was never invoked. No government elected to date could force privatization in face of the strength and importance of trade union workers. As a result, privatization in Poland became a voluntary process.

While voluntary privatization was accepted as reality, the government did have some measures to persuade companies to enter the privatization process. As an incentive for workers to opt for privatization, the law qualified that they could buy up to 20% of the shares of their company at preferential prices.[10] Another incentive was that once a firm became private, wages were no longer restricted by an excess wage tax. As disincentives the government could, and did, cut off the subsidies to state enterprises, and it could reject privatization proposals that the government deemed unacceptable.

Eight months after the passage of the privatization law, the Warsaw Stock Exchange opened for business. The public bought, paid for and sold shares in five large formerly state-owned enterprises (this, following a sophisticated, French designed media blitz promoting privatization). Polish banks participated in privatization through equity positions by distributing shares and giving investment advice to their customers, all in ways previously unimaginable. No country had ever privatized so much in such a short amount of time. Unfortunately, the volume of the work that lay ahead dwarfed those early accomplishments. In February of 1991, the newly appointed Minister of Privatization, Janusz Lewandowski, faced the hundreds of remaining large,

[9] Ministry of Privatization, Law on Privatization of State-Owned enterprises of 13th July 1990, Article 6, Warsaw.

[10] Weschler, *Shock*, p.100.

valuable companies awaiting privatization, firms that would take decades to privatize through public offerings.

The Minister had other ideas

Backed by a new government, appointed by the newly elected Prime Minister, who was in turn backed by President and fellow Gdansk resident Lech Walesa, Lewandowski turned his attention and resources to implementing his pet plan - Mass Privatization. Lewandowski hired Jerzy Thieme, a Polish born, Wall Street banker to manage the newly created Mass Privatization project. Thieme reported directly to Lewandowski and acquired the financial backing of the European Economic Community. In short order, he hired a law firm as a full-time legal advisor while an investment bank provided financial and advisory services. Other firms were hired for support activities, and the in-house staff grew quickly. Before the end of the year the project occupied no fewer than a dozen offices within the MOP.

While the Mass Privatization Program demanded nearly the full attention and political backing of the Minister, the other methods of privatization within the multi-track system developed more or less as they could under the various department heads within the MOP. The Department for the Privatization of Small and Medium Enterprises flourished and privatized 500 companies through management/employee takeovers, regional auctions through the Fast Track program and bankruptcies. [11]Also in 1992 the Department of Privatization through Restructuring came about, allowing for ownership transformation after a process of recovery.

The Sector Approach Emerges

In 1990, after two years of negotiations, an exasperated acquisitions team from Philips N.V. continued to attempt to acquire shares in Poland Pila, the major Polish lighting manufacturer. In the absence of a privatization law, an agreement based on the law on joint ventures formed the basis of discussion. The Ministry of Industry had been representing the government in these negotiations, as they did in most joint venture negotiations. Soon that changed.

To push privatization, the Balcerowicz reformers declared acquisitions preferential to joint ventures. This shift in policy meant that foreign firms seeking major joint ventures received approval only if they instead purchased a majority of shares in the Polish company. The MOP now assumed responsibility for negotiating the majority purchases, including the purchase of Poland Pila.

[11] Andrew Berg, Ph.D., The Logistics of Privatization in Poland - Chapter 4 of Dissertation, Department of Economics, Massachusetts Institute of Technology, 1992, p. 19.

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With a majority of shares now up for sale and the issue no longer simply a joint venture, an international tender for the sale of Poland Pila was called for by government officials and their advisors. The MOP budget for an advisor amounted to a little under $40,000, fully provided by the Europeans.[12]

Selected as advisor, the British merchant bank Samuel Montegu (SM) first conducted a sector overview to assess the impact of the Poland Pila acquisition on other companies in the Polish lighting industry. As part of their work SM also evaluated current and projected competition from similar acquisition targets in Hungary, the Czech Republic, and East Germany. Informing the MOP of the potential benefits and downside of a completed transaction, SM made a clear case for forging ahead with the deal. The message was clear - if the MOP did not act fast, the Polish lighting industry would lose ground in very stiff regional competition.

The actions of SM made the deal possible because they steered the government towards an opportunity for both privatization and revenue for the treasury. In assistance to the investor, SM jumped through many of the bureaucratic hoops which thus far had stalled the deal. The novelty of this approach, together with an atmosphere of trust created during the process, provided a resolution to the negotiations.

The agreement between the government and Philips N.V.concluded in early 1991 and called for Philips to pay $15 million to acquire a two-thirds interest in Poland Pila. Phillips additionally agreed to investment commitments of a further $40 million.

Almost simultaneously, Unilever approached the MOP, complaining that negotiations had dragged on for too long with Pollena Bydgoszcz, a large detergent manufacturer. For more than a year, Unilever attempted to establish a cooperative agreement and now they wanted to accelerate the process. The MOP then decided that the sector analysis, which proved informative in the Philips transaction, should be applied to the 24 companies in the detergent sector. Following that, an international competitive tender for the targeted Polish firm would take place.

Part of the MOP's rationale for a high profile bidding process for Pollena Bydgoszcz was the hope that it would attract worldwide investor interest. That done, sector overview in hand, the sector advisor would be in a strengthened position to pitch the attractiveness of the sector to other investors within the industry. Expectations were high such that additional trade sales would occur, which in fact happened.

[12] This figure is, as is much of the description of the beginning of the sector approach, recalled from discussions with Mr. Klaus Hermann and others who were present during the initial period of the MOP's operation.

Bain & Company was selected as advisor for the detergent sector, receiving $800,000 for the sector analysis, plus a success fee for completed transactions in the sector. The economies of scale achieved through the sector approach were much greater than expected. For example, in the detergent sector, Unilever initially proposed a $12 million joint venture, promising only $3 million of that amount in cash. Following the sector analysis, Unilever agreed to pay $25 million to acquire 80% of the shares in the Polish firm, money that went directly into the State Treasury, while making an investment commitment of another $25 million. In Mr.Hermann's words, "We spent $1 million to get $25 million, and for the same money also got full information on 15 other companies in the detergents, cosmetics and toiletries sector. This enabled us to do two more deals for [revenue of] another $40 million."[13]

Initially, privatization officials expected the advisors to shepherd firms not sold via trade sale to alternative privatization paths such as internal take-overs, joint ventures or liquidation. However, unlike trade sales, no institutional incentives existed for either the advisors or the capital department personnel to follow through on alternative actions. No success fees were offered for advisors to complete other forms of privatization. And neither inter- nor intra-ministerial lines of communication were in place to facilitate the movement of firms into alternative privatization paths.

By the spring of 1991, the MOP identified over a dozen sectors for inclusion in this new "sector approach" (see exhibit 3-sectors and sector advisors). Managers were hired by the MOP within the Capital Privatization Department. They coordinated the activities of the sector advisors and acted as liaison to other involved government agencies. Beyond any doubt, the sector approach efficiently multiplied the strength of the of available personnel, yet the department remained severely understaffed, with only 10 to 15 professional and 15 to 20 support staff. In 1992, Mr. Hermann estimated that at least four times this many people were needed, implying that, "You need the full attention of one or two qualified people per sector to work with the advisors towards making deals."[14]

Objectives of the sector approach

The sector approach aimed to facilitate the use of the multi-track privatization program, privatizing in a way that enhanced the competitiveness and long term prospects of Polish industry. In addition to the privatization of companies within the sectors, the sector approach had a number of secondary objectives, which included:

[13] Ibid., discussions with Hermann.

[14] "Polish Investment Report: Privatization," Development Journal, Issue 2, p. 10, 1992.

- **raising revenue for the treasury:** raise enough money for the privatization process to be self-financing.

- **developing an information base:** create an economy-wide "sector map" to demonstrate privatization and restructuring options for individual companies. Extend the use and availability of the sector map beyond the MOP to other policy bodies as well as to foreign investors and those in need of understanding the cross-company effects of privatization.

- **generating world-wide investor interest in Poland:** increase the number of potential investors by presenting several options for acquisition; make privatization in Poland an investor-friendly process by having one source (the advisor) where information is dispensed, negotiations are conducted and decisions are made; advertise companies for sale in the international press and publicize their sale, thus giving notice to the international investment community that Poland is ready to do business.

- **improving the transparency of privatization:** present information about individual enterprises in a wider context to a world-wide audience, with explanations regarding their status, their availability for sale and the process for purchasing state-owned firms.

- **preventing foreign investors from "cherry-picking":** require advisors to work with entire sectors, allowing the MOP to negotiate a satisfactory arrangement for more than the "crown jewel" companies.[15]

- **preventing Polish state-owned companies from competing with one another for investors:** represent the larger interests of the state by negotiating with all interested parties. This was necessary because foreign investors were known to pursue several investment partners within the same sector; when one Polish company would not meet their demands they would turn to another similar company, playing one state-owned company against the other.

Taking it step by step

Implementation of the sector approach was conducted in three phases and relied on the MOP hiring an advisor(s) skilled in condensing business and policy information to a point where decisions could be presented back to the MOP. The MOP initiated its search for an advisor through the issue of a "terms of reference" seeking a proposal from potential advisors (glass sector example in Annex III).

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[15] Klaus Hermann, Michael Rusiecki and Tom Kolaja, "Sector Approach to Privatization: Concept, Objectives, Operational Details", Ministry of Privatization, Warsaw, July 1991.

Each terms of reference requested the advisor to conduct an international and domestic sector diagnosis, describing the competitive structure of the industry.[16] Intended to lay the foundation for not only government policy in the sector but also individual company strategies, Phase I work developed likely scenarios or outcomes for companies in the sector in the near and mid-term future.

Conducting Phase I involved comparing each company with the others in the sector by rating them using some sensible measure inherent within the industry. Typically a "good, bad, worse" list emerged with minimal effort. For example, two or three of the eight firms in the flat glass subsector were distinguished by good management and a focus on the downstream processing market. Superior crystal manufacturers were marked by the steps they had taken to reduce their dependance on Minex, the state trading monopoly. In the glass container subsector, only one out of nine companies had both state of the art technology as well as the capacity to do the work.

Next, the advisor compared the performance of the Polish sector to that of the same sector in a similar environment, often to Europe or another country within Europe. To do this comparison, the advisor in Phase I relied in equal measure on in-house research as well as field work in Poland, typically including at least one visit to every firm in the sector. Advisors frequently hired an industry expert (in many instances a retired executive) to advise them on the more technical aspects of the sector. The advisor concluded Phase I services with the delivery of a report, oral and written, that described the competitive terrain and prognosis for industry growth.

Phase II comprised a detailed analysis of the individual companies in the sector. Getting through the financial records and past the numbers of a Polish glass sector firm required on average two to three man days of 2 to 3 staff people - more for the larger firms. Some cases required real-estate evaluations which demanded additional time. These intensive efforts required little activity outside Poland. Within Poland, however, staff travel often entailed visiting sites two or three times. For the glass sector, a Warsaw based staff was used to coordinate logistics and maintain MOP contacts.

At the end of Phase II, the advisor prepared and delivered a formal presentation to officials of the MOP recommending specific privatization plans of each company within the sector. If the MOP approved the work, potential investors were alerted to firms considered "international tender" candidates and preparations commenced for Phase III work. Implementation of the approved recommendations of Phase II became the essence of Phase III.

[16] Phase I required an international and domestic description of the industry structure, the participants, the degree of consolidation, the status of existing technology, a market analysis as well as a sector strategy and sector policy. This was not intended to contribute to an official industrial policy as such, especially given the commitment of the government to move away from all aspects of central planning. Rather the point was to develop a strategy to increase the competitiveness of the sector as a whole.

It was customary for the MOP to contract the same advisors for Phases I and II, and then re-bid the work for Phase III. Officials at the MOP felt the need for a second bidding procedure because they could not otherwise properly manage investment banks, and law and consulting firms without careful controls on payment. There lingered a fear that the international firms would not put their best effort forward, and instead would produce academic studies or perhaps even pursue a separate agenda unless closely monitored. Payment reflected the MOP's strongest leverage, thus a second bidding procedure was installed.

Payment for Phases I and II were based on a simple pre-agreed fee. Payment for the Phase III work hinged upon the success fees generated from transactions. Success fees were based on the total value of the deal. The total value of the deal equaled 100% of the equity, plus the long term debt, plus any additional equity attained within 15 months of closing. So, if an investor paid $5 million for 50% of a company and that deal included $5 million in debt, the total value would equal $15 million. It is upon this figure which a success fee would be based.

Though negotiated separately with each firm, there were usually two schemes for success fees, one for smaller transactions (under $25 million) and another for larger transactions (anything over $25 million).

For transactions under $25 million success fees were usually paid on a sliding scale. For example, the MOP awarded advisors 5% on the first million dollars, 4% on the second, 3% on the third, 2% on the fourth and 1% on the fifth, sixth, seventh, eighth, ninth and up to the $25 million threshold. So, for a transaction with a total cost of $15 million the success fee would be $250,000.

For transactions over $25 million the MOP often paid a flat fee of 1.3% on the total amount. For a transaction of $100 million the success fee would be $1.3 million.

Consulting companies normally required a retainer from the Ministry to begin work on Phase III, a typical fee may have been $200,000. If companies were sold, the MOP would later deduct $200,000 from the success fee.

In addition to a success fee for the transaction, the MOP also built in incentives for consulting companies to negotiate the highest possible committed capital investment. For example, it paid the consultants a flat fee of .75% of the committed capital investment amount.

The golden ring of success fees drew the best talent from abroad. Advisors performed their best to jump briskly and flawlessly through the hoops of Phases I and II in order to be in position to win the prize of international tenders in Phase III. Unfortunately, while re-bidding may have provided the benefit of more highly motivated consultants, it also created a towering mountain of paperwork for an already overworked MOP staff. Invariably increased procedure, delayed decisions and payments, and the ensuing friction between all parties involved detracted from the professionalism of the process.

Sector Approach: No longer employed

In theory, the sector approach should have led firms to any one of several methods of privatization. However, the sector approach was conceived of and implemented by members of the Capital Privatization Department within the MOP. The mission of that department was to sell the largest and most valuable industrial firms owned by the state for revenue. To this end, the scope of the Capital Department's authority was limited to transactions via trade sale or IPO. This limitation preordained the sector approach to forego its broader mandate to shepherd all firms in the sector through the privatization process.

Moreover, inter- and intra-ministerial cooperation which would have offered additional implementation options for companies in a sector, never occurred. For example, the Ministry of Industry possessed funding for restructuring, but establishing an agreement on common objectives between the two Ministries came close to impossible. Additionally, the Department for the Privatization of Small and Medium Enterprises within the MOP which handled management/employee takeovers and joint ventures did not benefit from the analysis nor association with the sector advisors. As well, a certain structural rivalry developed between the Department of Mass Privatization and the Capital Privatization Department. Both needed high performing companies to be successful in fulfilling their mission and selected from the same "pool" of state-owned enterprises.

In 1993, the Government ceased awarding new advisor contracts, effectively abandoning the sector approach. Though retaining some sector advisors on a case-by-case basis, the MOP ceased to expand or continue other parts of the project. Donor agencies followed suit. For example, USAID funded Phases I and II of the glass sector work but did not fund Phase III. As a result the MOP awarded the sector advisor, the Price Waterhouse - International Privatization Group (PW/IPG) a one-year (non-paying) contract to carry out as many capital privatizations as possible, on a success-fee basis.

Some companies in the glass sector, for which no investor could be immediately identified, were put into the MPP, or left in limbo to await bankruptcy, asset sale or (with luck) a restructuring program.

Even though the sector approach failed to accomplish its broad goals, its achievements in the area of capital privatization deserve much acclaim. Through the use of international tenders, Polish industry gained: (i) exposure to the international investor community; (ii) a clear picture of the competitive environment in both the domestic and international market place, and; (iii) hundreds of millions of dollars in investment capital. In the container glass subsector for

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example, the American glass manufacturer Owens-Illinois purchased controlling interest in the Polish firm Jaroslaw. Through their investment, technological know-how and market connections Polish container glass is now internationally competitive. Additionally, the closing of this transaction marked an increase in interest in Poland by other glass industry players. This deal, combined with the Pilkington/Sandomierz acquisition, significantly enhanced Poland's status within the international business community.

Problems encountered

A year after the functional demise of the sector approach and the decrease of activity within the Capital Privatization department, a look back reveals many structural defects in the design and implementation of the program. Why was the sector approach limited in its achievements? Fundamentally, it overreached its capacity. Equally important, it was administered from within the confines of a single department within the MOP rather than coordinated from a supra-ministerial body. Obvious problems included:

- **human resource constraints:** Although the sector approach was created in part to use limited personnel more efficiently, the program expanded beyond the ability of the staff to manage it. Lack of foresight, and, more to the point, the bureaucratic inertia of the MOP, prevented sector officials from hiring and adequately paying the numbers of quality staff needed to run the program. This resulted in a seriously overworked staff, high turnover, poor monitoring and, ultimately, a lower quality public service. After two years of operations, the Capital Privatization Department fell under investigation by the Polish equivalent of the IRS, several scandals rankled in the press and staff morale sank to the bottom.

- **inter-departmental conflict:** The sharing of information and coordination among the Capital Privatization Department, the Department of Selection and Commercialization, and the Department of Small and Medium Enterprises was critical for arriving at swift decisions regarding the privatization of several companies within a sector (see exhibit 4-organizational chart). It also proved crucial for following up on the advice for the disposition of each company provided by the sector consultants. But the MOP's internal structure is an old-style pyramid, preventing effective interaction among the various departments. Each department operated under a different Secretariat in the Ministry, with reporting lines that converged only at the Ministerial level. This eliminated much needed informal communication, caused rumors to predominate as the source of information between departments and ultimately led to a rivalry within the MOP itself.

  Competition among departments of the MOP was particularly acute between the Capital Privatization and the Mass Privatization departments, though it need not have been. The criteria for selection of companies into each program were similar; both methods required companies of a certain size, profitable (or at least not too unprofitable), and not overburdened by debt. Because of the rivalry for the companies meeting those criteria, the Capital Privatization department and the Mass Privatization department often refused to share information or cooperate in other ways.

- **lack of institutional and political support:** As a "top-down" approach to privatization, in which decisions regarding the disposition of each company were made in Warsaw, the sector approach would require a great deal of explaining and public relations. Given the defacto voluntary nature of the privatization process, success of the sector projects rested on the informed involvement of employees and a consensus of support from the public and ministerial bureaucrats. Unfortunately, the sector approach was never a priority of the existing MOP public relations arm. Therefore, the sector approach remained a mystery to parliament, to industry, to other Ministries, to other departments within the MOP, to mid-level bureaucrats[17], and most importantly to the affected SOE and its employees.

  Moreover, Minister Lewandowski, the most renowned Polish privatization advocate, while not opposed to the sector approach, chose to spend his time and political capital on developing mass privatization. Consequently, there was little or no outside support for the program.

- **lack of authority by the MOP to force privatization:** The main political constraint, not only for the sector approach but for almost all privatization initiatives in Poland, stemmed from the defacto voluntary nature of privatization decisions and a corresponding lack of political will by the MOP and ultimately the Council of Ministers to exercise its legally-given coercive power. Thus, the privatization program in Poland accorded significant power to the Workers' Council in each enterprise, which vested them with the authority to determine whether or not to privatize the enterprise, and which form of privatization to pursue.

  The MOP's inability to set the terms of debate over privatization forced it to play a reactive role. Rather than guiding and influencing these terms, the MOP spent most of

[17] Many bureaucrats were reluctant to cooperate with the sale of Polish industry to outsiders. As well, people feared the consequences of this ground breaking activity. They worked slowly to prevent having to make decisions. As Andrew Berg states in his previously cited paper, "As a result, where rules are broken, especially in privatization transactions, corruption is suspected. Thus each minor piece of a transaction, such as the publication of a request for tender offers, requires the signature of the head of the department, who may be criminally liable if there turn out to be mistakes in the advertisement. The result is that the Polish bureaucracy is in effect on a 'work-to-rule' strike."

its energy responding to proposals and requests from companies or founding bodies. This was the difficult position the sector approach attempted to optimize.

- **trade sale biased program:** By separately contracting Phase III, with payment based only on a success fee, sector approach administrators effectively assured that trade sale methods of privatization would dominate the results of any sector project. The use of success fees was meant to increase incentives for maximum performance from consulting firms. Instead it narrowed the advisor's interests to companies that would "pay-off" via a big sale. Accordingly, the MOP refused to offer success fees for the culmination of other forms of privatization including joint venture deals. The goals, objectives and scope of the projects eventually folded into doing what the consultants were more-or-less used to performing - international tenders. This left other avenues of privatization untravelled and led to the loss in opportunities to assist many poor performing firms with the expertise of sector advisors.

- **ad-hoc selection of companies and definition of sectors:** Reacting to the will of investors, the MOP often commissioned sector projects in a self-defeating manner. Not only did the MOP designate a number of questionable sectors for inclusion in the process, it created too broad a front to defend. Ultimately this caused the sector approach to outgrow itself. For example, the bicycle "sector," which consisted of only one company, was included in the sector approach. Given the heavy burden on the staff, was it worth the administrative effort?

The Sector Approach In Perspective

All things considered

Maintaining the principles of reform laid out in the Balcerowicz plan, Poland recently reduced its external debt to Western banks to $7 billion.[18] Privatization was chief among the structural reforms in the economy, an important contributor to an economy which is expanding at 4 to 5% a year. Already rated as the most successful of the Eastern European economies,[19] Poland owes some of the credit for this success to the sector approach. Significant foreign investment was captured through this process (see exhibit 6).

Given the preceding analysis, the question remains as to how the sector approach contributed to Poland's economic reform process. And, by what means are we to judge the results? Finally what lessons can donor organizations extract from the Polish experience? Three measures can be used to guage the results of the sector approach's contribution: macroeconomic impact on the economy; impact on the firms that were included in sector projects; and impact on the process of privatization.

Macroeconomic Impact

As a national privatization strategy, the sector approach is often judged against the chief alternative - mass privatization. Mass privatization is selling or giving away large groups of companies simultaneously rather than through individual transactions and is useful for mainly political rather than economic reasons. Economically, mass privatization delivers the foundation of a market economy. It sells itself as an investment with the pay-off coming years into the future. Mass privatization schemes in the Czech Republic, Moldova, Russia and (soon) Kazahkstan are in the process of being implemented to create capital markets where none previously existed. The leadership of these countries chose against a Polish style sector approach in favor of total public participation. To a large extent, the wide-scale voucher system emerged as a guarantee against a revival of central planning by still influential communists.

Poland has yet to implement its Mass Privatization Program. Advocates of the sector approach accepted the reality that individual transactions rather than mass privatization were likely to be the rule in Poland. In this context, the best to hope for in terms of accelerating a structural transfer process was to use efficiently the limited capital and human resources available to implement a case by case approach.

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[18] "Debt Relief for Poland", Washington Post, Editorial page, September 16, 1994.

[19] Ibid., Editorial page.

Though not as vast as mass privatization promises to be, profound changes have taken place within the context of the sector approach. The glass industry, for example, now embodies firms that operate at nearly equal technical capacity to those in the same industry in Western countries. This was unthinkable three years ago. The same could be said of a dozen other sectors which now owe their increased capacity, technical ability and efficiency to the sector approach because the sector approach delivered foreign investors. Even if the case is made that the same foreign investment would have found its way to Poland without the sector approach, the sector approach certainly accelerated the process.

Returns to the treasury are the most measurable effects of the sector projects. In 1993, privatization revenues amounted to about $225 million and was presumed to increase to $560 million in 1994, or about 2% of total government revenues. An approximate total expenditure for the sector approach equaled $50 million, broken down to an average cost of less than $1 million for Phase I and II of each sector, and an estimated $20 million to $30 million for advisory services and success fees for all Phase III activities. MOP estimates projected that capital privatization could generate up to $200 million in 1994 alone. Total receipts since 1991 amounted to more than $700 million. Additional investment commitments may total an additional $1 billion or more. More difficult to quantify were proceeds from taxes of private firms that were sold through the sector approach, though undoubtedly dozens of major corporations now turned private are paying taxes.

As stated earlier, the economies of scale achieved through the sector approach were much greater than expected. An early example is in the detergent sector, which is summarized in the remarks by Klaus Hermann, "We spent $1 million to get $25 million, and for the same money also got full information on 15 other companies in the detergents, cosmetics and toiletries sector. This enabled us to do two more deals for [revenue of] another $40 million."[20]

Investor driven, the sector approach focused on international tenders and eventually became synonymous with a program for conducting trade sales. Influenced by the experience of foreign consultants and using a contracting regimen based on a success fee assured the continuation of trade sales as the chief product of the sector approach.

In 1991, when the sector approach was first applied, it was clearly needed to both equalize the government's position in regard to foreign investors as well as to unlock the channels of bureaucracy. The sector approach revealed that it may be the most efficient way for companies undergoing privatization to gain exposure to a wide range of potential investors, while also affording such investors the opportunity to investigate multiple investment opportunities. Thanks to this approach, a multitude of new investors are now committed to Poland when they could have gone elsewhere.

[20] Discussions with Hermann.

Of approximately 600 companies included in the sector projects, the MOP sold 85 companies through trade sales and another 50 companies remain in the negotiation process. Officials estimate that before the end of 1994 a total of 130 enterprises will have been privatized through sector-based trade sales.

In principle the sector approach was intended to inform a wide range of policy makers. Certain policies that effect all firms in an industry would be better developed through the perspective offered by the experience of a sector approach project. To some extent this was true in the treatment of environmental liabilities.[21] Some sector projects required environmental audits before a transaction was to take place. In an environmental audit samples are drawn from the air, water and soil and around a plant site and chemically analyzed for pollutants.[22] This information was shared by the MOP with the Ministry of Environment and other regulatory bodies. Officials responsible for national environmental policy grew to depend on this data (see Annex III).

Another macro-level outcome of privatization was work force reduction, so it was not unexpected when each privatized glass sector firm decreased its work force. For example one glass company shed over 100 employees after privatization and another, which had already reduced its work force by nearly 100 (15% of total) employees before privatization plans still further reductions once the ownership transformation takes place. There remains, of course, the expectation that when companies improve their financial standing they will increase employment over time.

In some cases the sector approach contributed to short-term preservation of jobs through negotiated employment guarantees. Nearly each trade sale contained a clause to address the issue, thus assuring a receptive and supportive work force.

Microeconomic Impact

The scope and magnitude of the sector projects created a greater understanding of Polish industry than would have been otherwise possible. During the course of PW/IPG's involvement in the glass sector, for example, one glass firm began a restructuring process which focused on down-stream processing. This shift in production was consistent with PW/IPG recommendations and demonstrated the value of informed scenarios projected into the future.

The sector approach occasionally contributed more to negotiations than to finding an investor. For instance, the management of one glass company found its own investor because the glass

[21] Berg, p. 18.

[22] Thomas Kolaja, "Appendix to Terms of Reference", Ministry of Privatization, Warsaw, 1992.

sector started too late. However, they still needed help with negotiations. PW/IPG was able to help because of its role as glass sector advisor.

Advisors prepared better bids used in solicitation of offers because of their knowledge of the sector. This was a direct result of the advisor's work on Phases I and II. Given the specialized sales skills needed to market a company from Poland, the sector approach may have been a requirement in completing a transaction.

One of the universal benefits of the sector projects on the firm level, though, was that advisors provided the Polish companies with information they would not have had otherwise. Some firms used this information to their advantage. For example, one glass company analyzed but not sold by the sector advisors, identified for itself a potential investor using data created by the sector advisor.

Access to information sharing was a two way street. Advisors benefited from the structure of the sector project because as part of a comprehensive government program approved at the highest level, they received greater access to information. If the advisors had been working on one firm at a time, it would have been more difficult to enlist the assistance of the remaining firms.

Impact on the Privatization Process

There are many cases where the sector approach rendered the voluntary, multi-track and inherently idiosyncratic system "user friendly" to foreign investors. Achieving over 130 deals in a matter of three years, marked by the beginning of a difficult transition to a market economy, was nothing short of an outstanding accomplishment. At the same time, abundant anecdotal evidence suggests that some investors waited for long periods for advisors to complete Phase I and II, only to complete transactions which would have been completed regardless of the sector work.

Nonetheless, the base of knowledge developed by the sector advisors was essential in matching many Polish companies with potential investors. In view of the fact that the companies sold were not always the best of the pick, their discovery would likely not have come about without the active search of the sector advisor.

The economies of scale generated by the sector approach allowed Poland to attract the international consulting expertise that it needed, which proved too expensive on a firm-by-firm basis. The presence of international firms became important for several reasons: (i) at the start of the program, only international firms possessed the skills necessary to conduct the financial and technical evaluations required; (ii) technology transferred from international firms contributed to the development of a domestic financial, accounting and consulting capability; (iii) despite existing criticism, the involvement of such advisors probably averted even greater

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criticism that would have occurred had a similar program taken place without outside involvement.

Currently Poland is at an accelerating stage of economic development. Having convinced the West of its unwavering progress toward a market economy and developed a capital market system capable of tapping international financial markets, there now stands an abundance of willing investors and a shortage of attractive investment packages. Often what investors consider most seriously are the remnants of sector projects. For example, the Foreign Investment Agency relied upon the sector projects as a means of initiating their activity. Additionally, USAID and the MOP put in place a "Privatization Assistance Team" (PAT) in the fall of 1993.

This PAT team consists of a group of foreign advisors, many Polish-Americans, who serve as counterparts to privatization department heads including Capital Privatization, Privatization of Small and Medium Enterprises, Department of Supervision of Companies, and the Department of Privatization through Restructuring. By design, the PAT compensates for one of the critical flaws of the sector approach - lack of intra-ministerial communication and cooperation. The goal of this team is to "dust off" the sector studies and implement the privatization plans suggested, but not executed, by the sector advisors. Simply, the team is charged with executing the unmet balance of the original goals of the sector approach --moving the remaining SOEs through the privatization process.

Lessons Learned

A number of lessons can be extracted from the Polish experience. First and foremost, implementation of the sector approach requires a large and skilled (or in training) local staff. Technical training and "team building" staff development should be an integral part of any privatization effort as broad in scope as the sector approach. In Poland, project officials underestimated the human resources necessary for successful implementation of the sector approach. As a result, sector projects tended to expand beyond the ability of the available personnel to properly manage them.

Privatization is a political process as well as an economic tool. Free flowing communication between the various entities involved in privatization proves crucial in sector-wide projects. The correlation between public acceptance and program momentum tends to be high. This is particularly true when programs have the potential to impact large segments of the national population.

The best means to prevent conflict and delay is to administer the privatization process through a supra-ministerial body. Privatizing an entire industrial sector invariably means cutting across the boundaries of multiple government entities. This often generates intra- and inter-ministerial conflict, as was the case between the Capital Privatization and Mass Privatization departments, reflected also between the MOP and the Ministry of Industry.

Sector projects in the future would be far more valuable if they were able to leverage the advisor's expertise to assist marginal firms as well. Poland's experience with the sector approach was biased towards conducting trade sales on an international level for only the best firms within the sector. SOEs that could not generate a price tag large enough for an attractive success fee received little benefit or attention from the sector advisor.

The sector approach to privatization proves most valuable when the advisors can identify the optimal paths to privatization for the greatest number of firms within the sector. Through the process of an objective party looking at the sector as a whole, a range of alternative applications for privatization are made evident. For some firms, though certainly not all, international tenders appear as the best means of entering the private market. Other firms will no doubt benefit more from restructuring before sale, while yet others may prosper through a management/employee buyout. In many cases further investment is pointless, leaving bankruptcy as the only alternative.

Clearly the sector approach succeeded as a method for matching foreign investors with SOEs. In addition, the sector approach produced many benefits for the government including but not limited to revenue for the treasury, an impressive amount of investment capital, foreign technology, new markets and an unprecedented base of industrial information.

In contrast to these achievements, the sector approach failed to attract total public participation and to fully apply the multi-track approach to privatization as it had originally intended. As governments and donor agencies face the task of designing national privatization policies, they can look to these results as a guide.

Exhibit 1
Privatization Options

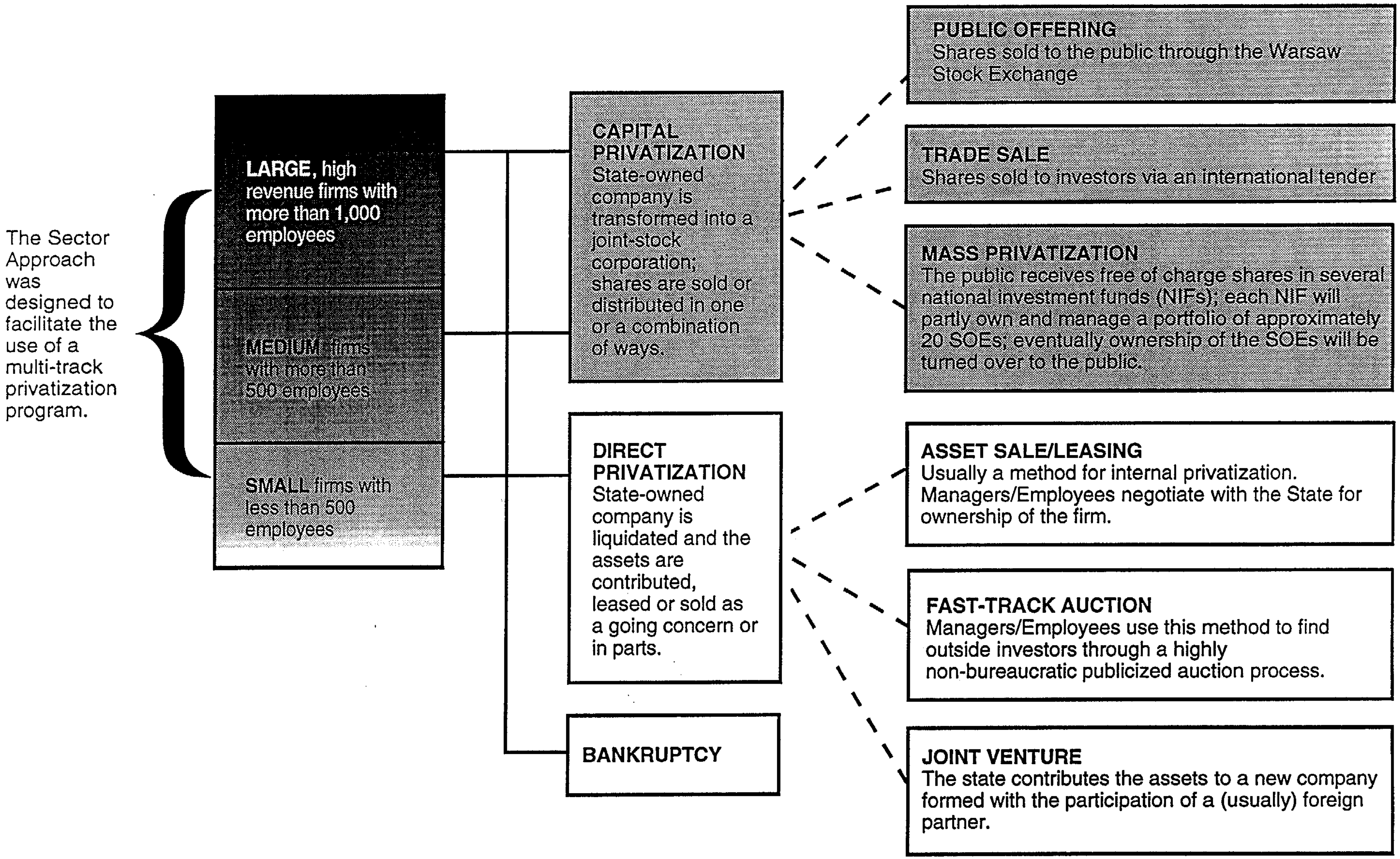
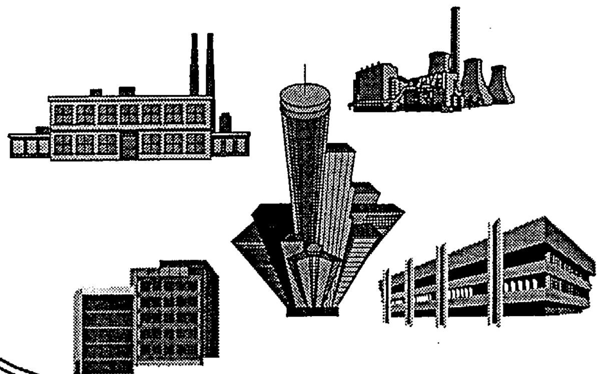


Exhibit 2
Sector Project Development

Sector Selection



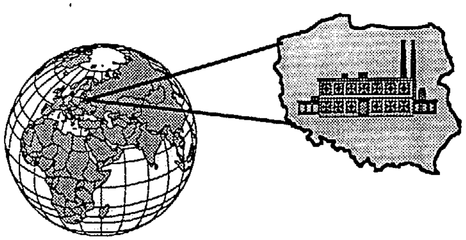
Project Manager Assigned

- Organizes Competitive Bid for Sector Advisor
- Collects Proposals
- Ministerial committee selects Advisor (if the project is financed by donor agency, donor agency procedures are observed)

Concept of Sector Project Implementation

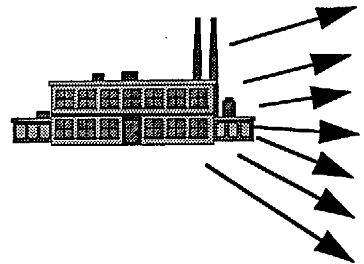
Phase I Analysis

Sector Advisor conducts quick review of individual companies and comprehensive analysis of sector within national, regional and international markets.



Phase II Strategy Development

Advisor develops and makes final recommendations for the privatization and restructuring strategies for the individual firms. Given MOP approval, advisor alerts foreign investors to firms considered "international tender" candidates.



- **Trade Sale**
- **Public Offering**
- **Mass Privatization**
- **Asset Sales/Leasing**
- **Fast-Track Auction**
- **Joint Venture**
- **Bankruptcy**

Phase III Implementation

Advisor conducts privatization, restructuring, or liquidation as per recommendations in Phase II.

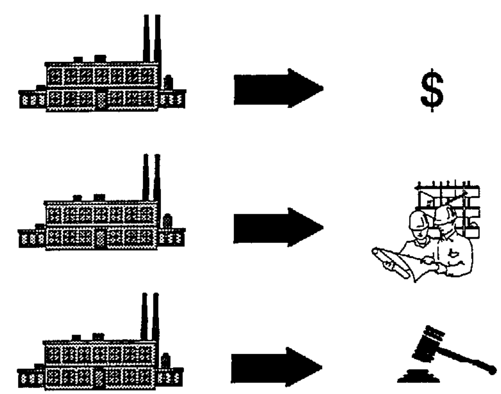
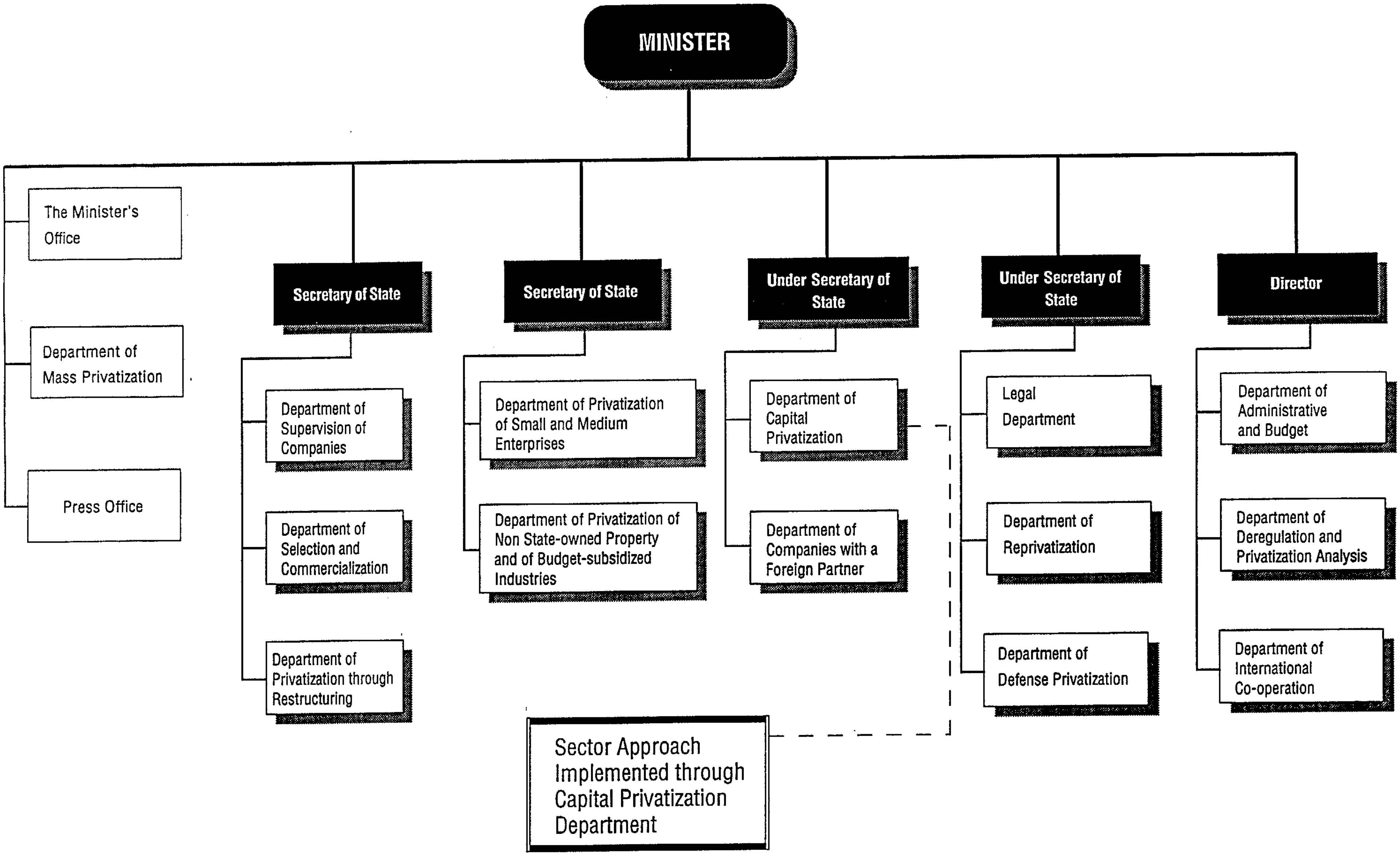


Exhibit 3 Sectors and Sectoral Advisors

Sector	Advisor	Number Of Co.	Comments
Breweries	Sankt Annae International/Company Assistance Ltd.	24	
Ball Bearings	Kleinwort Benson	4	
Cement	IFC	19	
Construction	Boston Consulting Group	30	> 1500 companies in sector; 30 in sectoral approach
Cosmetics, toiletries & detergents	Bain & Company	16	little investor interest
Electronics/telecommunications	Bain & Company	30	
Fruit/vegetable processing	Creditanstalt	10	all privatized by liquidation
Furniture/panel boards	KPMG	72	
Heavy chemicals	McKinsey	26	privatization prospects poor because of slump in Western industry
Glass	Price Waterhouse	32	
Industrial gases	Samuel Montagu	11	little progress; most companies too small
Limestone	IFC	4	plants too small to compete internationally
Machine tools	Pro-Invest	28	
Paint	Deloitte Touche Tohmatsu (3) Schroders (5)	8	all privatized
Meat processing	Ernst & Young	68	
Potato processing	Ernst & Young	13	only 10 of the 41 judged privatizable
Power engineering	Samuel Montagu	4	
Pulp & paper	Hambros	41	strong investor interest e.g., Pirelli and Siemens
Rubber/tires	Société Générale	11	depressed world market; Polish companies too big
Shoes	Company Assistance Ltd.	36	
Textiles/garments	NMB Bank Handlowy/Bain & Co.; Warsaw Consulting Group	10	300+ companies in sector; 10 transformed w/o sectoral study
Tobacco	Morgan Grenfell	7	Stalled by Agriculture Ministry and parliament moves to state tobacco monopoly
Auto components	BZW/Coopers & Lybrand	23	
Cables & wires	Bain & Co.	15	
Confectionery	Central Europe Trust	21	
Electrical equipment	Interbank	16	
Shipping	ING Consultants	5	
Domestic appliances	Business Analysts & Advisors Ltd.	15	
Phamaceuticals	Business Analysts & Advisors Ltd.	2	progress unlikely without health care system reform
Mining machinery	Creditanstalt	3	
Lighting	Interbank	2	
Bicyles	Arthur Andersen	1	
Trucks/commerical vehicles	Lazard Freres	3	
Passenger cars	Credit Suisse First Boston	2	

EXHIBIT 4


MINISTER
The Minister's Office
Department of Mass Privatization
Press Office
Secretary of State
Department of Supervision of Companies
Department of Selection and Commercialization
Department of Privatization through Restructuring
Secretary of State
Department of Privatization of Small and Medium Enterprises
Department of Privatization of Non State-owned Property and of Budget-subsidized Industries
Under Secretary of State
Department of Capital Privatization
Department of Companies with a Foreign Partner
Under Secretary of State
Legal Department
Department of Reprivatization
Department of Defense Privatization
Director
Department of Administrative and Budget
Department of Deregulation and Privatization Analysis
Department of International Co-operation
Sector Approach Implemented through Capital Privatization Department

Firms in the Glass Sector

Exhibit 5

	Trade Sale	Mass	Joint Venture	Asset Leasing	Asset Sale	Transformed (yes/no)
FLAT						
Szczakowa	✯	✯				no
Jaroszowiec		✯				no
Zabkowice		✯				no
Kara		✯				no
Kunice	✯					yes
Murrow		✯				no
Krakszklo	✠					yes
Walbrzych					✯	no ✻✻
CONSUMER						
Violetta		✯				yes
Julia			✠		✠	no ✻✻
Zawierce					✠	no ✻✻✻
Sudety			✯			no ✻✻✻
Tarnow			✯			no
Rozalia	✻					yes
Hortensja	✯					yes
Zabkowice					✯	no
Lubartow					✠	no ✻✻✻
Pienskie					✯	no ✻✻
Bialystok	✻					yes
Jelenia Gora	✠					no
CONTAINER						
Jaroslaw	✻					yes
Ujscie		✯				no
Warta	✠	✠				no
Orzesze	✠	✠				no
Antoninek	✯	✯				no
Czestochowa					✯	no ✻✻
Feniks						no ✻✻
Jedlice					✯	no ✻✻
Pollena-Czechy			✯	✯		no
Wyszkow					✠	no
Wolomin	✠	✠		✠	✠	no ✻✻✻
Wielkopolskie						no ✻✻

✻ Transaction Process Completed
✯ Transaction Process Underway
✠ Transaction Process Stalled

✻✻ Bankrupt
✻✻✻ Nearly Bankrupt

No Public Offerings conducted within the PW/IPG sector project

Exhibit 6

Sample List of Companies Privatized by the Capital Privatization Department by May 1994

	Company name	Sector	Ownership	Investor's country of origin
1990	Exbud S.A.	Construction and Engineering	45% Public Offering 20% Employees 17.5% Management 17.5% International Trading and Investment	Luxembourg
	Slaskiej Fabryki Kabli	Cables	83% Public Offering 10% Employees	
	Prochnik S.A.	Clothing	80% Public Offering 20% Employees	
1991	Krakbud S.A.	Industrial Construction	80% Management 20% Employees	
	Swarzedski Fabryki Mebli	Furniture	70% Public Offering 20% Employees 5% State Treasury 5% Other	
	Techma-Krakow S.A.	Modernization of Machinery	60% HEAN 20% Employees 20% Management	Poland
	Wedel S.A.	Confectionery	40% Pepsico Inc. 20% Public Offering 20% Employees 20% State Treasury	Holland
	Pol-Baf	Potato Processing	80% Basic American Foods 20% Employees	
	Pollena Bydgoszcz	Detergents	80% Unilever 20% Employees	International
	Pollena Raciborz-Helenowek	Detergents	72.35% Henkel 20% Employees 7.65% State Treasury	Germany
	Pollena-Nowy Dwor Benckiser S.A.	Detergents	80% Benckiser 20% Employees	Germany
1992	Alima Rzeszow	Food Processing	60% Gerber 20% Agricultural Supplies 19.18% Employees 0.82% State Treasury	USA
	Pomorska Fabryka Mebli	Furniture	80% Karl-Heinz Klose 20% Employees	Germany
	Amino Poznan	Food Concentration	80% CPC Int. 20% Employees	USA

Exhibit 6

Sample List of Companies Privatized by the Capital Privatization Department by May 1994

	Company name	Sector	Ownership	Investor's country of origin
	Malta Poznan	Paper Mill	80% Kronospan 20% Employees	Switzerland
	Przedsiebiorstwo Przemyslu Miesnego Opole S.A.	Food Processing	55% Penelex 20% Employees 20% Agricultural Supplies 5% State Treasury	Austria
	Chifa	Surgical Equipment	80% Unilever 20% Employees	International
	PWN sp. z.o.o. Warszawa	Publishing	51% Cambridge Holding S.A. 20% Employees 14% Management 15% State Treasury	International
	Telfa Bydgoszcz	Telecommunications	80% AT&T 20% Employees	Holland
	MEFTA sp. z.o.o. Warszawa	Transformers	51% AEG AG 9% T.H. Elektrin S.A. 20% Employees 20% State Treasury	Germany Poland
	Wizamet Lodz	Razor Blades	80% Gillette 20% Employees	USA
	Olmex sp. z.o.o.	Edible Fats	70% Unilever 20% Employees 10% State Treasury	Holland
1993	Zaklady Wyrobow Sanitarnych KOLO	Sanitary Equipment	80% Sanitec Ltd. OY 20% Employees	Finland
	Fakop sp. z.o.o.	Industrial Boilers	80% A. Ahlstrom Corp. 20% Employees	Finland
	Pollena Wroclaw	Detergents	80% Cusson Group Ltd. 20% Employees	Great Britain
	PZT Telecom Warszawa	Telecommunications	80% Alcatel 20% Employees	Spain
	Szczecinski Przemyst Drzewny S.A.	Wood Products	80% IKEA 20% Employees	Sweden
	Huta Szkla Bialystok	Glass Mill	80% Euro-Intercom, Glass Eckerty, Sozzilluminaz	Liechtenstein Germany Itlaly

Exhibit 6

Sample List of Companies Privatized by the Capital Privatization Department by May 1994

Company name	Sector	Ownership	Investor's country of origin
Vistula S.A.	Clothing	65% Public Offering 20% Employees 15% Management	
Sokolow S.A. Warszawa	Meat Products	60% Public Offering 20% Employees and Agricultural Products	
Hydrotrest S.A.	Construction	21.7% Polish American Enterprise Fund 24.5% Polish Private Equity Fund I 23.8% Polish Private Equity Fund II 10% Managers	Poland
Cementownia Odra S.A.	Cement Mill	80% Miebach GmbH 20% Employees	Germany
Czerska Fabryka Mebli	Furniture	80% Karl-Heinz Klose 20% Employees	Germany
Angella S.A.	Carpets	80% Angella Plus S.C.	Poland
Novita S.A.	Carpets	80% Novita Holding-Management	Poland
Browary Wielkopolski S.A.	Brewery	40% Euro-Agro Centrum 20% Public Offering	Poland
ZWUT S.A.	Electronics	80% Siemens AG	Germany
ELWRO S.A.	Electronics	80% Siemens AG	Germany
Jaroslaw S.A.	Glass Mill	35% Owens-Illinois Inc.	USA
Zaklady Celulozowo Papiernicze w Kostrzyniu	Paper	80% Trebruk AB	Sweden
Goscinska Fabryka Mebli	Furniture	80% Karl-Heinz Klose	Germany
1994 Zakladow Przemyslu Cukierniczego San S.A. w Jaroslawiu	Confectionery	80% United Biscuits (McVitie's Group)	United Kingdom
WARTA S.A.	Cement and Lime	75% Polen Zement Beteiligungsgesellshaft mbH	Germany
Indukta S.A.	Electric Machines	80% Elektrin S.A.	Poland
Slupskie Fabryki Mebli	Furniture	75% MM Beteiligungen	Germany
Browar Szczecin S.A.	Brewery	51% Jozef Adelson	Poland

Chronology of Events in Poland 1989 - 1990

1989

- **JAN**: Lech Walesa announced that Solidarity's threat to strike remained as talks, unless the government failed to restore the union's legal status.
- **FEB**: Round table talks were inaugurated.
- **APR**: A Warsaw voivodship court extended legal registration to the independent Solidarity trade union.
- **JUN**: The government adopted an economic program recommended by the IMF and the World Bank for 1989-1992.
- **JUL**: An article in Gazeta Wyborcza argued that Solidarity ought to form Poland's next government in exchange for the union's support for a communist presidential candidate.
- **SEP**: Polish Finance Minister Balcerowicz outlined the government's economic plans to the Sejm, emphasizing the need to fight inflation, dissolve state monopolies, privatize enterprises, end state subsidies, and control wage increases.
- **OCT**: Poland's new government announced plans for a market economy.
- **NOV**: Walesa addressed a joint session of the U.S. Congress as only the second non-American who was not a head of state or government invited to do so.
- **DEC**: Solidarity-led government announced belt-tightening policies.

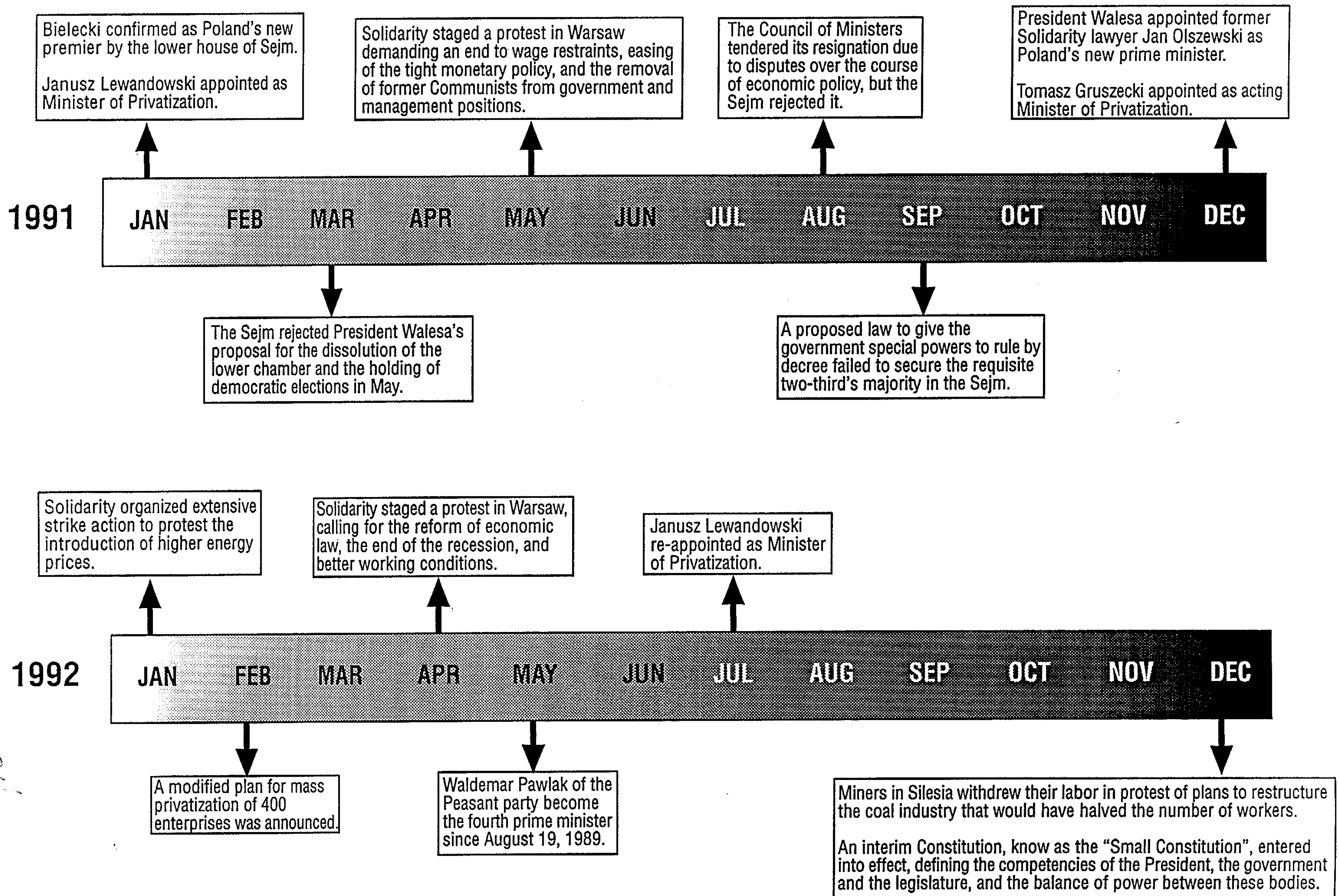
1990

- **JAN**: Poland formally began its radical economic reform policies.
- **FEB**: Paris club agreed to schedule the repayment of $9.4 out of Poland's $39 billion debt to Western creditors.
- **APR**: Local elections held. Solidarity candidates won more than 40% of seats, the Peasant party won 7%, and no other party got more than 2%.
- **JUL**: Privatization of large state-owned enterprises unofficially began.

  The Law of Privatization of State Enterprises was approved.
- **SEP**: Waldemar Kuczynski appointed as Minister of Privatization.

  Walesa formally declared candidacy for presidency.
- **DEC**: In a runoff election, Walesa received over 74 percent of the votes.

Chronology of Events in Poland 1991-1992



Chronology of Events in Poland 1993 - 1994

1993

JAN FEB MAR APR MAY JUN JUL AUG SEP OCT NOV DEC

MAR: The Sejm rejected a mass privatization plan affecting some 600 state enterprises.

APR: A motion expressing 'no confidence' in Janusz Lewandowski, the Minister of Privatization, was defeated.

The government presented parliament with new proposals for the divestment of the state sector, later approved by the Sejm in late April and by the Senat in early May.

MAY: Wieslaw Kaczmarek appointed as Minister of Privatization.

OCT: Amendments to the electoral code were adopted and aimed at reducing the number of political parties represented in parliament.

The Sejm approved a motion of "no confidence", which was proposed by the Solidarity group in continued dissatisfaction with government economic and social policies.

1994

JAN FEB MAR APR MAY JUN JUL AUG SEP OCT NOV DEC

FEB: Solidarity organized a demonstration in Warsaw, demanding increased government investment in the public sector and improved measures to combat unemployment.

MAR: Solidarity began a nation-wide program of strike action, intended to affect different sectors of the economy in rotation.

APR: Walesa threatened to dissolve parliament in response to a proposed amendment to the Small Constitution giving ultimate responsibility to the Sejm, not the Head of State, to ratify government appointments.

*See bibliography for a list of sources used.

Annex I

REPUBLIC OF POLAND

Price Waterhouse LLP

Annex I: Case Studies in the Glass Sector

Designated lead advisor for the glass sector in mid-1991 by the MOP, the Price Waterhouse-International Privatization Group (PW/IPG) began work with 32 state-owned companies. Phases I and II were entirely funded by the United States Agency for International Development. Of varying size, ranging from annual sales of approximately $1 million to more than $50 million, the glass sector was divided into at least three distinct subsectors, each employing different technologies and addressing different markets. The subsectors were classified as: "flat glass", "glass container" and "consumer and technical glass."

The flat glass subsector comprised 8 companies, some of them manufacturing sheet glass and others transforming sheet or float glass into value-added products such as automotive glass, mirrors, and double glazing.

The glass container subsector comprised 12 companies, mainly producing beverage and food containers, as well as pharmaceutical and cosmetics vials and ampules, laboratory vessels, and Thermos bottle liners.

The consumer and technical glass subsector comprised 12 companies producing lighting glass, hand-blown crystal, glass tubing, ceramic fruit, tableware and giftware. In contrast to the other subsectors, the consumer and technical glass subsector was far more export-oriented than the other two subsectors, with many companies exporting more than 50% of their production.

By the first week in September of 1991, PW/IPG assembled a team of professionals to undertake the sector work. Assigned to each subsector was an industry specialist, a senior and junior financial analyst and a locally hired consultant fluent in English and Polish. An overall project manager directed logistics, represented the project to the MOP and prepared to assume the role of transaction negotiator.

Before visits to individual firms took place, managers from every Polish glass company assembled in Warsaw for an orientation on the sector project. Officials from the MOP and PW/IPG explained the purpose and objectives of the sector project. An open forum addressed questions about procedure and outcome of the project. Each firm received a questionnaire to begin assessing the state of their financial health. Finally, appointments were scheduled for a visit to each of the firms, and Phase I was underway.

Phase I included the preparation of a sector-specific diagnosis and strategy. This consisted of an examination of the competitive industry structure, status of industry technology, and the current regulatory environment. Simultaneously, a market analysis of the sector was conducted which evaluated the current market size as well as customer profiles. Defining the sector strategy followed, which involved the analysis and critique of various scenarios affecting the glass industry through the sector approach. Recommendations derived from the above analyses comprised the formulation of a sector policy. (See Section 4.1 of the *Terms of Reference* for further discussion of Phase I).

During October and November of 1991, PW/IPG teams visited every glass firm within the sector project. Simultaneously, they researched the status of the glass industry worldwide. At the beginning of December in a formal presentation to the MOP, PW/IPG described the comparative state of the Polish glass industry against the worldwide industry and made recommendations on the future of the domestic industry. With the approval of the MOP, they commenced work on Phase II of the project.

In the beginning of March 1992, after weeks of focussed financial analysis of the individual firms within the glass sector, PW/IPG completed Phase II, recommending the specific privatization path of the 32 glass companies. Eleven of the 32 companies in the initial study were at or near bankruptcy, indicating that liquidation, followed by a sale of assets or some form of worker-management leasing arrangement, was the only realistic possibility. PW/IPG recommended also three other companies, only slightly more financially stable, for asset sale or leasing.

Upon completion of Phase II, PW/IPG, at the request of the MOP, initiated the final stage of the sector privatization - Phase III. Phase III called for active solicitation of potential investors, preparation and management of the public tender process and documents, the latter for distribution to potential investors. The bid package consisted of information memoranda, legal and financial audits prepared by independent auditors and a draft share purchase agreement. If environmental issues were deemed relevant, an environmental audit was also prepared. In addition, PW/IPG prepared an estimate of value for those companies under tender as well as evaluated bids and negotiated on behalf of the MOP as required.

Implementation of Phase III required first awarding a new contract to the selected advisor, regardless if the chosen advisor had won the contract for Phases I and II. The MOP awarded PW/IPG the Phase III contract, which negotiated compensation on a success fee basis. The contract covered Phase III advisory services, to be extended upon request, for the entire glass sector with specific references to those companies regarded as good privatization prospects.

As of June 1994, five enterprises (three consumer/technical, one each in flat and packaging) were privatized with a total transaction value (including loan and investment commitments, employment guarantees and debt assumption) in excess of $300 million. Three of these privatization transactions were through the sale of shares to strategic investors; one contributed its assets to a joint-venture company; and one involved the purchase of assets. An additional two companies in the flat glass segment had entered into joint cooperation with major foreign partners for the production and processing of glass.

In addition, another 13 companies were in the process of privatization. Of these, 11 were negotiating a trade sale or joint-venture with investors and the other two, Violetta and Tarnow, were designated for the Mass Privatization Program (MPP). Violetta was originally recommended for a trade sale to a strategic investor. It was shifted instead to the MPP as this was the stated and preferred privatization route of the Workers' Council prior to transformation to a joint-stock company. Similarly, the management and Workers' Council of Tarnow expressed from the very beginning a strong aversion towards privatization. Eventually, the company opted for inclusion into the MPP in preference to a sale to a strategic investor.

Of the remaining 12 companies, one was the focus of a bank-driven privatization mechanism and the remainder were left "as is," partly in response to the wishes of the management and Workers' Council and partly due to the unavailability of readily identifiable investors. Thus over 50% of the companies included in PW/IPG's initial sector portfolio had been or were in the process of being privatized as a result of PW/IPG's efforts.

For some companies in the glass sector, PW/IPG recommended restructuring prior to sale, as a way of stabilizing their financial position and making them more attractive to potential investors. But since the MOP demonstrated an unwillingness to pay PW/IPG for assistance in restructuring, the companies were left for sale "as is," a difficult task given that many of them had a negative net worth and significant social and environmental liabilities. Also, in view of the MOP's goal of maximizing revenues from the sale of state enterprises, many instances occurred in which they refused to approve a proposed sale, even in the absence of other existing or anticipated offers.

Case I: Huta Szkla Bialystok

The case of Huta Szkla Bialystok (HSB) is one example of how the sector approach improved the negotiation stance of firms *vis-a-vis* foreign investors. HSB successfully transformed customers into shareholders.

Business Summary[23]

At the time of the PW/IPG assessment in 1991, HSB held no long term debt and was one of two major Polish producers of handmade lighting glass globes and shades and a minor producer of fiber optics. All of HSB's production was handmade, spanning a broad range of forms and skilled decorating activities including hand painting and etching. HSB designed about 70% of its products itself, while relying on its customers for the remaining designs. Consistently impressed with the product quality of the firm, HSB's European customers worked closely with management in creating a restructuring plan before privatization took place.

[23] See the company profile of HSB for a financial summary.

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HSB management led the restructuring campaign, successfully converting from glassware manufacturing to lighting globe production during the first three years of reform. Additionally, management reduced employment from 720 workers in 1990 to the present level of 680. Further reductions in the work force are anticipated by as much as 10-15% through downsizing the amount of indirect labor, ultimately projecting to reduce indirect labor costs to 5% of total labor.

The transfer of workers from indirect to direct labor succeeded in increasing productivity, which enabled the company to increase wages to a level higher than that of most other companies in the glass sector. The average monthly salary received the equivalent of $210 dollars, while most skilled workers (master blowers) received the equivalent of $465 dollars. This contrasts with an average monthly salary equal to $150 and a top wage which is the equivalent of about $280 at other consumer glass manufacturers such as Julia and Hortensja, roughly the same level that HSB paid prior to its privatization.

In April 1993, following a bidding and negotiation process directed by PW/IPG, a consortium of three European HSB customers-turned-investors acquired 80% of the shares in HSB, each paying $250,000. The purchase agreement included a commitment to maintain existing employment for 18 months, and to invest a further $2.5 million dollars over a 5-year period.

In the year since privatization, HSB's exports rose dramatically which resulted in a net profit of $335,000, or approximately 6% of sales. In the summer of 1994, the Italian and German markets together accounted for about 15% of HSB's total sales, and the Scandinavian market accounted for 30% of total sales. In early 1994, the company began to export to the U.S. and Canada, which amounted to about 5% of total sales. Other important export markets included France, Spain, Belgium and Australia. In sum, HSB profited from the trade sale process, increasing its proportion of exports dramatically, to 68% of sales, or $3.7 million.

Privatization Considerations

In July 1991, at the request of the Managing Director, the Worker's Council voted to transform HSB into a joint stock company. Not until 1992, following PW/IPG's Phase II recommendations, did HSB formally apply for transformation into a joint-stock company.

PW/IPG recommended privatization for HSB through trade sale because it would provide four essential inputs from the strategic partner: market access, production technology, management ability and capital. By the time it completed privatization in 1993, HSB had made significant progress in addressing each of these concerns on its own, except for its continuing need for additional capital.

In an effort to increase exports and end its reliance on Minex, the state trade monopoly, the company hired two sales agents (see figure 2). This helped HSB improve its contacts with foreign trade customers and was the first step in converting customers into investors. However, HSB lacked the expertise and authority to take the next steps toward a completed transaction.

When it became clear that a buyer was interested in HSB, the government and HSB turned to PW/IPG for assistance in negotiating and closing the transaction. PW/IPG then advised the MOP and HSB on procedures for bidding. After a competitive tender was staged, PW/IPG conducted negotiations with the winning bidders. In April 1993, a consortium composed of Euro-Intercom of Liechtenstein, Glass-Eckerty of Germany, and Sozzilluminaz of Italy, acquired 80% of the shares in HSB.

HSB employees also stood to gain as shareholders. As of May 1994, each share had a value of about PZl500,000, nearly double the PZl270,000 value upon issuance in April 1993; thus, each eligible worker could buy 19 shares, worth PZl9.5 million, for only PZl2.6 million, or PZl135,000 per share (in addition to this, the foreign owners indicated their intention to give 5% of the company's equity to the managers, in a formula worked out subsequently).

The investors paid an equivalent of $750,000 to the State Treasury for 80% of the company which was a satisfactory settlement to all parties involved. By the summer of 1994, however, the $2.5 million investment commitment had not yet been expended. Moreover, the initial plans for the new furnace and production line to be operational by the end of 1994 have been delayed.

Case II: Huta Szkla Okiennego Kunice

Huta Szkla Okiennego Kunice (Kunice) received three benefits from the sector approach - assistance in changing its market focus, finding a credible investor and negotiating the terms of its trade sale.

Business Summary[24]

Flat glass is commonly thought of as "panel glass" which is used for windows in buildings and cars. Thus it serves two main markets: the automotive and construction industries (see figure 1). The manufactured product usually requires a certain amount of processing. Processing involves laminating or toughening, applied by either the manufacturer or the distributor.

Technological developments in the flat glass industry -- most importantly, the introduction of the float glass process --have fundamentally changed the industry's structure. The quality of the relatively new float glass is significantly higher than the now out-of-date sheet glass; consequently, float has rapidly displaced sheet all over the developed world. In the West, sheet

[24] See the company profile of Kunice for a financial summary.

glass is noticeable in the windows of very old buildings. There is a certain "wave" that runs through the glass and distorts the view. Moreover, float is the lower cost product.

The displacement of sheet glass in the European market has been rapid and irreversible. Since the first float plant was introduced in continental Europe in 1973, only a few sheet glass manufacturers were left ten years later.

In 1992, at the time of the PW/IPG analysis, Kunice's main product areas included: (i) *Automotive Toughening*: Kunice produced toughened glass, mainly for use in the domestic automotive industry. Well organized, the toughening operation met international quality standards, and had normal manning levels by Western standards; (ii) *Sheet Glass Production:* Kunice produced clear sheet glass in Plant A, bronzed sheet glass in Plant B. Due to changing market conditions, however, demand for sheet glass declined dramatically.

Kunice was known primarily as a sheet glass manufacturer and processor until the advent of Polish made float glass. Responding to the rapid and sustained transformation of sheet glass technology into the superior float glass technology, Kunice discontinued all production of sheet glass manufacturing in 1993. Management dedicated the firm to the transformation of the company from a flat glass manufacturer to a glass processor, and to expanding the company's marketing capabilities following the recommendations of PW/IPG as the sector advisor.

Once employing as many as 586 people, just 400 people worked there by May 1994 since it no longer manufactures sheet glass. Using toughening and bending technology to serve the automotive market, Kunice is the dominant supplier of automotive side windows for FSM, the largest Polish car manufacturer. A small portion of toughened glass production also goes into the domestic household appliance industry, mainly for oven doors and refrigerator shelves. Ancillary assets of the company include a sand mine, the closed-down flat glass plant, a sewage treatment plant and various social assets.

In 1994 demand for float glass in Poland would exceed, for the first time, that for sheet glass. Of an estimated total demand in 1994 of 192,000 tons of flat glass, sheet glass would make up only 81,000 tons, while imported float glass would account for the rest. By 1998, domestic demand for flat glass is projected to fall to 5,000 tons.

Privatization Considerations

The company had initiated steps toward privatization three years previously. Presently, Kunice is a joint stock company fully owned by the State Treasury. It is in advanced stages of negotiations with a foreign investor.

PW/IPG's initial sector analysis recommended the privatization of Kunice via a trade sale, as the means most likely to engage a foreign strategic investor. Clearly, the firm would need a partner to finance and guide the necessary restructuring. Kunice was among the first companies to initiate the capital privatization process, having applied in October 1990 for transformation to a joint stock company. The transformation took place in January 1991, which included the dissolution of the Workers' Council and the appointment of the Supervisory Board.

In 1993 Kunice started to experience significant pressure from its two principal domestic competitors, Szczakowa and Sandomierz. Both companies had already established close ties with foreign companies: Pilkington acquired Sandomierz, and PPG partnered itself with Szczakowa. Both companies, each with 1500 employees and two to three times the annual revenues of Kunice, represented significant threats to Kunice's survival.

At the beginning of Phase III, PW/IPG arranged for several foreign glass companies, including PPG, Pilkington, and Saint-Gobain, through Vegla, its German subsidiary, to hold exploratory talks with Kunice management and with the Ministry of Privatization. However, these failed to result in a purchase offer. Although many factors contributed to this lack of interest on the part of foreign investors, it probably related more to the then-uncertain future of the Polish automobile industry, which constituted Kunice's major market as well as the domestic political uncertainty.

Kunice management then began to explore the possibility of a management/employee buyout. Because this approach could not raise the capital the company required, it went back to the MOP and PW/IPG, requesting assistance in pursuing a trade sale once again.

Although the competitive situation in Poland made an investment in Kunice risky for any foreign glass producer, there did exist a countervailing pressure on Vegla (Saint-Gobain) to proceed with an investment in Poland. Vegla responded belatedly to publicity surrounding the Kunice offering. Vegla estimated Kunice would require an investment of several million dollars for both refurbishing and expanding its existing automotive glass facility and to build a new insulating glass production line. Vegla wanted to invest $12 million for this purpose and an additional $14 million for construction of an automotive laminating glass production line, to produce automobile windshields.

Issues in the trade sale included the government's wish to secure jobs for 24 months following privatization. Kunice, in consultation with Vegla, began to develop plans to spin off many of the non-production functions into separate companies. Vegla committed in principle to provide some financing and management training for these new enterprises. As of May 1994, negotiations between Kunice and Vegla began to advance and are expected to conclude in October. PW/IPG is the lead advisor to the MOP on this transaction and is working on a success fee basis.

It appears that the acquisition of a majority (80%) of Kunice's shares by Vegla will take place, resulting in substantial investment to upgrade and expand Kunice's productive capacity. If a trade sale could not be negotiated, Kunice would most probably be placed into the Mass Privatization Program or, alternatively, re-explore opportunities to undertake some form of management/employee buyout or asset leasing.

Case III: Julia

Julia found a foreign investor due to the direct efforts of the sector advisor though it completed negotiations on its own. The sector approach would have served Julia better if the advisors were presented with an incentive for assisting companies using privatization paths other than trade sales.

Business Summary[25]

Julia is both the oldest and the smallest of Poland's crystal manufacturers and was recently purchased by a US based investment group. It reported 1994 sales of $2.2 million dollars. Julia's current domestic market share is estimated at 15%. Competitors include two very large firms and a few small manufacturers similar to Julia. Prior to privatization, the firm established a reputation for satisfying small orders with good quality production. All of the company's production is handmade lead crystal giftware. This includes blown, pressed and centrifuge products which are generally highly decorated.

Julia has three plants, two of which are closed. Operations were consolidated into one plant in order to reduce costs. Employment has declined from 603 workers in 1992 to a current level of 460.

In 1992, Julia exported 43% of its production, mainly to Western Europe and North America. Nearly all of these exports went through Minex, the state-owned trade monopoly for the glass industry. The percentage of export sales rose, however, to 80% as the company severed its relationship with Minex and began to market almost all of its exports directly. This was a direct effort on management's part to establish Julia's brand name by duplicating direct sales techniques of hand crafted crystal manufacturers from around the world (see figure 2).

Both the Polish and worldwide markets for crystal have been declining over the past three years. As giftware, crystal is subject to cyclical downturns in fashion and preference. As a result, sales are quickly effected in times of economic recession.

[25] See the company profile of Julia for a financial summary.

Privatization Considerations

Julia encountered severe liquidity problems in 1991. Subsequently, the Workers' Council voted in favor of privatization through liquidation. After Phase II of the sector project, PW/IPG recommended a full environmental audit of Julia which, if positive, should be followed by an accelerated privatization through trade sale effort. However, environmental concerns were severe. Thus, given these difficulties, combined with the firm's financial and marketing problems, Julia became an unlikely candidate for a successful international tender.

As glass sector advisors, PW/IPG was cognizant of the precarious state of other small Polish crystal manufacturers. Therefore PW/IPG developed a proposal to combine five Polish glassware and crystal manufacturers into a single holding company which would undertake to restructure the companies using Western technical expertise, financial management skills and market access. Perhaps most importantly, the holding company promised to be a source of badly-needed capital, since Western managers would have the access to and leverage with Western banks.

Implementation of the holding company concept never occurred. The MOP was not convinced that such a scheme was in its best interest. First of all, there was the perception that the holding company would generate lower privatization revenues than would individual transactions. Secondly, allowing the management company to receive substantial fees and possible royalties for designs and technology, without having to invest any equity, seemed to run counter to the objectives of the privatization program. As well, there was reluctance on the firm level to re-enter a relationship with an organization which operated similarly to Minex.

In 1993, however, continuing losses forced the company to apply for liquidation. The local authority appealed to the sector advisors to solicit bids for the purchase of the company. PW/IPG found Weslon, a U.S. investment group led by a Polish-American importer and distributor. Weslon offered an initial investment of about $800,000, to be followed by additional investments of $3 million over a three-year period. The offer price, however, for the bankruptcy receiver, the local authority, and the courts was considered too low.

Local authorities considered it too low, primarily because inventories alone, due to increases in inventory days and successive revaluations listed a book value that exceeded $1 million. The net book value of the company also calculated at about $1 million, but this included assets, both social assets and unused factory space, that had no economic value to any potential investor.

Unfortunately, local privatization and legal officials were evaluating the Weslon offer in a vacuum. Since the privatization of Julia followed the liquidation path, the company was no longer subject to oversight by the Capital Privatization Department of the MOP and was therefore outside the scope of any official involvement of PW/IPG. More to the point, the sector advisors had no incentive to assist companies in privatizing through liquidation. Since liquidation did not involve payments to the treasury, there was no mechanism for advisors to be paid.

Thus the local privatization officials were left to evaluate its single bid without the knowledge and experience base established by PW/IPG through the sector project. In short, the local privatization officials negotiated a transaction without understanding the environment and markets in which Julia had to compete. Additionally, the local privatization officials did not benefit from the expertise of and the key relationships established between PW/IPG and the broader investor community which may have been leveraged to generate further bids for Julia.

In early June 1994, Weslon and the local officials closed on the sale of the assets of Julia. The reported sales price was about $900,000, all of which went to pay off creditors.

Company Profile

Huta Szkla Bialystok "HSB"

Employees: 678

Products: Handmade clear and opal lighting globes

Facilities:

Two facilities -

Main facility: two eight-tonne/day gas end fired regeneration furnaces with centrifuge; two three-tonne/day electric furnaces for opal; acid etching line

Auxiliary facility: two six-tonne/day gas end fired regenerative furnace; one three-tonne/day electric for opal glass

Production:

1991 export total - 568 tonnes | 1991 domestic total - 849 tonnes

1993 export total - 959 tonnes | 1993 domestic total - 485 tonnes

1994 export total - 483 tonnes | 1994 domestic total - 237 tonnes

Financial Summary:

Figures in zloty millions	1990	1991	1992	1993	6/1994
Exchange Rate (Z1/$)	9,500	10,583	13,631	18,145	22,168
Total Sales	41,658	49,123	61,849	77,293	47,936
Pre-Tax Profit	10,541	225	930	2,042	2,923
Net Profit (1)	3,380	(2,435)	(2,100)	13	1,372
Net Working Capital (2)	6,087	9,854	8,612	1,713	5,056
Total Debt	1,300	7,600	6,929	26,290	24,496
Total Assets	56,874	52,604	43,038	70,654	71,452

(1) Pre-Tax Profit less income tax, state dividend and excess wages tax ('popiwek")
(2) Current Assets – Current Liabilities
(3) Exchange Rate – National Bank of Poland

Company Profile

Huta Szkla Okiennego "Kunice" S.A.

Employees: 400

Products: Antisol, Automotive Tempering

Production Facilities:

Site A: Fourcault Furnace (clear sheet) - shut down
Site B: Pittsburgh Furnace (Antisol)
Automotive Tempering Division

1992 Production Output (000m2 rd):
1,903 (clear)
770 (tint)
595 (toughened)

9/93 Production Output (000m2 rd):
745 (clear)
580 (tint)
487 (toughened)

Financial Summary:

Figures in zloty millions	1990	1991	1992	1993	6/1994
Exchange Rate (Z1/$)	9,500	10,583	13,631	18,145	22,168
Total Sales	108,768	91,148	155,206	177,153	93,241
Pre-Tax Profit	35,119	4,365	16,636	21,058	14,036
Net Profit (1)	20,808	3,456	7,011	7,843	4,855
Net Working Capital (2)	20,487	24,236	18,382	28,072	25,710
Total Debt	0	2,086	3,000	3,000	1,000
Total Assets	114,997	91,148	98,018	108,193	116,241

(1) Pre-Tax Profit less income tax, state dividend and excess wages tax ('popiwek")
(2) Current Assets – Current Liabilities
(3) Exchange Rate – National Bank of Poland

Company Profile

Huta Szkla Krysztalowego "Julia"

Employees: 603

Products: Handmade lead crystal giftware

Facilities:

Three facilities -

Piechowice: one four-tonne/day coal gas, end-fired, regenerative furnace and centrifuge; 150 hand cutting lathes, Achthal acid polishing and six engraving lathes:

Szklarska Poreba: one ten tonne/day electric furnace, Achthal acid polishing;

Jelenia Góra: 50 hand cutting lathes

Production:

1991 export total - 297 tonnes | 1991 domestic total - 446 tonnes

1993 export total - 226 tonnes | 1993 domestic total - 164 tonnes

1994 export total - 152 tonnes | 1994 domestic total - 71 tonnes

Financial Summary:

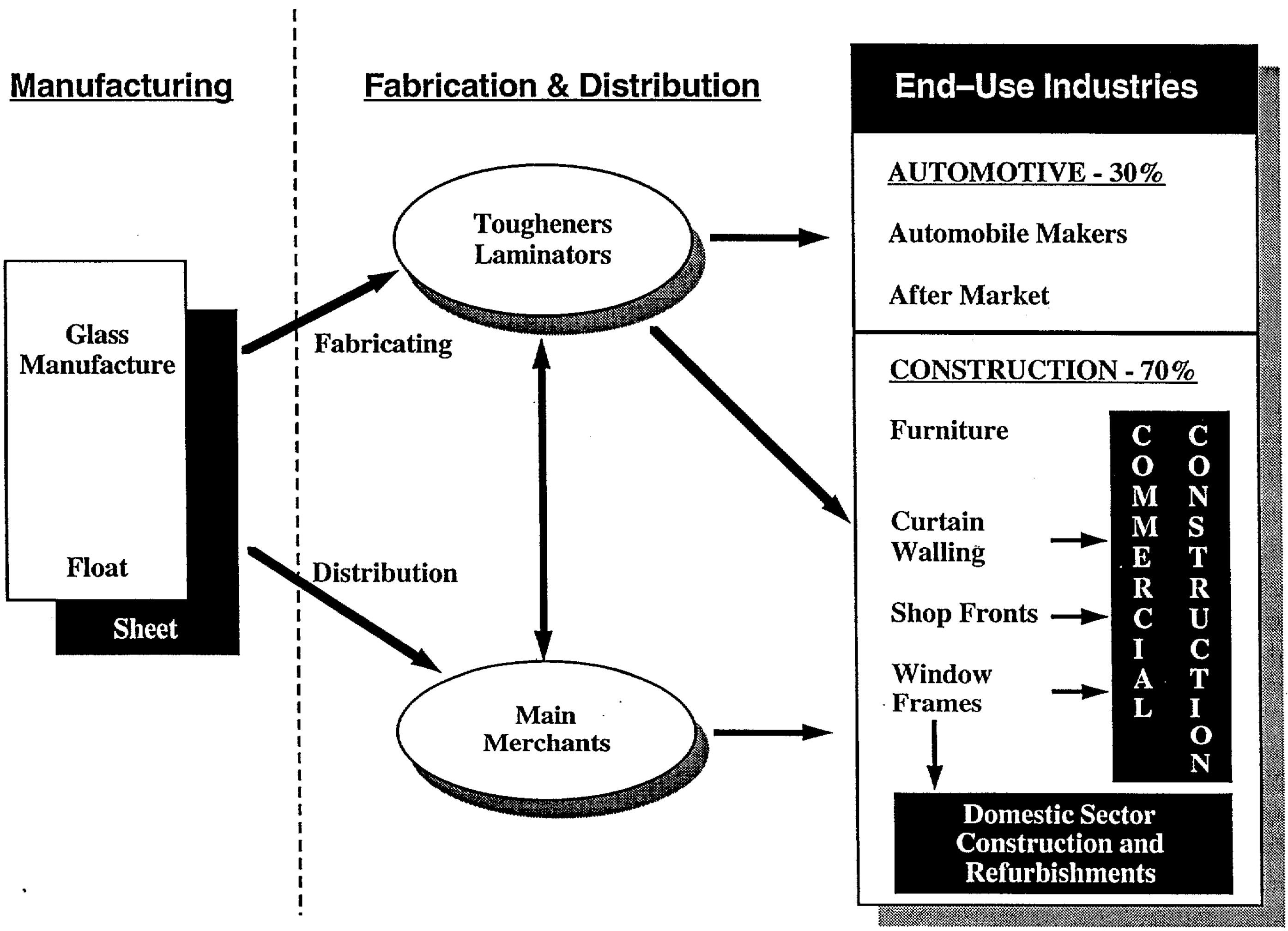
Figures in zloty millions	1990	1991	1992	1993	6/1994
Exchange Rate (Z1/$)	9,500	10,583	13,631	18,145	22,168
Total Sales	31,842	39,655	38,698	44,300	29,178
Pre-Tax Profit	2,963	(5,220)	(13,600)	(14,883)	3,299
Net Profit (1)	128	(8,523)	(14,858)	(15,739)	1,561
Net Working Capital (2)	3,981	(2,677)	6,423	4,413	15,974
Total Debt	2,446	1,801	72,000	71,915	69,350
Total Assets	37,678	34,012	63,424	62,588	61,843

(1) Pre-Tax Profit less income tax, state dividend and excess wages tax ('popiwek")
(2) Current Assets – Current Liabilities
(3) Exchange Rate – National Bank of Poland

Flat Glass Subsector

Figure 1

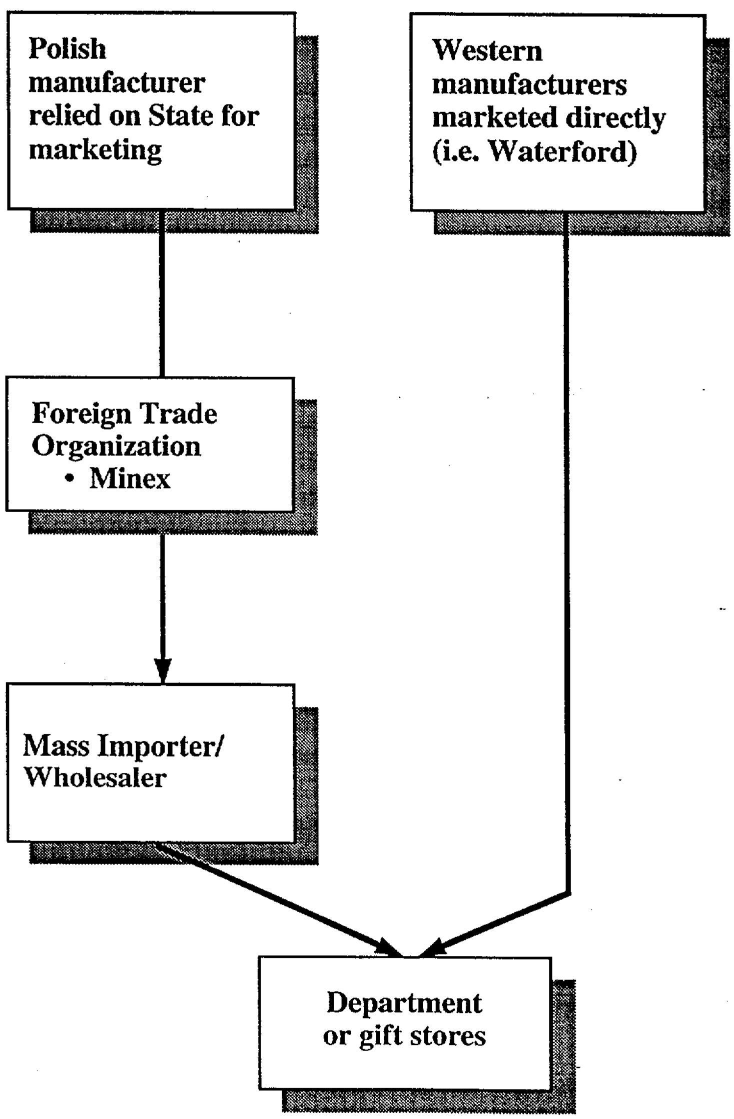
Flat glass serves 2 main markets, the automotive and construction industries, and is divided into manufacturing and fabrication sectors.



Consumer/Technical Glass Subsector

Figure 2

Polish crystal manufacturers never established a brand name because they exported through the intermediary Minex.



Annex II: Definitions of Privatization Methods

The section below describes the options for privatization through the Ministry of Privatization. The privatization law enacted August 1, 1990 specified two major privatization methods: capital privatization (a.k.a. transformation) and privatization through liquidation (a.k.a. direct privatization). Within each of these categories, several paths were identified.

Capital Privatization (a.k.a. transformation): This term refers to the transformation of a state-owned enterprise into a joint stock company allowing for three distinct paths to privatization: 1) public offering; 2) trade sale (a.k.a. international tender); and 3) mass privatization.

Transformation can be initiated at the enterprise level by the founding body (though it would still need the approval of the Workers' Council). In extraordinary circumstances, the Prime Minister can order the transformation of a state-owned enterprise.

The MOP may decline the transformation request on financial or economic grounds, particularly in cases in which the enterprise is insolvent. Upon transformation the State Treasury is appointed the owner, which is also represented by the MOP. The law dictates that privatization must occur within two years of transformation. The average time from transformation to privatization has been well over a year.

> **1. Public Offering.** This term refers to privatization by means of selling transformed, joint stock company shares to the public through the Warsaw Stock Exchange. The first year of the privatization program was devoted to public offerings, partly as a mechanism for increasing public awareness of the importance and potential benefits of privatization, and as a way to accelerate the development of Polish capital markets. Currently there are just under 30 companies listed on the exchange.
>
> **2. Trade Sale (a.k.a. international tender).** This term refers to privatization by means of selling transformed, joint stock company shares in a competitive process (followed by negotiations) to a "strategic investor", often a foreign company. Two objectives of this process are: a) to transfer ownership from the state to individuals or private institutions, and b) to provide companies with the management, marketing and technical know-how to operate in a competitive market economy.
>
> As of March 1994, 85 companies achieved privatization through trade sales, as compared to an initial target of 300 transactions for completion by mid-1994. In two of these cases, management secured a majority interest, although in most other instances a smaller shareholding, typically ranging from 5% to 20% was either purchased by management or given by the strategic investor to management as an incentive. Employees also obtained a significant interest in each of the trade sales ranging from 10% to 20%, which

by law allows them to acquire shares at a discount of 50% or more. Foreign investors participated in about 55% of the trade sales. In a few cases foreign investors joined in a consortium with a Polish investment partner, but in most cases the foreign investors alone acquired a controlling interest.

3. Mass Privatization. Mass Privatization refers to privatization through the free public distribution of shares in several newly created investment funds (NIFs), each fund to be managed by professional fund managers. The NIFs will become the equivalent of closed-end mutual funds, whose shares will eventually trade on the Warsaw Stock Exchange. Designed as a mechanism to combine Western management skills with Polish ownership, the program has not yet begun.

The initial phase of the Mass Privatization program may include several hundred companies. Each of the funds will manage between 30 and 60 companies, in aggregate worth approximately $700 million. The NIFs will be the core group of shareholders making the decisions necessary for a company to become and remain competitive.

Direct Privatization (a.k.a. liquidation) This term refers to privatization through the sale of assets or of a whole company (as a going concern) through three paths 1) asset sale/leasing; 2) Fast Track Auction; and 3) joint venture.

As a decentralized process, direct privatization grants significant authority to the company's founding body, usually a local regional authority (a.k.a. voivoda). The founding body of the enterprise (usually medium to small size) is responsible for removing the company from the state ownership registrar as a distinct legal entity (this process is called liquidation in Poland and is not necessarily the equivalent of bankruptcy).

1. Asset Sale/Leasing. This term refers to privatization by means of the sale or leasing of the whole or part of an enterprise. Most often this is an internal privatization path, through which the workers and managers of that enterprise take ownership of the company. The typical formula for a worker-management buyout involves a 20% contribution of the purchase price in the initial paid-in capital, while the remainder is paid on an installment basis (lease-purchase). More than 900 direct privatizations have taken place.

2. Fast-Track Auction. This term refers to privatization through a streamlined process of a nationally advertised auction. Only three months after applying for the program, medium and small enterprises (as going concerns) are advertised for sale to outside investors. Companies are advertised in blocks of less than a dozen at a time. Advantages of this method include speed, cost-effectiveness, and generally, an absence of many of the operational and financial constraints facing worker-owned firms. Avoiding the complex and costly valuations inherent in other privatization methods, the auction has increased in popularity among firms choosing privatization.

3. Joint Venture. In Poland this refers to a privatization path whereby the founding body contributes the assets of a state-owned company in exchange for payment, investment guarantees and a minority equity share in a new, privately owned company.

New Privatization Initiatives

During the unfolding of Poland's privatization program in 1990, no one knew whether or not the program would work. This inclination to lean towards experience and to develop new programs in response to the lessons from earlier ones is very much in evidence today. The Mass Privatization Program, conceived as early as 1990, but only now beginning to be implemented, is one such example. Other initiatives currently under consideration or in the process of implementation include: mass commercialization, stabilization/restructuring privatization, and the regional privatization initiative.

The Enterprise Pact/Mass Commercialization. In 1992, the government of then-Prime Minister Hanna Suchocka proposed a "State-Owned Enterprise Pact, " intended to be a nation-wide agreement on the pace and direction of economic changes. Perhaps the most important achievement of the Enterprise Pact, if passed , would be the modification of the wholly voluntary character of the privatization program. Without reducing the workers' power to determine the destiny of their enterprise, the Pact would force them to make a decision and implement it. The financial provisions of the Pact, which have already been passed, will allow banks to engage in debt/equity swaps with state-owned enterprises.

Stabilization/Restructuring Privatization. The Stabilization/Restructuring Privatization Program (SRP), which began as a pilot program in mid-1993 aims to prepare companies for privatization first through restructuring. The SRP is based on the belief that some companies, usually those too big to be subject to a management/employee buyout or too heavily indebted for capital privatization, will remain in the state sector for some time.

Management groups, composed of both Polish and foreign consultants, carry out the restructuring. They obtain their fees from the transactions themselves, rather than being paid by the MOP.

Regional Privatization Initiative (RPI). The RPI focusses on training and promotion at the company level and assisting each company to devise their restructuring and privatization plans. The program is expected to retain something of a sector orientation, but rather than dealing with a sector nationwide, it targets the main sector or sectors in a given region. One of its strengths is that, instead of being based in the MOP in Warsaw, most of its activities are carried out through the 13 regional offices of the MOP, each covering three to four voivodships. Thus, the first RPI activities include: privatization of mines in Lower Silesia; privatization of seaports in the Gdansk region; and, an overall restructuring plan for the Sieradz voivodship.

The role of foreign advisors is substantially smaller in the RPI than in other elements of the privatization program, although Polish advisors involved in the earlier sector approach may be used. The focus tends to be on direct, rather than capital privatization, while the RPI itself is likely to overlap considerably with the fast-track auction program.

Annex III: Terms of Reference--Glassworks Sector

1. Introduction

The Ministry of Privatization (MOP) is exploring ways of privatizing substantial portions of the Polish economy through the use of a sector approach to enhance its competitiveness and long term prospects. The MOP recognizes that to achieve this, the development of a sector privatization strategy that will address both sector and company-specific issues must precede a sector privatization.

The MOP therefore wishes to retain an Advisor to develop and implement such a strategy for the state-owned glassworks industry. The principal aim of this project is to carry out a sector analysis, to develop a set of recommendations for the privatization of the state-owned enterprises and joint stock companies within the glassworks industry, and to implement the strategy.

The project should provide the MOP with the information and recommendations necessary to implement the privatization of the companies involved in the sector.

2. Industry Background

The Polish glassworks industry is comprised primarily of four subcategories -- consumer, technical, construction and packaging glass. Although these subcategories differ widely in their production methods and end-user markets, it will nonetheless be the responsibility of the Advisor to include all four in the sector project. It should be noted that numerous firms are engaged in production in multiple subcategories; the Advisor must consider the implications of each firm retaining its product lines or whether grouping of assets from several firms would be more feasible. (See Exhibit 5 for the list of firms and their general product lines).

In addition, the Advisor will be responsible for identifying other potential target companies for inclusion in the project, and for notifying the MOP of these inclusions.

Several glassworks firms have already entered the privatization process, partially if not completely. In the fall of 1990, one completed an initial public offering and is currently one of seven firms traded on the Warsaw Stock Exchange. The MOP retained a Polish consulting firm, Proinvest, to complete and implement the privatization analysis and strategy for Huta Irena. The privatization, currently in progress, is comprised of approximately 5% public offering, 20% employee share purchases, 10% management contract, and 65% trade sale. The public offering began in July 1991. The MOP also retained the British firm, Arnold Hill for the pre-privatization analysis of Huta Radomsko.

Other developments in the sector include negotiations or discussions between potential investors and Polish firms. One such example is Huta Sandomierz, which was approached by the British glass company Pilkington regarding an acquisition; although discussions were previously coordinated through the Ministry of Industry, all further developments have been halted until the MOP retains an Advisor to examine the situation. The Advisor is expected to examine the details of the above privatization developments and to consider their impact on the subsequent privatization of the rest of the sector.

The analysis, as described more fully later, must consider the full chain of production in Poland, and specifically address the issue of forming linkages between the different stages represented in the sector, from raw materials to finished goods and distributors.

3. Nature of the Assignment

The Advisor will serve as the MOP's agent for investigating the glassworks industry. The Advisor must develop a set of likely scenarios for the future of the sector, adapting a sector strategy to which the Polish firms should adhere. The Advisor must similarly formulate a coherent sector or industrial policy for the Government of Poland which supports the sector strategy by stipulating the Government's role in establishing the marketplace. The Advisor must also develop and implement company-specific strategies for privatization which are consistent with the sector strategy and policy.

Further, throughout the course of the project, the Advisor will take responsibility for the bulk of the administrative duties of the project, including all relations aspects. It is expected that the Advisor will regularly develop press releases both domestically and internationally. In addition, the Advisor, in conjunction with company management, will provide weekly privatization and information reports to the company employees, at the discretion of the MOP.

The Advisor will coordinate the activities of any subcontractors necessary for the purposes of legal and financial auditing, investment banking, management consulting, public relations and environmental assessment. The Advisor will assume responsibility for hiring any subcontractors; however, this is subject to the approval by the MOP, and the Advisor must therefore identify any subcontractor it intends to use. Any consortium should include either a Polish consulting firm or Polish nationals affiliated with another consortium member.

4. Guidelines

This assignment can be divided into three primary phases. The first shall include the preparation of a sector-specific diagnosis and strategy. The second shall include company-specific diagnoses and strategies. The company strategies should serve as the basis for the third phase -- the actual implementation of privatization of the individual companies. The basic format or set of guidelines to serve as a model for Phases I-III is as follows:

4.1. Phase I — Sector Analysis

1. Sector Diagnosis: International and Domestic

- -- competitive industry structure: participants, degree of consolidation, economies of scale, degree of vertical integration, input/cost analysis, distribution and marketing standards

- -- technology: status of existing processes and equipment relative to competitors

- -- regulatory environment: analysis of trade protection and incentives in comparative economies

2. Market Analysis

- -- current market size, segmentation and expected growth by product/segment

- -- customer profile: industrial or consumer, buyer power, purchasing processes, brand importance, valued product attributes, export opportunities, and import threats

3. Sector Strategy

- -- business definition(s) of sector with descriptions of strategic clusters or groupings within the industry

Develop a set of likely outcomes or scenarios for the Polish marketplace given the above analyses, forecasting the positions of both Polish and international firms. Critique the probabilities of each and discuss the strengths and weaknesses of each in regards to the Polish firms and the Polish economy. This portion of the analysis will play a critical role in the development of not only sector policy but also individual company strategies, all of which must logically flow from the different scenarios or outcomes developed.

4. Sector Policy

Formulate a sector, or industrial, policy for the Government of Poland, and specifically the MOP, based on the analyses above. The policy must support the sector strategy by outlining the role of the Government of Poland in the establishment of a competitive market for the sector. It must be consistent with the Advisor's findings and the MOP's objectives, addressing issues including but not limited to:

- long term viability of Polish sector, and foreseeable changes in this position
- number and scale of firms to remain in the sector
- suitable ownership structures
- suggested views towards foreign ownership and competition
- recommended regulatory or other macroeconomic policies

4.2 Phase II — Company Analyses

The Advisor will note that the following suggestions for methods of company diagnoses are to be considered separately from the pre-privatization analysis of each company, which is comprised of the legal and financial audits that will be compensated for by the individual firms. The following diagnoses are therefore intended as primarily strategic assessments of strengths and weaknesses, and not as complete bases for restructuring or business plans.

1. Company Diagnoses

- product lines and product attributes, brand awareness, market share
- manufacturing capabilities: capacity, productivity, plant and equipment condition, adaptability to new methods of production, or production of different products
- analysis of cost structure and comparison with industry standards
- efficiency of distribution systems in utilizing capacity and meeting customer needs
- structure and quality of sales and marketing organization
- assessment of management organization and skills
- competitive advantages and weaknesses based on these criteria
- financial condition, with regards to both management of working capital as well as of capital structure

In addition to the pre-privatization work it is expected that a Phase I environmental audit, as broadly understood by the U.S. Environmental Protection Agency, will be quickly completed to provide an initial assessment of the environmental state of health of the firms. If necessary, this initial assessment may need to be followed by a Phase II environmental audit, again as understood by the U.S. EPA.

The MOP believes that to fully evaluate the environmental conditions for the firms and thus facilitate their privatizations, the Advisor will need to obtain the services of environmental specialists. The choice of subcontractor will, as stated earlier, be subject to the approval of the MOP, and provisions for their fees must be included in the Advisor's proposal, although detailed separately from the overall fees for the Phase I and II completion.

Pertinent environmental issues regarding this project are further discussed in section 11.

2. *Company Strategies*

Using the results of the company diagnoses and with strict adherence to the sector policy, determine privatization strategies for each company. These strategies must consider the implications for the entire sector, and must provide detailed, enactable means of privatization, to include not only the recommended methods, but also to specify sources of capital and potential investors.

In short, the Advisor must design a realistic framework for implementing the privatization moves, and recommended order and timing of transactions within the sector.

4.3 Phase III — Implementation

The Advisor will be responsible for executing the privatization of companies which are ready for ownership transfer. The following methods exist for the privatization of Polish joint stock companies into private ownership: public offerings, trade sales, management or employee buyouts, and liquidation or asset leasing. However, the MOP recognizes that none of these may be singly feasible for each case. The Advisor must therefore define realistic scenarios for future company operations and develop action plans for achieving these goals. Implementation steps must include, but not be limited to:

- preparing business valuations
- preparing offering memoranda and prospectae
- identifying potential domestic and foreign partners or investors
- coordinating and executing the selection process for potential partners

-- conducting negotiations with potential partners in coordination with and on behalf of the MOP
-- providing for and coordinating all other necessary advisory work for the completion of transactions
-- finalizing the contractual agreements, including the provision of and coordination with all legal counsel necessary for the MOP.

In addition to the above, dependent upon the individual company strategy, the Advisor may receive the mandate for implementation of the restructuring plan prior to actual privatization. In principle, Phase III will be awarded upon satisfactory completion of Phases I and II.

5. Deadline

Following selection of the Advisor, the MOP expects that the studies and implementation measures described in this *Terms of Reference* will have been effectively completed within three months, or by November, 1991.

6. Submission and Approval of Reports

The Advisor will prepare weekly briefings for the MOP staff on the progress of the sector project. After concluding work on Phase I, the Advisor will prepare written and oral presentations of the results for the MOP, and separately for the individual companies within the sector. The written presentations will be prepared in the English and Polish languages, and contain the following:

-- sector overview, giving qualitative and quantitative information on the sector and the companies within the sector;

-- presentation of the analyses requested in these *Terms of Reference* for Phase I of the study.

Similarly, upon the conclusion of Phase II, the Advisor will present recommendations for the companies, also in written and oral formats. In addition to these reports, the Advisor will be expected to provide additional documents relating to specific aspects of the project upon request by the MOP. The MOP will reserve the right to request all raw data used in the compilation of the analyses in order to retain the knowledge base developed through the project.

7. Additional Services

The Advisor will make members of the project team available to the MOP or other representatives of it (for example, additional advisors performing complementary functions) throughout the implementation of the privatization stages.

8. Standard Contract

The MOP will request that the Advisor agree to a standard contract employed by the MOP. The final contract, which is not negotiable, will be in the Polish language.

9. Proposal Format

The Advisor Proposal should include the following items:

- Brief presentation of the firm and description of its most relevant experiences in privatization and advisory work (1 page).
- Description of experience in Poland and Central Europe (1 - 2 pages).
- Detailed approach and timetable outlining the firm's plan for undertaking the assignment (maximum 20 pages, including figures).
- Brief description of team members, assigned responsibilities, and expected time allocation on the project (also include an appendix with team members' curricula vitae).
- Identification of other advisors or firms likely to be used in the assignment, including a description of the plan for integrating subcontractors into the project. (Note: This section should also address the issue of including Polish nationals wherever possible.)
- Sealed envelope containing price proposal, including the manner in which fees and expenses would be determined and an estimate of their amounts, as well as any fees for subcontractors. The price proposal is to include a fixed fee for the completion of the sector analysis as well as the company diagnoses and strategies. The costs of any audits necessary will be assumed by the individual companies and by the MOP, but the Advisor will be responsible for their completion, so any estimates regarding these costs wold also be helpful.

Bidders are invited to comment on the above draft *Terms of Reference* in their proposals, or under separate cover.

10. Selection Criteria

10.1 Experience

-- Experience in this type of project, in this industry, in Poland and Central Europe, in working with Polish firms and consultants, and other relevant work.

10.2 Technical Approach to the Project

-- Insight into and diagnosis of the problem, strategy for study and implementation, and work plan. This will be an essential criterion, as the nature of the problem is somewhat unique to other Polish industrial sectors, and thus the MOP will be most interested in creative solutions beyond simple market studies and transaction execution.

10.3 Project Staffing

-- Mix of people, seniority, and time in Poland.

10.4 Price

11. Environmental Assessment

An environmental assessment is necessary to facilitate privatization of the heavy industries in Poland. This section only addresses responsibility for clean up, not pollution control.

11.1 Background

An environmental assessment of firms destined for privatization is necessary to begin to resolve two seemingly contradictory positions. On the one hand, the Polish government is understandably reluctant to give open-ended indemnities to new owners for, particularly unidentified, past environmental damage. On the other hand, certain potential investors (particularly U.S. concerns) will not proceed with an acquisition if they or the investor company thereby inherit the liability for all previous environmental damage.

Although the government's avoidance of granting indemnities should not be construed as a reluctance to finance clean-up operations, it is evident that these conflicting positions are capable of frustrating the privatization of most heavy industry in Poland.

11.2 What makes these two positions seemingly irreconcilable?

Currently, investors and the Polish government must decide whether to (and who is to) accept an enormous amount of uncertainty. No one knows whether pollution is present in the soil underneath and around the plant site, and whether pollutants have entered the water table and affected the health of the local population.

The government cannot currently be expected to provide open-ended indemnification. It does not know the extent of the pollution and cannot estimate the cost of clean-up. Even if the extent of contamination were known, in the present domestic economic situation, environmental indemnities would be very costly. These unknown liabilities could cause a substantial drain on the State Treasury. Indeed, the costs could be so great that remediation could not feasibly be undertaken. This could, in turn, lead to pressure being placed on the Ministry of Environmental Protection not to enforce environmental standards. This would perpetuate the pollution problem in Poland and thus is not a constructive solution.

However, this reluctance may be at the cost of frustrating a successful privatization since investors may simply refuse to proceed.

11.3 Environmental assessment is the solution

Environmental assessment and audits are a technically and economically feasible method of reducing uncertainty for both the Poland government and foreign investors.

In an environmental audit, samples are drawn from the air, water and soil on and around a plant site and chemically analyzed for pollutants. The product is a report on the environmental health of the firm. The benefits are:

- by clearly articulating exactly what is on the site, the studies greatly reduce the uncertainty faced by both the government and the foreign investors;
- both the cost of installing equipment to stop present pollution, and the cost of soil and ground water clean-up can be determined once the degree of pollution is understood;
- the report assessing the soil and ground water pollution on the site can provide a basis for negotiation between seller and purchaser on the issue of responsibility and cost and, hopefully, allow financial ceilings in the government's exposure to be negotiated.

The Advisor must appreciate the Ministry of Ownership Transformations' requests that the environmental assessment and remediation be performed using the most cost effective methods.

The MOT feels that these costs can be substantially reduced by using the domestic labor market and perhaps adjusting the scope and breadth of the audit to the Polish situation.

Annex IV: List of Persons Contacted

Government of Poland

MOP of Privatization

Susan Cummings	Former Environmental Attorney
Klaus Hermann	Former Advisor to the Minister
Michal Mrozek	Director, Department of Foreign Relations
Pawel Wojciechowski	Advisor to the Minister
Ewa Zbroch	Project Manager, Capital Privatization Department

USAID

Eve Anderson	Private Sector Coordinator

Private Sector

John Butt	Country Manager, Price Waterhouse-IPG, Poland
Tomasz Pyrich	Consultant, Price Waterhouse-IPG, Poland
Zbyszko Tabernacki	Manager, Corporate Finance, Price Waterhouse, Poland
Malcolm Griffin	Managing Director, Huta Szkla Jaroslaw S.A.
James Hatt	Chief Financial Officer, Huta Szkla Jaroslaw S.A.
Jacek Mielczarek	Management Advisor, Huta Szkla Jaroslaw
Jerzy Kulbat	Managing Director, Huta Szkla Gospodarczego Hortensja
Pawel Jagiello	Managing Director, Pro-Invest International, Ltd.
Andrzej Kawecki	Partner, Soltysinski, Kawecki & Szajkowski, Legal Advisors
Jan Dorosz	Director, Huta Skla Bialystok
Grzegorz Medza	Access Ltd.
Jeffrey Grady	Manager, KPMG Peat Marwick Policy Economics Group
Michal Jankowski	Consultant, Company Assistance Ltd.

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Krystyna Fiejdasz	Finance Director, Huta Szkla Okiennego Kunice
Julian Wisniewski	Former Commissar and Technical Director, Huta Skla Krysztalowego Julia
Andrzej Idziak	Deputy Director, Huta Szkla Krysztalowego Julia

Other

Piotr Wielowieyski	Corporate Finance Services, International Finance Corporation
Michal Rusiecki	Vice President, Enterprise Investors/Polish-American Enterprise Fund
Robert Manz	Vice President, Enterprise Investors/Polish-American Enterprise Fund

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