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VLADMIR TRACTOR WORKS

RUSSIA

Final

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VLADIMIR TRACTOR WORKS (A)

RUSSIA

On May 21, 1994, two weeks after taking over as Vladimir Tractor Works' (VTW) new director, Joseph Bakaleinik sat down in his office to prepare an action plan to rescue the ailing industrial plant. Some 18 months prior, VTW had been privatized through Russia's Mass Privatization Program.

Vladimir Tractor Works, located about 180 kilometers northwest of Moscow, used to be one of the Soviet Union's showpiece industrial companies. Now the loss of the company's main principal customers -- state cooperatives and government-supported agencies -- threatened the newly industrialized company with the specter of bankruptcy.

In March 1994, its new shareholders (principally workers and two outside investors) turned in desperation to the only person they knew who might be able to save the company -- Mr. Joseph Bakaleinik. Bakaleinik was previously the Deputy Director of Vladimir Tractor Works before he left in 1990 for Harvard University, where he studied for his Masters in Business Administration (MBA).

As he began to prepare VTW's action plan, Bakaleinik considered the enormity of the task at hand. He believed the company had great potential. But he also knew it was close to bankruptcy. Bakaleinik knew that time was at a premium and resources were limited. He needed to quickly identify a course of action that would buy the company sufficient time in the short term to survive, while establishing the foundation for future growth. His reputation and the fate of more than 12,000 workers were in his hands.

Company Privatization Background

Privatization Decision

In early 1992, the Vladimir Tractor Works management held discussions with the national privatization implementation agency (GKI) about the different possibilities for privatizing the largest tractor company in Russia. In July of the same year, the Workers' Commission at VTW voted to go through Mass Privatization (see Technical Note for an overview of the Russian privatization process).

This case study was written by Peter Boone and Ophelia Yeung of SRI International under the supervision of Price Waterhouse as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation. The authors wish to thank the management of Vladimir Tractor Works for their support in the research. The case study was undertaken through the Privatization and Development Project (PAD) funded by the United States Agency for International Development (USAID). August 1994.

On September 24, 1992 a general staff meeting was held to decide on one of the three, government defined, share ownership structure options for the new company. Seventy percent of the staff of 19,000 voted for a share ownership plan whereby the workers would be offered about 51 percent of the company's shares. The remaining shares would be sold through the auction system (27 percent), an investment tender (17 percent), and an Employee Stock Ownership Plan (5 percent).

Following the workers' approval of this privatization plan, Vladimir Tractor Works was registered with the regional administration as a joint stock company in October of 1993.

Purchase of Shares

A closed subscription of shares for the new joint stock company took place from October 26 to November 5, 1992. Fifty-one percent of the shares for the new joint stock company were made available to the workers of the company.

The Vladimir Region Property Fund (RPF) held three separate public vouchers auctions to sell 27 percent of the company's authorized capital between March and October of 1993. The remaining 22 percent of the company's shares was to be allocated at a later date through an investment tender and an Employee Stock Ownership Plan (ESOP).

The largest buyers participating in the voucher auctions were Alpha Capital,[1] a Russian investment fund company, and Renova, a Russian-U.S. joint venture investment company which Mr. Bakaleinik had helped organize. In addition to these buyers, a number of buyers including company employees and other individuals purchased small allotments of shares. According to auction observers from the town of Vladimir, the biggest drama at the events was the heated competition to accumulate shares between Alpha Capital and Renova.

By March 1994 the workers' share of company ownership had decreased to 38% through workers' sale of stock. The breakdown of share ownership as of March 1994 is provided in Exhibit 1. During the time period from the first auction until May 1994, the two outside investors, Renova and Alpha Capital, gradually increased their share ownership in VTW by buying up an additional ten percent of the company's share capital through private trading with employees and other individual share owners. By mid 1994, Renova and Alpha Capital owned a combined total of 38 percent of the company's shares.

[1] Alpha Capital was actually serving as an agent in this auction for Tractorexport, the government-owned tractor export company which was in the process of being privatized.

Election of a General Director

On June 23, 1993 Vladimir Tractor Works held its first shareholders' general meeting. The meeting was convened at the factory's Torpedo Stadium which was the only venue with sufficient space to accommodate the 3,000 or so shareholders (principally the factory workers but also private investors) who were to attend the meeting. At the top of the meeting agenda was the election of a new General Director, Board of Directors and amendments to the Charter.

The incumbent General Director, Anatoli Grishin, had some 40 years of experience at the factory. Mr. Grishin faced a challenge from Joseph Bakaleinik. The week before the shareholders' meeting, Mr. Bakaleinik attempted to increase the number of shares under his control by offering to buy them from workers for a price of up to 2,500 rubles per share. However, he was unsuccessful in accumulating any significant new quantities of shares at that time.

Bakaleinik went into the meeting with 15 percent of the shares under his control through the Renova joint venture company. During the meeting, Bakaleinik emphasized the need for Vladimir to make substantial changes in order to reduce costs and make the company profitable. "Only tough measures would save the factory," he told the already hard-pressed work force.

Taking a completely different approach, Mr. Grishin, who had campaigned actively within the factory, promised there would be no layoffs; he also vowed to maintain the plant's large social-service sphere which included dozens of kindergartens, apartment buildings, and three farms which provided subsidized food to the work force.

Mr. Grishin emerged victorious, winning 82 percent of the ballot. But Mr. Bakaleinik gained a partial victory, winning a seat on the Board of Directors.

During its first six months as a privatized company, VTW ran into serious problems. Orders for it products dropped precipitously, and accounts receivables soared, as insolvent customers were unable to pay for their tractors and engines. VTW encountered major liquidity problems, and was unable to meet its payroll in September 1993. Nearly 2,000 workers had to be laid off in mid-September. During the month of December, the factory was forced to temporarily close down. In January 1994, Grishin resigned as General Director.

Mr. Bakaleinik Takes the Helm

Shortly after the resignation of Mr. Grishin, the plant's Board of Directors contacted Mr. Bakaleinik to find out if he was still interested in taking the job as General Director. Mr. Bakaleinik found the job too intriguing a challenge to pass up.

At the shareholders' meeting to elect a new General Director in March 1994, Mr. Bakaleinik told the workers why he wanted to try to rescue the nearly bankrupt company. Having grown up in Vladimir and having worked most of his career for VTW, he felt a personal commitment to help rescue the company, he explained. He also revealed that, if elected as General Director, he would probably be offered a remuneration package which included a number of stock options in the company. If the company's turnaround was successful, his stock options would be worth a lot of money, he acknowledged.

Bakaleinik then gave an honest, but specific, assessment of the painful measures that he felt would be necessary to save the factory. He explained candidly that as General Director he would have to trim the work force, cut back on social services, and adopt tighter accounting controls. He argued that cost-cutting was the only way Vladimir could survive.

Bakaleinik then used a mountain-climbing metaphor to illustrate the challenges facing the company. "It's like climbing the Himalayas," he told the 700 shareholders who attended the meeting. "You go up, and if you are lucky you come down."

The next day, Mr. Bakaleinik received 98.6 percent of the votes to become the plant's new General Director and Chairman of the Board of Directors. He took up his new post on May 11, 1994.

Russian Agricultural Farm Structure

In recent years the Russian farm structure had gone through some major structural changes that were having a significant impact on Vladimir's market outlook.

The agricultural collectives accounted for 90 percent of the agricultural land, and employed some 20 million Russian farmers and workers as of May 1994. Collectives ranged in size from about 500 to 5,000 hectares. The agricultural collectives had run into serious financial problems as the subsidies and soft credit that used to flow to these units had dried up. As a result, these collectives sharply curtailed purchases of supplies and equipment which they used to purchase annually as part of the central planning process.

A small number of the collective farms had been privatized to workers and pensioners during the period from 1992 to mid-1994. Land reform had been one of the chief obstacles to speedy implementation of privatization of the agricultural collectives. The Russian Constitution, which was adopted in December of 1993, guaranteed the right to own land, but did not specify how land ownership should be registered, nor how land should be bought and sold. A draft land code did little to clarify these problems.

However, the trend towards smaller private farms was expected to continue in the future. Russian private farms typically ranged from about 20 to 100 hectares in size. In the privatizations which had occurred, the workers and pensioners usually grouped themselves together into partnerships which then took ownership over smaller parcels of the collective's land. A total of about 8 percent of Russia's agricultural land was in private hands as of May 1994. Private Russian farms typically devoted a large share of their activities to crops, as opposed to livestock.

The short-term outlook was that private small farmers would be more likely to select labor-intensive technologies than collectives. Hence in the short term private farms would not be as inclined to purchase tractors as the larger collectives. However, it was thought that this trend could change over the longer term if the private farms prospered and expanded, and if they were more able to obtain agricultural credit. At the time, banks were less willing to lend to farmers because unknown land tenure could not be used as collateral.

The Company

Vladimir Tractor Works was established in 1992 as a private enterprise. The company's principal products were tractors and tractor engines; VTW was the largest producer of small tractors in the former Soviet Union. Its basic tractor products included: 25 and 30 horsepower tractors (Models T-25A and T-30A-80) and 2- and 4-cylinder air-cooled engines. The company had approximately 12,700 employees as of May 1994.

As of 1994, VTW's main competitors in the local CIS market were Kharkov Tractor Works, Ukraine (models T16 MT, AM-1), Kishinev Tractor Works, Moldova (K-70M), and Chelyabinsk Tractor Plant, Belarus (T-02-01). There were no competitors in the local CIS market for engine production.

The primary customers of Vladimir's tractors were agricultural cooperatives and companies in Russia, and greenhouse producers in Russia, the CIS countries and the Baltic states. Principal tractor exports were to the United States, Hungary, Poland, Bangladesh, the Czech Republic, and Egypt. In 1994 about half of VTW's production was exported. The main customers for engines in the local CIS market included tractor plants in Russia, Ukraine, and Uzbekistan.

VTW's main suppliers of materials and components were plants and enterprises in Lithuania, Russia, and Ukraine.

The company's extensive facilities in Vladimir, located about 180 kilometers east of Moscow, housed: a tractor plant, a design bureau for engines, two engine building plants, a plant for manufacturing specialized tools, a consumer products plant, and a foreign trading company, "Vladimirets."

VTW's New Organizational Structure

Following privatization, VTW adopted a new organizational structure at its Board of Directors' Meeting on July 7, 1993 (Exhibit 5). As an open joint-stock company, the shareholders elected their representatives to the Board of Directors. In addition, they elected the General Director of the firm, who automatically became Chairman of the Board of Directors.

VTW's Board of Directors comprised ten individuals (Exhibit 6). All of these individuals were either shareholders or employees of the firm.[2] Since inception, VTW's Board of Directors had met once a year. The Board of Directors had the authority to elect the General Director and members of the Management Board.

VTW's Management Board, under the direction of the General Director, was responsible for the day-to-day management of VTW. As Exhibit 5 illustrates, the company's Management Board included the heads of all key departments: Production; Economy and Finance; Domestic Marketing and Commerce; Export Marketing; and Personnel. Except for the election of the new General Director, no management changes had occurred in the company since it was privatized in late 1992. However, the company was considering possible changes in its organizational structure as of May 1994.

Both of VTW's outside shareholders (Renova and Tractorexport) held one seat each on the company's Board of Directors. The presence of two outside investors on VTW's Board represented an opportunity to exert additional pressure on management to maximize profits.

The relationship between Renova and Bakaleinik was a rather close one. Renova was a Russian-U.S. joint venture investment company. Renova relied mainly on U.S. capital for its equity base. Renova was in full support of Bakaleinik in both elections for the position of VTW's General Director.

Bakaleinik's (and VTW's management's) affiliation with Tractorexport was a little different. Tractorexport had a dual relationship with VTW. It was a significant shareholder in VTW, but also a buyer/distributor of VTW tractors in export markets. Tractorexport was the former government-owned (now private) Russian tractor export company. Tractorexport previously enjoyed a monopoly on all Russian tractor exports. It sold Russian tractors manufactured by VTW as well as for its two main Russian competitors in North America. Tractorexport had a North American subsidiary company called Belarus Manufacturing, headquartered in Milwaukee, Wisconsin. As of mid-1994, Tractorexport distributed VTW tractors in North America through Belarus. VTW management felt that the payment terms on these export sales (up to five year

[2] Four of VTW's Board of Directors members were also members of the company's Management Board.

repayment period to VTW) were not particularly favorable to VTW, and therefore could need reconsidering.

VTW'S Declining Production Trends

During the late 1980's VTW's production of tractors was just over 36,000 units per year. By 1993, the first year of privatization, the company's tractor production had plummeted to 21,358 (Exhibit 2). The company's tractor production forecast for 1994 was only 16,000 units. Annual production of engines had taken a similar decline. After peaking at 178,000 engines in the mid-1980's, production plunged to 87,500 units in 1993, with a further drop to about 45,000 units expected by VTW's management in 1994 (Exhibits 3 and 4).

Vladimir's production trends in many ways mirrored the structural trends of the entire Russian industrial sector. Officially recorded industrial production fell by 29 percent between April 1993 and April 1994. Before the collapse of the Soviet Union, the major customer for industrial production was the government. With the disintegration of the former Soviet Union, industrial orders for nearly all of the major industrial enterprises had dried up.

Plant Operations

The Vladimir factory was extremely vertically integrated by worldwide standards. It internally produced the vast majority of the component parts of the tractors, including engines and bodies. Mr. Golubev, the plant's chief engineer, explained that the vertical integration allowed for a higher utilization rate of existing plant, equipment, and personnel. Moreover, it reflected the fact that historically VTW's outside suppliers of components and inputs had not always been reliable, and their costs were often high.

The plant operations were neither bustling nor idle. Workers assembled the tractors that slowly rolled down the assembly line. A significant portion of the plant and equipment was outdated. About 30 percent of the factory's equipment dated back to the United States Lend-Lease Program of the 1940's.

A factory tour showed that extensive inventories of components and raw materials had been piled up throughout the factory. The tour also revealed some potentially dangerous work conditions such as poor lighting, untreated oily spots on the factory floor, and the absence of protective equipment such as face masks to protect workers from dust and debris.

VTW's Precarious Financial Situation

One of Mr. Bakaleinik's first tasks as General Director was to answer the question: "Is the company solvent?" Mr. Bakaleinik wanted to get a quick handle on the financial position of the company, but he could not get the required information from his accounting staff. Mr. Bakaleinik found a number of deficiencies in the financial information system that he inherited upon arrival. His accounting staff could not run financial statements which gave him a clear picture of the company's net cash position and key financial data -- such as detailed breakdowns of costs and revenues, profit/sales ratios, estimates of net cash flow or working capital, etc. -- were not available from the main financial statements.

The problems of VTW accounts were symptomatic of the accounting problems of many Russian companies, particularly former state-owned companies. He observed that key financial data arrived too late to serve as an effective tool for management decisions. He also surmised that much of the data was often inaccurate, reflecting inefficiencies in data collection, and weak systems for measuring and classifying costs and revenues. One of the fundamental constraints was the fact the company's accounting system was executed almost entirely manually.

VTW's internal accounting problems were compounded by the astronomic inflation problem in Russia (the annual inflation rate was about 600 percent in 1993). As of May 1994, Russia's accounting standards did not allow for LIFO (Last In First Out) methods of accounting. Hence VTW consistently showed a "paper profit" on each sale, as the price of the finished product exceeded the cost of labor and materials from an earlier time period. The "paper profits" increased VTW's already high tax liabilities.

The company's financial statement for 1993 indicated a profit for the year (Exhibit 7). However, Mr. Bakaleinik observed that VTW paid a large portion of its operating income in taxes. In addition, the General Director noticed that dividend payments to shareholders were made that same year, despite the extremely tight financial position of the company. Several problems with the information from the financial statement made it difficult to evaluate the source of profit and the company's cash position. Based on his best assessment of the company's financial statements and some discussions he held with the Deputy Director of Finance and Economy, it appeared to Mr. Bakaleinik that the company had a negative net cash-flow position as of May 1994.

The General Director believed that a high percentage of company funds was spent on the upkeep of the company's social assets such as housing, pre-schools, farms, and medical centers. In the first quarter of 1994, the cost of running the kindergartens alone amounted to 500 million rubles ($263,000). The costs of maintaining workers' housing were also high.

Looking at the balance sheet (Exhibit 8), the General Director found that the company had about $8 million in export (hard currency) receivables from reliable overseas customers. These payments were due anytime between May 1994 to five years into the future, mainly due to Tractorexport's payment terms. He also noticed that VTW's long-term debt was 1.6 billion rubles (less than $850,000).

Short-term liabilities were higher: VTW had incurred some expensive short-term debts, and several payments were in arrears. A large portion of the late payments were to the tax authorities and to the electricity company. When payments to these two agencies were in arrears, they typically carried very costly overdue charges with them. VTW's costs of short-term borrowing from commercial banks were also very high, with interest rates of close to 500 percent per annum.

After sorting through the short-term liabilities numbers, Mr. Bakaleinik concluded that the company's short-term debts and late-payment charges amounted to some 7 billion rubles ($3.7 million). The company had no working capital, and was having trouble meeting payroll.

Collapsed Markets and Distribution Networks

Upon the request of the new General Director, VTW's Director of Marketing and Commerce, Mr. Tunitsyn, immediately prepared a memorandum outlining the company's problems and opportunities in the marketing area.

The first constraint identified by Mr. Tunitsyn was the scarcity of staff. Mr. Tunitsyn's memorandum explained that in the pre-privatization days, the Soviet Tractor Ministry made all the country's tractor orders, as part of the annual budget exercise. Another state agency distributed the tractors to the farmers. The Director of Marketing emphasized that even though payments were often late, VTW eventually got paid for their sales in the former system. Under these conditions, VTW management did not have to worry much about marketing, selling, and financing the sales.

However, as the entire economic relationship among the republics and the factories had changed, Government and cooperative orders had dried up. Both the agricultural complexes and the tractor factories that Vladimir factory once supplied had become essentially insolvent, reflecting the wider problems of the Russian economy. VTW's third traditional customer, municipal governments -- which purchased modified tractor vehicles such as street cleaners, bulldozer, and snow plows -- had also become virtually bankrupt, according to the marketing director.

Mr. Tunitsyn reasoned that the logical successor to the former client base would be newly-created, smaller individual private farmers. He knew that Russia's farm restructuring privatization process was still evolving, however, and the emergence of a new, strong private farm unit in Russia had not yet materialized.

Another problem that had developed was the lack of long-term financing available for customer tractor purchases. Purchasing a tractor would cost the Russian farmer about the equivalent of one year's crop revenue. In the absence of a longer-term financing package, most Russian farmers would not have sufficient capital on hand to buy a tractor.

However, VTW tractors priced at 4 million rubles, were about a third of the price of comparable imports, depending on the features. The low cost of VTW tractors could represent a potent marketing advantage, if a financing and distribution networks could be established. The Director of Marketing and Commerce believed that VTW would need to create a distribution and financing system to fill the void left by the collapse of the old distribution and finance network. One of the issues would be to find financial backing to develop the new distribution and financing system.

Due to the lost customer base and customer financing problems, VTW's sales of tractors declined by more than 50 percent, and sales of engines dropped by 75 percent from the late 1980's to 1994 (Exhibits 2 and 3). Not only had local market sales plummeted, but a high percentage of VTW's local buyers were either slow to pay or were in complete default on their payments for delivered products.

But export sales accounted for almost 45 percent of the company's sales in 1993 (Exhibit 9). Reviewing export sales trends, the General Director observed that they had risen over the past two to three years in North America, South America, and the Middle East. In 1993 the plant sold 20 percent of its tractors in the United States, Canada, and Mexico. In 1993, Belarus Machinery Inc. -- a subsidiary of Tractorexport (formerly Russia's state-owned tractor export company) -- sold about 1,000 Vladimir tractors in the competitive U.S. market.

Mr. Bakaleinik learned from Mr. Tunitsyn that price was the main competitive advantage Vladimir tractors enjoyed in the North American market. In early 1994, Vladimir tractors were retailing in the United States for $6,000 to $9,000. One of Vladimir's chief competitors in the North America market was a low-end Massey Ferguson model tractor that was manufactured in Poland. As of May 1994, it retailed in the U.S. market for $11,500.

Personnel Issues

Mr. Bakaleinik's surmised that VTW had a good number of productive laborers and a solid team of engineers who could design engines and tractors. However, he believed there was a serious shortage of managers at VTW with experience and skills in the areas of financial management, marketing, sales, accounting, and even human resource management. Filling this gap with new talent from the outside or retraining existing managers would be a major challenge in the short term.

During the 18 month period following its privatization, the company's total work force had already shrunk by 25 percent from some 19,000 to about 12,700 workers. The current work force was much older on average than had been normally the case in the past, as younger workers were attracted to outside work which usually paid more.

Given the factory's low capacity-utilization rate, maintaining the existing level of work force could not be justified on purely economic grounds. Even before being elected as General Director, Mr. Bakaleinik informed the company's workers that additional cost-cutting measures such as further work-force reduction would be required. While the direct costs of salaries represented a low proportion of total factory operating costs (5 percent), indirect costs such as the extensive set of social costs including food, medical care, housing, and pre-schooling for workers and their families became much more expensive (an additional 12 percent of operating costs).

Social Services

VTW had a vast social-services sector including: dozens of apartment buildings which provided low-cost housing to workers; kindergartens for workers' children; health care facilities; and three agricultural farms which provided subsidized food to workers. Vladimir's recurrent costs in the social-service sector represented a significant share of operating costs. In the first quarter of 1994, the company spent some 500 million rubles on its 25 kindergartens alone.

In addition to the direct costs of operating VTW's extensive social assets, they represented a substantial administrative burden to the company. It was clear to the new General Director that social asset administration diverted attention away from the critical issues upon which the factory most needed to focus: producing high quality tractors and engines at a low cost, and quickly generating higher levels of sales for its products.

In an effort to reduce social infrastructure costs, the General Director thought the company should seriously consider selling the farms and apartments, and transferring the kindergartens to the municipal government. However, after discussing the issue with his Deputy General Director, Mr. Scherbovich, Mr. Bakaleinik decided that imposing additional hardship on his workers at the time should be avoided. Therefore apartment and farm sales were to be postponed. He also discovered that transferring the kindergartens to the municipal government would be difficult. The municipal authorities in Vladimir initially rejected this proposal, arguing they did not have the money to maintain the kindergartens.

Mr. Bakaleinik's Preparation of a Plan of Action

Two weeks into his new job, Mr. Bakaleinik decided that his first significant management step would be to issue an executive order and a plan of action to the employees of the company. This clearly defined what needed to be done to make the company more viable. He recognized that in order for the plan to be successful, he would need to ensure full employee support of the plan.

12

In order to prepare a coherent strategy, Mr. Bakaleinik needed to make sense out of the corporate ledgers and determine the solvency of the company. To improve liquidity and generate some working capital, Mr. Bakaleinik considered a short-term line of credit. However, in looking over the company's ledger and balance sheet, it was not immediately clear to Mr. Bakaleinik what assets could be used as collateral to obtain the credit. He knew from his banking experience that commercial banks would probably insist on strict collateral requirements in light of VTW's tenuous financial situation.

He also wanted to raise longer-term investment capital for the company. Mr. Bakaleinik took note of the fact that the company's investment block of shares had not yet been sold.[3] The unsold investment block of shares (17 percent of total authorized capital) was still being held by the local fund authorities. He knew that this investment tender could generate critical new capital required for modernization of the plant, while at the same time improve the company's balance sheet.

In addition to addressing the company's financial situation, Mr. Bakaleinik was aware that VTW urgently needed to expand sales, both domestically and abroad as a sufficient amount of new orders were not coming in. He felt it was essential to find quick access to new orders in order to bring in enough revenue to keep the plant running. He also needed to identify customers who could pay for their purchases on time.

Mr. Bakaleinik was aware of several monumental constraints which would make restructuring difficult such as the plant's run-down equipment and machinery, the paucity of private business experience and skills within the company, the extensive social services sector, and the massive work force which was being under-utilized, but was also poorly paid and facing serious economic hardship.

Mr. Bakaleinik wanted to present a course of action that would allow the company to survive in the short run, while establishing the foundation for future growth and profits. He knew that if he did not act quickly and decisively the company could go bankrupt. He considered the various types of action that he should take: the need to tackle the company's precarious financial situation and stabilize the cash-flow crunch, and the need to deal with the collapsed marketing networks, among others. He also wondered how to set priorities, and which of the myriad of problems to tackle first.

[3] Through the investment tender, privatized Russian firms could sell blocks of shares to obtain funds for the firm. The bidder whose proposal best met the criteria of the investment program, not necessarily to the one who offered the highest price, gained the right to purchase the shares.

Exhibit 1

VLADIMIR TRACTOR WORKS

SHARE OWNERSHIP STRUCTURE AS OF MARCH 18, 1994

I.	**Total number of shareholders including:**	**17,856 people**
	a) Individuals	17,816 people
	b) legal entities	40
II.	**The total number of shares with the nominal price of 250 roubles issued by VTW**	**2,263,840 shares**
	a) Placed with individuals	910,854 shares or 40.2%
	including: with the Vladimir Tractor Works personnel	860,260 shares 38.0%
	b) Placed with the legal entities	1,352,986 or 59.8%
	Voting shares make up the amount of	2,148,280 shares or 94.9%
III.	**The largest shareholders:**	
	a) "Alpha-Capital" investment fund	399,224 shares or 17.63%
	b) Renova joint venture	457,344 shares or 20.2%
	including:	
	equity shares (common stock)	376,284 shares
	by proxy	81,060 shares (votes)
	c) the GKI total	494,194 shares or 21.8%
	including: voting shares	381,002 shares or 16.83%
	ESOP (5%)	113,192 shares
	Other legal entities	115,370 or 5.11%
IV.	**Non-voting shares: total**	**115,556 shares or 5.1%**
	including: the GKI 5% of ESOP	113,192 shares
	Vladimir Tractor works joint stock company	2,364

Exhibit 2

VLADIMIR TRACTOR WORKS
EVOLUTION OF TRACTOR PRODUCTION

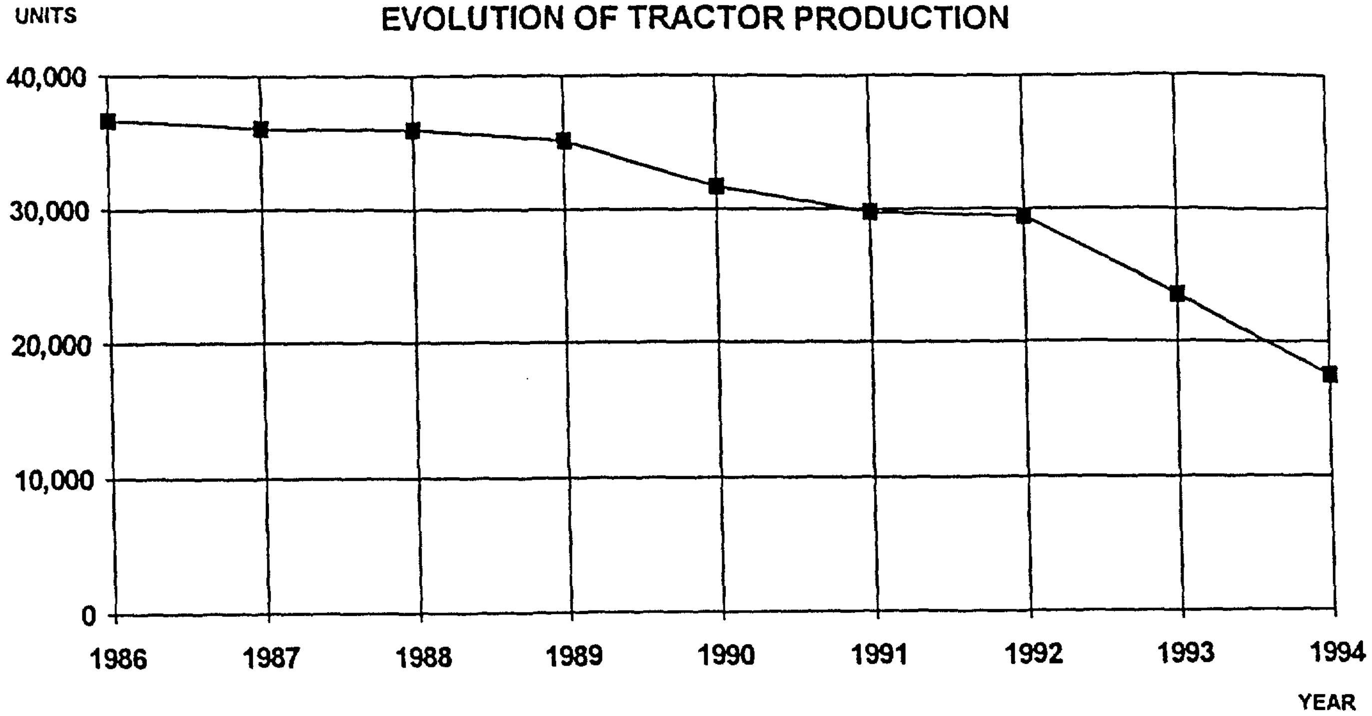


Exhibit 3

VLADIMIR TRACTOR WORKS
EVOLUTION OF ENGINE PRODUCTION

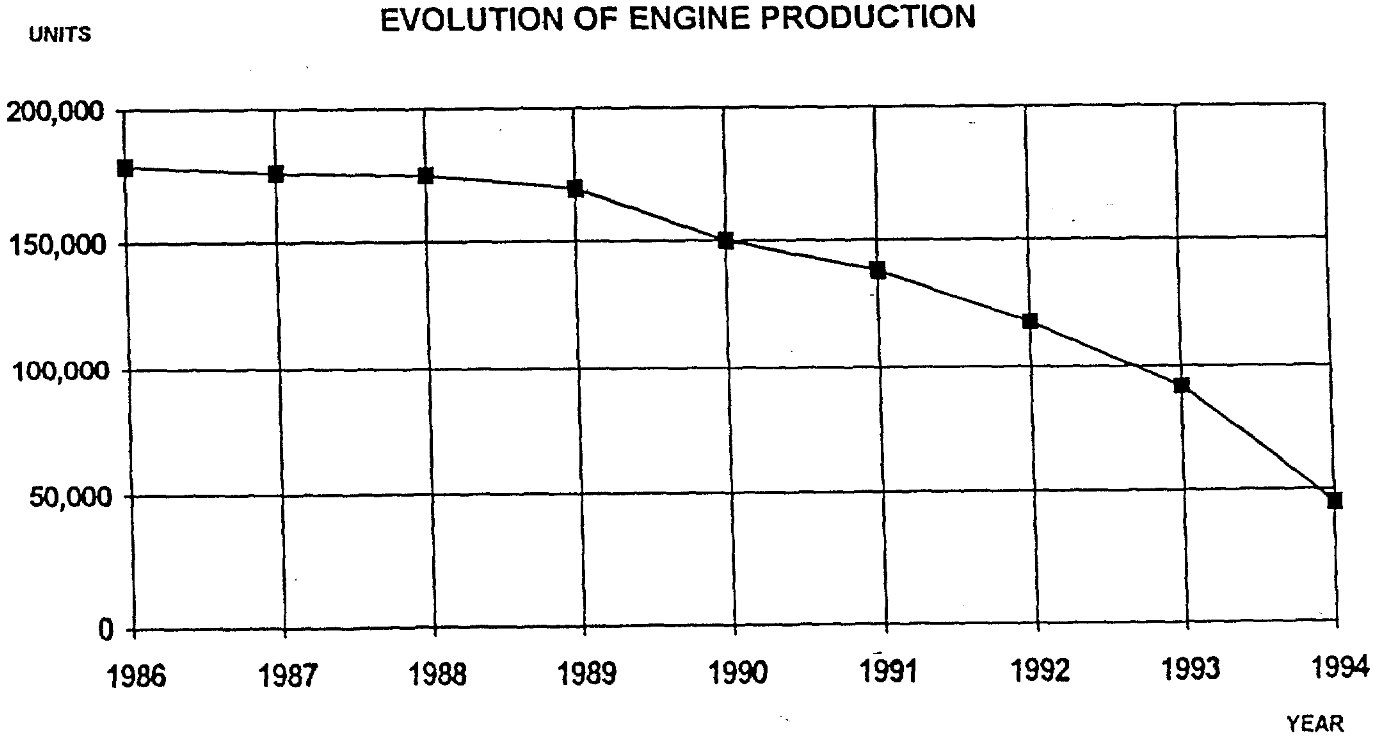


Exhibit 4

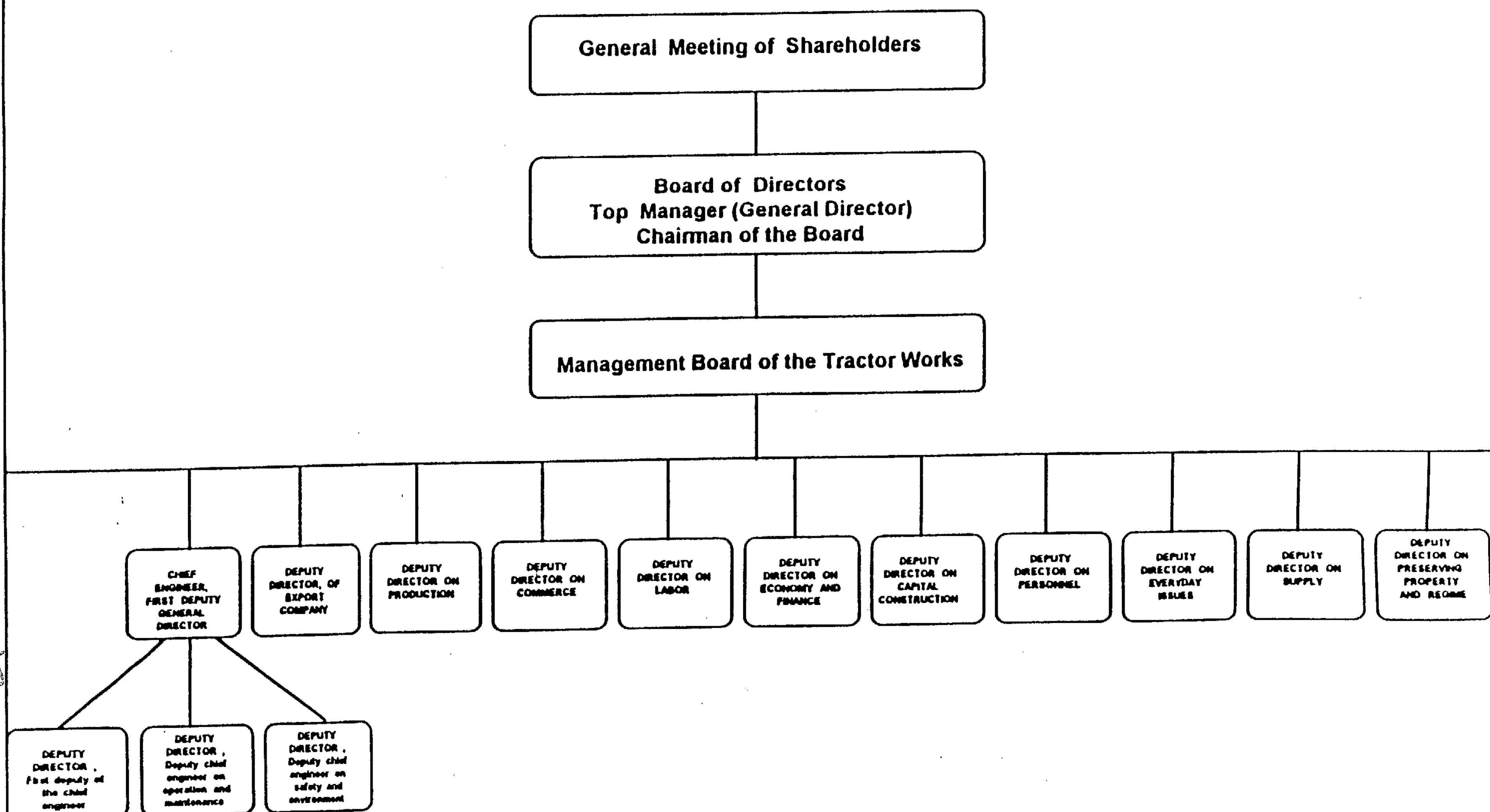
VLADIMIR TRACTOR WORKS

FINANCIAL AND PRODUCTION INFORMATION

Indices		Units of measure	III quarter 1992	I quarter 1994
1.	Marketable products	mln R	881	14,295
2.	Marketed products	" - "	966	11,420
3.	Tractors - total	pieces	6,808	1,954
4.	Engines - total	" - "	25,379	6,827
	including D-144	" - "	14,692	3,506
	D-21(D120)	" - "	10,687	3,506
5.	Spare parts	mln R	101	1,833
6.	Consumer goods	" - "	61	933
7.	Cooperation	" - "	52	299
8.	Personnel on the payroll	people	16,759	14,689
9.	Balance profit	mln R	424	4,283
10.	Capacity utilization %			
	tractors		85	22
	engines		65	15

Exhibit 5

VLADIMIR TRACTOR WORKS
ORGANIZATIONAL STRUCTURE



Endorsed by the Board ' Directors of the "Vladimir Tractor Works" Joint Stock Company on July 7, 1993

Exhibit 6

VLADIMIR TRACTOR WORKS
BOARD OF DIRECTORS

Mr. Bakaleinik	-	General Director
Mr. Golubev	-	Chief Engineer First Deputy of General Director
Mr. Scherbovich	-	Deputy General Director
Mr. Radchenko	-	Deputy General Director
Mr. Loginov	-	Head of mechanical plant
Mr. Khomutov	-	Head of the work shop
Mr. Tsukanov	-	Tractorexport
Mr. Radchenko	-	KI
Mr. Andrianov	-	Local authorities
Mr. Balayesku	-	"Renova"

Exhibit 7

Approved by the Ministry of Finance of the Russian Federation for the 1993 annual report

REPORT ON FINANCIAL RESULTS AND THEIR USE

From January 1 to January 1, 1994

Enterprise, organization Joint-Stock Company "VTZ" /OKPO/
Branch (activity) Tractors, engines, spare parts and Consumer Goods Production and Sales /OKONH/
State property management body________________________ /OKPO/
Measuring unit: 1,000 rub.________________ /Control sum/
Address _________ City of Vladimir ______________________

I. FINANCIAL RESULTS

Index name	Page Code	Profits	Losses (expenditure)
1	2	3	4
Profits (gross income) from the sale of goods, works, services	010	44216129	X
VAT	015	X	3886038
excise duty	020	X	-
Customs duties	030	X	15889
Expenditure on production of sold goods (jobs, services)	040	X	27276244
Sale results	050	13037958	-
Other sale results	060	190503	78185
Profits and expenditure on other transactions	070	3436219	1486450
including:			
on securities and shares of joint stock companies	071	444	X
exchange rate difference on hard currency transactions	072	2615070	264071

Exhibit 7 (cont'd.)

Index name	Page Code	Profits	Losses (expenditure)
1	2	3	4
Total profits and losses	080	16664680	1564635
Balance profits or losses	090	15100045	-
REFERENCE			
The sum of excessive expenditure on enterprise workers' wages	100	+ 2297700	X

II. USE OF PROFITS

Index name	Page Code	End of period under review
1	2	3
Payments to the budget	200	4722110
Payments to the reserve (insurance) fund	210	-
Channelled to:		
accumulation funds	220	6023243
consumption funds	230	2920056
charity	250	8250
other purposes	260	926386
REF.		
Rent excluding depreciation payment	270	-

Exhibit 7 (cont'd.)

III. PAYMENTS TO THE BUDGET

Index name	Page code	Amount Due	Amount Paid
1	2	3	4
Property tax	300	219721	169695
Profit (income) tax	310	4722110	4811628
Payment for titles to mineral resources and discharge of pollutants	340	987	987
Land tax	350	52459	52459
Value-added tax	355	2056120	1315568
Excise duty	356	-	-
Export customs duties	360	15889	15889
Import customs duties	365	56003	56003
Income tax	380	675137	557912
Other taxes	386	10660	6800
Economic sanctions	390	789096	789096

IV. EXPENDITURE COUNTED DURING CALCULATION OF PROFIT TAX EXEMPTION

Index name	Page Code	Actual expenditure during period under review
1	2	3
To finance production and non-production capital investments	500	1521697
To carry out environmental measures	520	79767

Exhibit 7 (cont'd.)

Index name	Page Code	Actual expenditure during period under review
1	2	3
To maintain health, educational, cultural and sports facilities, homes for the elderly and disabled, nurseries and kindergartens, children's holiday camps, and the housing stock (from the outlays established by local soviets of people's deputies (531 1694166)	530	1741055
For charity, ecological and health funds, to public organizations, disabled, religious organizations (associations) and similar purposes	540	8250
________________	550	
________________	560	
________________	570	
________________	580	
________________	590	

Chief manager ________________ Chief accountant ________________

Exhibit 8

VLADIMIR TRACTOR WORKS

THE ENTERPRISE BALANCE SHEET
AS OF 1 JANUARY 1994

Enterprise, organization Joint-Stock Company "VTZ" /OKPO/
Branch (activity) Tractors, engines, spare parts and Consumer Goods Production and Sales /OKONH/
State property
management body________________________ /OKPO/
Measuring unit: 1,000 rub.________________ /Control sum/
Address __________City of Vladimir______________________

Mailing date
Receipt date
Presentation date

ASSETS	Page Code	Start of year	End of year
1	2	3	4
I. FIXED ASSETS AND OTHER NON-CIRCULATING ASSETS			
Non-material assets:			
original cost *)	010	-	-
depreciation *)	011	-	-
residual cost	012	-	-
Fixed assets:			
original (restoration) cost *)	020	7599778	8554702
depreciation *)	021	3823574	3945224
residual cost	022	3776204	4609478
Equipment	030	257848	754669

Exhibit 8 (cont'd.)

ASSETS	Page Code	Start of year	End of year
1	2	3	4
Unfinished capital investments	040	812227	3043393
Long-term fiscal investment	050	4534	9730
Settlements with founders	060	-	-
Other non-circulating assets	070	-	-
Total for section I	080	4850816	8417270
II. STOCK AND EXPENDITURES			
Industrial stock	100	2704515	5509792
Cattle for breeding and fattening	110	18006	164823
Not valuable and quickly depreciating items:			
original cost *)	120	169766	962847
depreciation *)	121	66156	433484
residual value	122	103610	529363
Unfinished production	130	623334	2537050
Future expenditure	140	1588	5366
Finished goods	150	205393	1648690
Goods:			
sale price *)	160	390485	805339
trade margin *)	161	56041	183369
purchase price	162	334444	621970
distribution costs of residue stock	170	385	7309
VAT on purchased values	175	-	1101856
Other stock and expenditures	176	-	3306619
Total for section II	180	3991275	15432838

Exhibit 8 (cont'd.)

ASSETS	Page Code	Start of year	End of year
1	2	3	4
III. FUNDS, SETTLEMENTS AND OTHER ASSETS			
Settlements with debtors:			
for goods, works and services	200	1808112	12756406
on collected bills	210	-	-
with branch enterprises	220	-	-
with the budget	230	-	-
with employees on other transactions	240	2442	19452
with other debtors	250	317007	1508214
Prepayment to suppliers and contractors	260	15328	138942
Short-term financial investments	270	-	-
Funds:			
cash account	280	3773	27246
clearing account	290	26736	4525
hard currency account	300	681322	3239437
other funds	310	5962	19487
Other circulating assets	320	-	-
Total for section III	330	2860682	17713709
Losses:			
previous years	340	-	-
the accounting year	350	X	-
BALANCE (the sum of 080, 180, 330, 340 and 350)	360	11702773	41563817

Exhibit 8 (cont'd.)

LIABILITIES	Page Code	Start of year	End of year
1	2	3	4
I. INTERNAL FUNDS			
Statutory capital	400	565960	565960
Reserve fund	410	-	-
Special funds	420	5414617	11226577
Target financing and receipts	430	-	41158
Lease obligations	440	-	-
Settlements with founders	450	1338	60557
Undistributed profits of previous years	460	-	-
Profits:			
of year under review *)	470	X	15100045
used *)	471	X	14600045
undistributed profits of year under review	472	X	500000
Total for section I	480	5981915	12394252
II. LONG-TERM LIABILITIES			
Long-term bank credits	500	75000	1427500
Long-term loans	510	3985	166675
Total for section II	520	78985	1594175
III. SETTLEMENT AND OTHER LIABILITIES			
Short-term bank credits	600	1382080	6893966
Bank credits for employees	610	325	3904
Short-term loans	620	-	600000
Settlements with creditors:			
for goods, jobs and services	630	2473789	9074368
on collected bills	640	-	-
on remuneration	650	122896	1052333
on social insurance and security	660	157097	949183
on property and personal insurance	670	-	-
with branch enterprises	680	-	-
on extra-budgetary payments	690	50145	916308
with the budget	700	225760	969787
with other creditors	710	1229781	2590737

Exhibit 8 (cont'd.)

LIABILITIES	Page Code	Start of year	End of year
1	2	3	4
Prepayment from buyers and clients	720	-	2416066
Anticipated profits	730	-	2108738
Reserves for estimated expenditure and payments	740	-	-
Reserves for bad debts	750	-	-
Other short-term liabilities	760	-	-
Total for section III	770	5641873	27575390
BALANCE (the sum of 480, 520 and 770)	780	11702773	41563817

Chief manager
Chief accountant

*) The data on these lines are not included in the hard currency balance.

Exhibit 9

VLADIMIR TRACTOR WORKS

PRODUCTION FIGURES

	YEAR		
	1991	**1992**	**1993**
Local Market*	18,300 (62%)	17,600 (60%)	12,200 (57%)
Export Market	11,439 (38%)	11,803 (40%)	9,158 (43%)
Total Production	**29,739**	**29,403**	**21,358**

* **Within Russian Federation**

VLADIMIR TRACTOR WORKS (B)

RUSSIA

Two weeks after taking over as General Director, Mr. Bakaleinik issued an executive order stating VTW's new objective: "to make money."

On the same day, Mr. Bakaleinik delivered an action plan to his Management Board. The action plan covered short- and medium-term measures needed to make the company more profitable.

Action Plan

1.Redress Company's Liquidity Crisis

The company began negotiating with three different Russian commercial banks to obtain a short-term line of credit for about $8.5 million. The line of credit would allow the company to pay off its 7 billion rubles ($3.7 million) in short-term debts and late-payment charges. The remaining $4.5 million of loan funds could be used to restore working capital, and to begin upgrading the company's accounting and marketing functions. The line of credit was to be backed by the company's $8 million in hard-currency export receivables. These accounts receivables were from tractors that had already been delivered to reliable overseas customers.

VTW preferred to have the loan denominated in U.S. dollars. VTW hoped to obtain the short-term credit line at a dollar-denominated interest rate of about 10 or 11 percent per annum. VTW's management decided that the relatively low interest, dollar-denominated loan would not carry the same risks as a high-interest, ruble-denominated loan -- which could become very expensive to repay in real terms if the inflation rate continued to fall.

2.Modernize/Automate Accounting System

The action plan also called for an updating of the company's outdated accounting system. An integrated computer network system would be installed to provide management with an accurate and up-to-date Management Information System (MIS). Outside consultants would be hired to install the new system, and to instruct VTW's accounting and finance personnel on how to operate the system.

3.Energize Marketing Activities

The first change in the marketing area was to increase the size of the department from one to 25. In addition, VTW appointed a new marketing director. Mr. Bakaleinik utilized his Harvard Business School network to identify an experienced Harvard MBA -- Mr. Ralph Hoagland -- to become VTW's new marketing director.

The plan called for Mr. Hoagland -- who had extensive experience in consumer marketing -- to initially focus on customer relations and acquainting himself with VTW's customers in the Russian market. He was also asked to identify the needs of Russian farmers and determine product affordability.

VTW management had concluded that a local distribution network could become a valuable asset in the future to attract a foreign investor such as John Deere or Massey Ferguson, should they decide to enter the Russian market. VTW's domestic marketing program would be channeled through a network of tractor dealerships. Similar to the North America model, these distributorships would be equipped with complete parts- and service- support capabilities, in addition to being retail outlets. VTW also wanted to create a leasing network to offer farmers longer-term financing options to facilitate purchase. The financing system would likely be operated through the distribution network.

VTW planned to attract loan and equity capital for the distribution and finance networks from Western finance companies and development banks such as the European Bank for Reconstruction and Development.

4.Introduce Tighter Payment Controls on Product Sales

In order to tighten credit controls on product sales in the local market, VTW management would introduce higher pre-payment requirements. Depending on the customer, advance cash payments of up to 100 percent would be required on certain product sales. Shorter repayment periods would also be required for export sales. Up until this time, VTW had been paid as much as 5 years after delivery in its export sales.

These payment-control measures were expected to significantly improve company's cash flow by sharply reducing the accounts receivables.

5. Become More Demanding With Suppliers

It was determined that as a private company VTW was now in a position to exert more control over its suppliers. The company planned to establish new tender procedures whereby firms would compete for contracts to supply many of the goods and services purchased outside the firm. This process was expected to allow VTW to become more demanding of its suppliers in terms of price, delivery, and quality. For certain categories of goods and services, overseas suppliers would be used more often than in the past.

6.Find $13 million to Modernize Machinery

VTW determined that it would need some 25 billion rubles ($13 million) over the medium term in new investment capital to modernize the company's outdated equipment and machinery.
VTW had not yet finalized the negotiations for this investment package at the time of the elaboration of its action plan. The company did, however, identify the possibility of raising this capital from various sources including: the investment tender (through selling the government's remaining shares in VTW); a new offering of shares (with an increase in the company's authorized capital); and long-term concessional loans from a development institution such as the European Bank for Reconstruction and Development (EBRD). Funding agencies such as the EBRD have made major commitments to assist Russian businesses, such as VTW, to make the transition to a market economy.

It was envisaged that the investment capital for both the investment tender and the possible new share offering would be raised from local investors. Although attracting a foreign investor such as John Deere or Massey Ferguson might also be possible, VTW preferred to consider that avenue at a later date when VTW would be in a stronger negotiating position. It was felt that the projected improvement in sales performance, improved profit/loss situation, and the establishment of a distribution network would all serve to enhance VTW's position as an acquisition prospect in the future.

7.Reduce Work Force

Faced with slack demand and an urgent need to compress costs in all areas, it was likely that further downsizing of the company's work force (totaling 14,500 as of May 1994) would be required. It was possible that up to 30 percent of the work force would need to be retrenched, but efforts were being made to keep as many of the productive workers as possible.
VTW management planned to work closely with the company's unions to make the process as fair and transparent as possible. Some of the likely retrenchments would take place in the social-sector, where the company was planning on spinning off a number of activities. In addition, some of the production-related services which were being performed "in-house" would also be candidates for divestiture. Early retirement options, and other quasi-voluntary methods of separation would be considered as much as possible.

8.Cutback on Social Services

The action plan also called for the spinning off of the company's major social services over the medium term. The plan was to set up a joint venture with the municipal government that would gradually shift the responsibility of owning and maintaining the company's 25 kindergartens to the municipal government. Funding would be sought from external donors to provide the municipal authorities with sufficient capital to properly maintain social assets after they were transferred.

The company also planned to divest the apartments and farms over the medium term. Because the workers were already under extreme hardship, VTW did not want to sell these social assets right away. If workers could not afford to buy their apartments, an alternative plan could be to give them away free to workers. By shifting ownership responsibilities, the company would be relieved of the heavy maintenance costs and the administrative burden that the apartments were carrying.

VLADIMIR TRACTOR WORKS

RUSSIA

TECHNICAL NOTE

1. Overview of the Russia's Privatization Program

a. Legal Framework

In July 1991, the Russian Parliament adopted the law "Privatization of State and Municipal Enterprises" which set the basic framework for privatization in the Russian Federation. This law applies to all forms of state-owned property in the Russian Federation, with the exception of land, housing, and social/cultural institutions, which are governed by separate legislation.

The 1991 privatization law defines forms and methods of privatization with respect to auctions, tenders, corporatization, and sale of shares of enterprises to workers on preferential terms. Subsequent presidential decrees issued in mid-1992 defined the methods for free distribution of property to all citizens through vouchers.

With the economic reforms that were introduced in November 1991, privatization was declared a key element of the transition to the free market. The Main Provision of the 1992 State Program of Privatization, adopted in December 1991, became the first document that actually regulated the process of privatization. In January 1992 the actual process of non-spontaneous privatization began.

b.Institutional Framework

Two major privatization implementing agencies were established by the 1991 privatization law. The first, the **State Committee for the Management of State Property (GKI)**, part of the executive branch, was given the authority for the design and implementation of the privatization process. This central agency was also given sole responsibility to issue subordinate acts or regulations related to privatization. For each type of state property which falls under its responsibility, the GKI's local counterpart (MKI) implements the relevant privatization program, particularly as it relates to approving a privatization plan and transforming a company to a joint stock company.

The task of selling enterprises and distributing the proceeds was assigned to the **Property Funds,** part of the legislative branch. This agency was given responsibility for ownership and control in its role as shareholder and seller of property. The operational boundaries between the GKI

33

and the Property Funds have not always been clear. For example, how far GKI's involvement should extend beyond corporatization of SOEs is not entirely clear. This ambiguity of roles has not, thus far, led to any serious delays in the implementation of the Mass Privatization Program.

c.Privatization Methods

There are basically three avenues for privatization. The first track involves the sale of small enterprises by local property funds and the local division of the GKI (i.e. MKI). The second involves the conversion of medium and larger enterprises to joint stock companies through distributions to workers and management and the sale of their stock through auctions. The third tract involves special procedures for very large enterprises under special plans prepared by the GKI. The 1992 State Privatization Program identified those sectors of the economy for which privatization would be mandatory, optional, restricted or prohibited altogether. It also divided all SOEs into categories of small, medium, or large enterprises, depending on the book value of fixed capital or the size of the work force.

Small-Scale Privatization. Small-scale enterprises comprise the bulk of all SOEs and were the first to be privatized under the Russian Federation privatization program. These are defined as enterprises with less than 200 employees and fixed asset values of less than 1 million rubles as of 1 January 1992. All small-scale enterprises (numbering around 200,000) were to be privatized through competitive auctions and tenders carried out by the Regional Property Funds and the MKI. Municipal and regional governments have typically been identified as the owners of these companies and hence have been responsible for their privatization.

Mass Privatization. Large-scale (and some medium-scale privatizations) are carried out under the Mass Privatization Program. The term Mass Privatization usually unites two independent, but closely related, processes.

The first process is large-scale privatization, referred to as corporatization or commercialization, and it involves the transformation of large state-owned enterprises into joint-stock companies. Medium-sized enterprises are not subject to the mandatory corporatization rule, but they can elect to follow the same Mass Privatization Program as large enterprises, if they choose to do so. Alternatively, they can be sold to external purchasers or be divested through internal buy-outs.

The second process is the distribution of share ownership. There are three different options for the allocation of ownership: Option One, Two, or Three. The government defined options specify percentage distribution of company shares to be allocated both internally, to enterprise managers and employees and externally to outside investors. External distribution may take the form of voucher auctions, cash auctions, hard currency investment, or government retention of shares. Internal distribution may take the form of free enterprise shares, employee funds, purchases of assets at price discounts, or a 100% buy-out. All internal distribution occurs through a closed subscription auction.

As part of the corporatization process, employees of the company vote for one of the three options.

Option One: Under this option, 25 percent of the shares, non- voting, are given free of charge to the workers, five percent of the voting shares to the management at full price, and ten percent of the voting shares are sold to workers at a 30 percent discount from book value. The balance of shares is offered to outside investors and individuals through auctions and investment tenders.

Option Two: Through this option, workers and managers are allowed to purchase 51 percent of all shares through closed subscriptions at 1.7 times their nominal book value. The remaining 49 percent is sold to the public.

Option Three: This option provides that if a group of employees makes a commitment to carry out the privatization and avoid bankruptcy for a one-year period, the group will be granted the option to buy 20 percent of the charter capital at face value. For the duration of the agreement, the group is entitled to voting shares on 20 percent of the total shares, but the shares are held by the appropriate property fund. All employees, including the group that is party to the agreement, can buy 20 percent of the enterprise capital at 30 percent discount and with a three-year deferred payment schedule. The option is available only to enterprises with less than 200 employees, and a book value of between one million and 50 million rubles.

Unless a two-third's majority of the Workers' Collective approves Option Two or Three, share ownership is to be allocated according to Option One. Buy the end of 1993, 24.2 percent of the mass privatizations went through Option One, while 74.2 percent selected Option Two, and only 1.6 percent followed Option Three.[1]

d.Privatization Objectives

Both of Russia's principal privatization programs (Mass Privatization and Small-Scale Privatization) have been driven by the government's desire to move as many firms as possible into private hands before political or policy changes could reverse the process. This contrasts with many other countries' privatization programs (e.g. Poland) where other criteria such as the

[1] See "The Russian Model of Mass Privatization: Government Policy and First Results," by Alexander Radygin, from Privatization, Conversion, and Enterprise Reform in Russia, edited by Michael McFaul and Tova Perlmutter, May 1994.

need to raise revenue, or the desire to attract investors with technical expertise, are also high priorities.

There are several illustrations of the preference for speed over revenue in the Russian privatization program. For example, under the voucher system, all citizens were given vouchers free of charge. As such, the government received no revenue for the vast majority of shares that were sold in the privatization program. According to decree # 1229, adopted in October 1992, at least 80 percent of the shares of a privatizing enterprise must be sold for vouchers. In 1992, 144 million vouchers, each with a face value of R 10,000 were distributed free to all Russian citizens.

Another confirmation of the preference for speed over revenue is the method for determining a company's book value which is the basis of a company's sale price. The book values of the some 14,000 enterprises privatized under Mass Privatization were calculated once in January 1992, and have remained unchanged since that time, even though inflation has surged by 10,500 percent in the intervening period.

e.Progress to Date

If progress in the privatization program is measured in terms of number of enterprises privatized and the speed of privatization, the Russian privatization program appears to be one of the most successful privatization programs in history. By January 1994, some 90,000 enterprises had been privatized.[2] Of these, some 13,000 had been privatized under Mass Privatization. Nearly all of these 90,000 privatizations took place during a one-year period between December 1992 and December 1993. By June 1994, some 70 percent of Russian industry had been placed into private hands.

While the size and speed of the Russian privatization program have been truly impressive, some other aspects of the privatization program are less encouraging. One of the problems has been that the technical, managerial, and financial restructuring that might have accompanied privatizations have been very limited in scope and number. To some observers, the shift in ownership has often been little more than a nominal name change for enterprises. This is true for the companies which have not changed their management team, work force composition, product mix, technology base, or market strategy since becoming privatized.

By the end of 1993, insiders (managers and employees) held majority shares in some two thirds of Russia's privatized firms. Many observers believe that the strategy of giving incumbent enterprise directors (and to some extent employees) extensive ownership and control over their

[2] See "Privatization in Russia," by Alexander Ivanenko, in Business World Weekly, No. 9/102, March, 1994.

enterprises has created barriers to the emergence of effective ownership. It has been argued by some that by not separating ownership from management, the Russian privatization program has reinforced key problems inherent in the Russian economy.

Many newly privatized firms have found themselves faced with sharp decreases in demand and with new hard-budget constraints. It has been reported that many of the privatized firms have devoted little energy to attracting new clients, and often have not managed to increase efficiency. Many of these firms have had no working capital for production, but have frequently tried to keep their traditional customers, and preserve their existing technology.[3] The former SOEs from the industrial sector have fared particularly poorly since privatization, as Russian industrial production dropped 30 percent between April 1993 and April 1994.

2.Results/Impact of Vladimir Privatization

a.Method Selected

The Vladimir Tractor Works (VTW) Workers' Collective selected Mass Privatization ownership Option Two, whereby the workers and managers were permitted to purchase 51 percent of all shares through closed subscriptions at 1.7 times their nominal book value. Following this Option, of the remaining 49 percent of the shares, 45 percent were available for sale to the public and five percent were to be distributed to the Enterprise's Employees Shareholder Fund.

b. Privatization Impact on Employees

At the time of privatization in October 1993, VTW had a work force of 19,000. During the 19 month period between October 1993 and May 1994, the work force was reduced from 19,000 to some 14,500. Over the same time period, employees' wage increases had not nearly kept pace with inflation.

By May 1994, most of the company's social services, which the company had made available to employees before privatization, still remained in place. The company had not yet divested the majority of its social assets including: 25 kindergartens, dozens of apartments, a medical clinic, three farms, and a subsidized cafeteria for workers.

As the largest shareholders, employees in the privatized company were able to realize financial gains and exercise new rights. First, the employees could realize financial gains through the sale of their stock. Between November 1992 and May 1994 VTW employees sold about 225,000 shares or about 10 percent of the VTW's total share capital to other groups, mainly the outside

[3] See "Russian Enterprises: Life in Crisis Conditions" by Expert Institute, Moscow, 1992.

37

investors -- Renova and Alpha Capital, two prominent Russian voucher funds. Second, workers could gain through dividend payments on their shares, if the company made a profit. Third, they were able to exercise new corporate governance rights as shareholders by electing their General Director and Board of Directors. This was an entirely new privilege for workers and gave them a new sense of importance and authority which they had not experienced in the previous structure.

As of May 1994, it was too early to tell if the workers' overall welfare position had improved as a result of privatization. The initial problems encountered by the workers included uncertainty about the future of their jobs, job cuts in some areas, and eroding salaries and benefits. The eventual hope was that the company would become profitable and hence would be able to pay higher salaries to a smaller, but more productive, work force.

In addition, workers would eventually be expected to take much greater responsibility (and the company a correspondingly diminished role) in obtaining and paying for social services provided by the private sector, including housing, food, and medical care. Compensatory pay increases would probably be required to enable workers to shoulder these social expenses.

Several structural issues will make divesting of social assets difficult for VTW. First, there are few private providers of these social services available in Vladimir. Second, the municipal government agencies, which might be candidates for transferring some of the kindergartens and other social assets, currently do not have the money to manage any new responsibilities. Third, there are some legal obstacles to selling some of the assets. For example, the Russian Housing Code places many restrictions on the conditions under which former SOEs can divest of their housing stock.

c.Impact on Government Revenue

Typical of Mass Privatization in Russia, the Vladimir Tractor Works privatization had a small, but positive, impact on government revenues. As stated previously, the government's objective under Mass Privatization clearly was speed and not revenue maximization.

For the sale of shares, the government received some 1.065 billion rubles (about $560,000) broken down as follows: 565 million rubles from the sale of shares to employees; 6 million rubles from the cash auction; a projected 381 million rubles from the sale of shares through the investment tender; and a projected 113 million through the Employee Stock Ownership Plan. For those shares "sold" through voucher auctions (60 percent of the total shares), the government received no revenue since the vouchers were given away free.

d.Effects on Production/Capacity Utilization

From the date of privatization until early 1994, VTW's production had fallen sharply. Tractor production had slipped from 6,808 in the third quarter 1992 to 1,833 units in the first quarter of 1994, representing a 70 percent decline. Engine output took a similar fall, dropping from 25,379 engines in the third quarter of 1992 to 6,827 in the first quarter of 1994.

VTW tractor capacity-utilization rate fell from 85 percent in 1992 to 22 percent in early 1994, while the rate of capacity use for engines fell from 65 percent to 15 percent during the same time period.

e.Effects on Suppliers

Although the impact of VTW's privatization on suppliers was not fully felt by May 1994, there were some clear indications of how VTW intended to change its supplier relationships. Before privatization, most of VTW's procurement decisions were made by central ministries, as part of the central planning process. Prices were also set at central government levels. Under this situation, competitive pressures among suppliers were minimal.

Under its new system, VTW intended to take much more control over its procurement decisions. The company planned to establish new tender procedures whereby suppliers would compete for contracts to supply goods and services to the firm. The process was expected to allow VTW to become much more demanding of its suppliers in terms of price, delivery, and quality.

f.Impact on Competitors

As of May 1994, the VTW privatization had not yet had a major impact on competitors, both domestic and foreign. VTW had not changed its product lines or product mixes, and it had not significantly changed its prices so the competitor impact in these areas was minimal.

The market for tractors and tractor engines in Russia had substantially plummeted during the post-privatization period for all classes of tractors. During this period, most of VTW's competitors had suffered similar losses in sales as VTW.

However, as the new structure for Russia's private farms eventually emerges, VTW could be in a stronger position to serve that market since VTW produces small tractors which are closest to being within the financial reach of a typical Russian farmer.

g. Impact on Customers/Buyers

VTW had not significantly changed its customer base since privatization. The only significant change was that a higher proportion of its customers were in foreign markets compared with before privatization. Export sales rose from 35 to 50 percent of VTW sales during the period from October 1992 to May 1994.

As of May 1994, VTW had not modified its domestic customer base since privatization; rather it tried to maintain its customary buyers. It had not yet devoted significant efforts to attracting new clients, but such efforts were being planned for the near future.

The thrust of the new marketing strategy for VTW was to become more customer oriented. VTW would like to get to know their customers better, and find out more about their technical needs and what they can afford.

In order to better serve their customers, VTW plans to establish a distribution network of retail outlets which also have after-market service capabilities. The company would also like to offer farmers longer-term financing options, including leasing, to facilitate tractor purchases. These changes, if successfully implemented, are likely result in improved service to customers and higher customer satisfaction.

VTW did, however, change the way it treated its customers following privatization. They became stricter in their payment terms. Higher pre-payment requirements for domestic customers were introduced, and shorter repayment periods were to be required in the export market. These measures were undertaken to reduce accounts receivables.

Tighter payments would have a negative cash-flow impact on VTW's customers, particularly the smaller private farmers. Payments of up to one year's crop revenues would be required, up front, for tractor purchases. This would be difficult for most Russian farmers, and underscored the need for VTW to provide longer-term financing to help soften this cash-flow crunch to farmers.

h. Changing Corporate Governance Structures

The corporate governance structure at VTW was dramatically transformed as a result of privatization. In the past structure, the ultimate decision makers outside of the company were members of the company's supervisory ministry (the Tractor Ministry). Within the company, the Workers' Council, in parallel to the Management Board, had substantial corporate governance rights and management decision-making authority.

The SOE structure was replaced by a new joint-stock company organization. The new stakeholders in their respective roles were the shareholders, Board of Directors, Management Board, employees, and outside investors. As of May 1994, VTW was about 40 percent owned by outside investors,[4] hence the potential for outsider parties to exert pressure to maximize profits (enhanced shareholder value) had been introduced with privatization.

The overall activity and effectiveness of the Board of Directors at VTW is difficult to assess. Interviews with the company merely confirmed that the Board existed. The Board of Directors had only met once in the previous year,[5] while in principle it should meet once a month. It was not evident how much power the Board of Directors was exerting over the Management Board, as the vast majority of management decisions appeared to be taken at the General Director or Management Board level. It was also not clear how independent the Board of Directors was from the Management Board, as four members of VTW's Management Board were also on the Board of Directors.

Following privatization, in certain domains the VTW workers saw their decision-making rights within the firm increase, while in other areas these rights diminished. Controlling some 48 percent of the company's voting shares, the workers exercised their rights by helping elect the company's General Director on two different occasions. In addition, they had major voting power in the election the company's Board of Directors.

An area where the workers had diminished corporate governance powers was within the Workers' Council. While the Workers' Council had significant management input in the previous SOE structure, under the private structure the Workers' Council role was shifting to representing employees interests vis-a-vis management. The Council's direct input in management decisions had been reduced.

3. Lessons Learned from the Post-Privatization Restructuring Process

a. Lessons Learned

Privatization, By Itself, Did Not Solve Vladimir's Problems. As the case study clearly demonstrated, Mass Privatization, alone, was not a sufficient economic solution for Vladimir

[4] This compares with a Russia-wide average outside shareholder stake of 19 percent for privatized companies.

[5] The frequency of the Board of Directors Meetings might have been constrained in part by the fact that one of the Board members, the representative from Renova, lives in the United States.

Tractor Works. Merely shifting ownership to the private sector did not begin to solve the company's myriad of problems, some of which were actually brought on by privatization.

Vladimir Tractor Works faced a multitude of obstacles in the areas of profit/loss performance, marketing, access to capital, management expertise, condition of the plant, etc. In many ways the privatization transaction was the easiest part of the transformation process. The hardest steps remained to be done after privatization: restructuring the financial situation; revamping the accounting system; establishing a distribution network; energizing the marketing efforts; modernizing the plant; and spinning off the social assets.

All of these steps would be critical in making the transition to a viable private company. Probably the most important initial step taken in that direction was the election of Mr. Bakaleinik as General Director.

The Importance of Changing the Corporate Culture. One of the most critical lessons to be learned from the Vladimir post-privatization restructuring is that in order to make a successful transition to the market environment, the company's basic "corporate culture" needs to change.

The outside world surrounding Vladimir Tractor Works was changing rapidly at the time that the company was being privatized. The traditional domestic market for their products was collapsing, as tractor orders plummeted and customers could no longer pay for their products. As an SOE, VTW's supervisory ministry had handled marketing and another government ministry managed distribution. In the past if VTW ever came up short on cash, the Soviet Finance Ministry provided it with subsidies.

Faced with a sharp decrease in demand and hard budget constraints, it became clear that VTW had to quickly find new clients. In order to obtain new orders for their products, significant changes would be required in the way VTW conducted its marketing activities. It was also clear to the company's management that they would need to focus more on quality management and customer satisfaction.

The first step in changing the corporate culture was to issue an executive order stating the company's new objective was "to make money." VTW realized that aside from this broad mandate, there were many other changes that needed to be made in the way the company did business.

One of the changes it planned to introduce was the establishment of a new distribution and servicing network which would bring their products closer to the customers. In order to make tractor purchasing more feasible, VTW also anticipated establishing new financing mechanisms that would offer long-term finance and leasing options to customers.

Numerous other changes would be needed, including major steps to compress costs and increase efficiency. Tighter payment controls would be also be required. Social assets would have to be spun off. Vladimir also needed to look to new suppliers and introduce more competition among existing suppliers.

Essentially, the company had two basic options: either adapt to the new environment by changing fundamental business practices, or continue as before and go bankrupt.

Establishing a Plan: In order to be successful in their efforts to restructure the company, VTW knew that they would have to articulate a coherent strategy and plan. The plan would need to focus on what needed to be done to make the company more viable. They also needed to ensure that the employees "bought into" the plan. Without a "road map," the employees would know not know in which direction to move.

The General Director prepared an eight-point action plan for restructuring the company. The plan focussed on the following points:

- Redressing the Company's Liquidity Crisis
- Modernizing the Accounting System
- Energizing the Marketing Activities
- Introducing Tighter Payment Controls
- Becoming More Demanding With Suppliers
- Finding Investment Capital to Modernize Equipment
- Reducing the Work Force
- Cutting Back on Social Services

In connection with his eight-point plan, the General Director had an additional challenge: to prioritize these new corporate objectives. It was clear from the plan that changes in many areas needed to be introduced. No simple, one-step change could transform the company. Several fundamental changes would be needed in the short and medium term. The most urgent tasks, critical to the company's survival, would need to be tackled first.

b. Addressing Tradeoffs

In the Vladimir restructuring case study, a number of tradeoffs can be identified within the decision-making process of how to transform the company into a profit-making enterprise.

Painful New Measures Versus Status Quo: One of the most vivid tradeoffs in the Vladimir case study was the question of taking new painful measures versus maintaining the status quo.

This strategic dilemma was manifested in the Vladimir case by the competition for the job of General Manager between the incumbent general director and the Harvard MBA challenger. The incumbent's "campaign platform" promised more of the status quo -- including pledges of no worker layoffs, and no reduction in the social service sector. Mr. Bakaleinik, on the other hand, was very frank in his assessment of the magnitude of changes that would be required to make the company profitable. He warned the factory's workers that only tough measures would save the company.

Ironically, Mr. Bakaleinik considered himself fortunate not to have won the first election, as monumental financial problems surfaced almost immediately afterward. After confronting problems such as worker layoffs, working without paychecks, and temporary shut downs, the workers became acutely aware of the risk of bankruptcy. Fully aware of the company's precarious financial situation and what could happen if they continued to operate without structural changes, the workers were much more willing to give the new director a stronger mandate to change the company.

Social Welfare Versus Efficiency: A second tradeoff that VTW management faced was the conflict between the social objectives of the company (which were inherited from the past structure) versus the company's primary objective of making money (or in the short term merely survival).

VTW's social sector represented a substantial cost item which clearly affected the company's viability. If the company were to become profitable, it would need to cut back on these social services. Scaling back could include either selling these assets, giving them away free, or retaining them while raising prices to ensure they were financially self-sufficient.

The main candidates for divestiture would be the services that could be provided more efficiently by the private sector and ones which were not considered to be essential to the company's operations. VTW social services in these categories included: housing, farms, kindergartens, and sports and recreation clubs.

Eventually housing could be privately owned and maintained. Farms could be sold or given away to private farmers or collectives. Kindergartens could be transferred to the municipal government, provided additional budgets could be made available to them to maintain the pre-schools. Sports and recreation clubs could be sold to the private sector.

The company would probably need to maintain certain social benefits and assets which could not easily be provided by the private sector or ones which are mandated by law. Social services in these categories included: social security payments, pension, and health insurance. The health care clinic would probably also be retained by VTW for the time being, as it provided a vital role in the welfare of employees, and no private sector or municipal government entity presently had the capacity or willingness to take it over.

Reducing social services in the short term would be difficult because the workers were already hard pressed from their poor salary conditions. In addition, the municipal government was resisting attempts to transfer some of these assets to them due to their lack of financial resources to maintain the assets. Another problem was the fact that certain legislation compounded the difficulties of divesting of social assets. For example the Housing Code placed a number of restrictions on transferring or selling company housing. In addition, the land legislation was unclear about the processes of registering and selling land. This would complicate the sale of the company's farms.

The company had not finalized its decisions for the social sector at the time of the case study, but it had decided on the eventual necessity to scale back in this area. The company's management was aware that harder decisions would need to be made in this sector if the company were to become profitable.

It is likely that the implementation of such hard decisions would meet opposition from some of VTW's employees and managers, who still felt that the company had major social obligations to its employees. One of the challenges to management would be to convince employees of the need to cut back on these services, as they were imposing major cost and administrative burdens on the company. Scaling back these services would likely result in higher company profitability, which could eventually result in higher wages to employees and increased job security.

One of the lessons learned from this case is that the process of social service divestiture is much more complicated and time consuming than one might first estimate. The privatization process itself left unsolved most of the difficult social service questions. Subsequent efforts by the company would be required to resolve these issues. Based on the experience of this case, social service divestiture can be a major undertaking and is likely to take up a significant portion of the enterprise restructuring effort.

Foreign Versus Local Investment: Another tradeoff VTW faced in its restructuring decisions was the option of inviting foreign investment in the company, versus relying only on local

45

investment. A related question was if a foreign investor were desired, under what conditions would it be best to bring them in?

VTW felt that the types of foreign investors that would likely be interested in their plant were companies like Massey Ferguson or John Deere. VTW was aware that it had three strengths that might be of some interest to a foreign partner: (i) access to the potentially large Russian market; (ii) low costs of production that would make Vladimir tractors cost-competitive in both local and foreign markets; and (iii) the extensive, though older, production facilities which were capable of significantly boosting output in the short term.

The potential benefits to VTW from attracting foreign investment would be increased access to capital, management expertise, technology, and marketing distribution channels abroad.

These benefits notwithstanding, VTW management found some drawbacks to bringing in a foreign investor in the near term. First, they pointed out that no foreign investors had yet expressed any interest in a joint venture or other commercial relationship with VTW. Second, VTW management felt that in the company's present condition, it would not be attractive enough to a foreign investor. Instead, they thought it would be wise to first introduce improvements in the company's sales performance and profit/loss situation. In addition, VTW considered that the establishment of their own distribution network would be a pre-condition for attracting a foreign partner, if they decided to enter the Russian market.

Having considered these tradeoffs, VTW concluded that a foreign investor could be desirable for the company, but that they would prefer to pursue that avenue at a later date, when VTW would be in a healthier condition. This would place VTW in a stronger negotiating position with a foreign partner, and would also offer the VTW shareholders the opportunity to reap higher financial gains from their shareholdings in the company.

VLADIMIR TRACTOR WORKS

TEACHING NOTE

Case and Audience

The Vladimir Tractor Works (VTW) case study has been developed for use in privatization and post-privatization training programs. Program participants are likely to be government officials and legislators with responsibility for privatization or post-privatization programs.

Learning Objectives

The case has the following learning objectives:

(1) To show what problems the state-owned enterprises, established in a centrally planned economy, face in the new economic conditions.

(2) Compare restructuring options for an SOE vs. a privatized enterprize.

(3) Discuss how the mass-privatization can be a tool in facilitating the restructuring process of SOEs in Russia.

(4) Discuss and evaluate the restructuring tasks that VTW needs to undertake to succeed in the new competitive environment.

Discussion Questions

1. What are VTW's problems?

2. What are the underlying causes of these problems?

3. Is it possible for VTW to solve these problems as a state-owned company? Why or why not?

4. How can the strategy of the previous director be characterized?
   Why is it impossible under the current economic situation in case of the privatized company?

5. How does VTW have to be restructured if it is to survive?

   (a) What do you think is the proper corporate governance role for employees within the new joint-stock company structure?

   (b) What impact will restructuring have on the employees? What can be done to reduce displacement/restructuring costs?

   (c) What do you think is the best strategy for VTW regarding provision of social services? Of the social services VTW is now providing, which, if any, should continue to be the responsibility of the company? What would be a suitable strategy for VTW to divest its social assets?

   (d) Of the many problems facing VTW which ones do you think are common problems for any privatized SOE? Which of VTW's problems do you think are representative problems that any business might sometime be confronting? In which ways is the Vladimir case unique?

6. How does privatization help to the restructuring process?
   What in the new corporate structure makes the management to be more conductive to changes? What are the basic reasons for the management to be more economically responsible for the results of the activity of the company?

7. If you were Mr. Bakaleinik and were preparing the restructuring plan for VTW, what measures would you take to transform the company into a viable private company? In your restructuring plan, which issues need to be tackled right away, and which ones could wait for another year or two? Would you seek an alliance from a foreign investor?

Discussion

1. What are VTW's problems?

   The purpose of this question is to determine the need for restructuring of the company.

   - Markets have collapsed and the marketing department does not know how to expand sales quickly.

   - Deficient accounting system makes it difficult to know the company's exact financial position. Accounting is basically reduced to bookkeeping.

- Financial department doesn't have necessary experience to raise external financing for the restructuring of the company. Neither does it have experience in the management of accounts payable/accounts receivable. The company is choked in the liquidity crisis.

- The management team has few of the skills necessary to run a business in a market economy.

- The plant is overstaffed for current levels of output, but the work force is hard pressed and has to be treated fairly.

- The plant maintains an extensive and costly social service sector.

- The plant and equipment are outdated.

- Absence of the Corporate Development/New Business Department makes it more difficult to develop new product lines and conduct long term strategic planning.

2. What are the underlying causes of these problems?

The purpose of the question is to show that the company faces rapidly changing environment, in which the old structure proves to be inadequate.

- Collapse of the USSR.

- Opening of the economy, increased competition.

- Shift from centrally planned allocation of resources.

- Disruption of supplier's network.

- Bad financial situation of the agricultural producers.

- Diminished/weak access to capital (mainly commercial banks).

3. Is it possible for VTW to solve these problems as a state-owned company? Why or why not?

The purpose of this question is to show that if the company remained SOE, it would rely on the state in solving its crisis. The basic problems of the company would not be solved. Instead of it, the inefficiency of the company would be covered from the state budget or through intra-ministerial transfer of funds from the profitable companies. This way to tackle the problems might include:

- Subsidized loan from the government to cover losses from unprofitable lines of business and meet payroll obligations.
- Negotiate the price increases with the Ministery or try to negotiate the transfer of production orders for unprofitable products to other companies.
- Can undertake some cost-cutting measures, but doesn't have clear incentives to do so.
- Under no-layoff policy the company would be unwilling to cut the workforce, but most likely will be forced to cut real wages[1].

4. How can the strategy of the previous director be characterized?

The purpose of this question is to show that once VTW has become a private company, it has no choice other to restructure. If the enterprise chooses to follow old managerial strategies and avoid real structural changes, it inevitably chooses its own death. This question should focus on the measures which were undertaken by the previous Director General of the company and on the reasons why he failed. It is also important to show that the means he tried to use are the legacy of the old approach, which is inappropriate for the company in market environment.

Characteristics of the old approach:

- Attempts to solve the liquidity problems using short-term commercial loans loans.
- No-layoff policy.
- Continued maintenance of the extensive social sector of the company.
- No significant attempts to restructure the company.

[1] Real wage is the one adjusted for the inflation or price index. Therefore, if the salary level remains constant, in an environment where the inflation is running over 50%, leaving nominal wages unchanged would act to reduce them more than in half.

The problem with this approach, as the old company director found, is that the VTW is a private company under new economic conditions:

- State is unable and unwilling to provide the company with subsidized loans.
- Commercial bank loans carry very high interest rates on short-term loans due to high inflation expectations.
- The state does not provide the company with raw materials on fixed prices, nor it is able to buy the production of the company or to liquidate its accounts receivable.

5. How does the privatized company have to be restructured to survive?

(a) What do you think is the proper corporate governance role for employees within the new joint-stock company structure?

Under the new corporate structure the corporate governance rights would be changing in the following ways:

- Employees (who are not shareholders) would have limited rights in the areas of corporate governance.
- As shareholders, employees would be able to exercise various corporate governance rights such as electing the CEO and the Board of Directors, and approving changes to the charter and charter capital, etc.
- The Workers' Council would no longer have management input in the new structure.
- Employee issues would be articulated to management through the Workers' Council and labor unions, focussing mainly on job security, increased wages, working conditions, and social benefits.

(b) What impact will restructuring have on the employees? What can be done to reduce displacement/restructuring costs?

Impact of the restructuring on the employees.

The restructuring process can be accompanied by some layoffs or displacement and training of unproductive workers. The layoffs, though, do not appear to be an inevitable option in the economy with big unsatisfied demand for a large variety of goods and services. Therefore, with appropriate restructuring strategy and availability of capital, the company can keep its workforce. Nevertheless, only those employees, who are either already productive or can be retrained will be retained. The ones with poor morale or unable to acquire necessary skills will be forced to leave. It will contribute to raise in salaries of the productive employees as well, as raise morale.

Considering this issue, one should keep in mind, that the employees of the company are its shareholders as well. Therefore, all shareholders-employees will benefit from the rise in profitability of the company.

(c) What do you think is the best strategy for VTW regarding provision of social services? Of the social services VTW is now providing, which, if any, should continue to be the responsibility of the company? What would be a suitable strategy for VTW to divest its social assets?

A clear tradeoff exists between the social objectives of the company (which were inherited from the past structure) versus the company's new number one objective of making money.

Strategy for the Provision of Social Services

One of the challenges to VTW's management will be to convince employees of the need for the company to cut back on these services, as they are imposing major cost and administrative burdens on the company. The company will also need to assess what are the most appropriate means of obtaining these services from the private sector, the municipal government, or other sources. Salaries may need to be raised so that employees can shoulder responsibility for these new costs.

Strategy for Divestiture of Social Services

If the company were to become profitable, it would need to cut back on these social services. The main candidates for divestiture would be the ones which could be provided more efficiently by the private sector, or which are not considered essential services. In the case of VTW, they would include:

- housing
- farms

- kindergartens
- sports and recreation clubs

Several strategies in scaling back these services could include:

- selling these assets
- giving them away free
- retaining them while raising prices to ensure they were financially self-sufficient.

Social Benefits to be Maintained

The company would probably need to maintain social benefits which cannot be provided by the private sector, or which are mandated by law, including:

- social security payments
- pension
- health insurance

(d) Of the many problems facing VTW which ones do you think are common problems for any privatized SOE? Which of VTW's problems do you think are representative problems that any business might sometime be confronting? In which ways is the Vladimir case unique?

This question is intended to highlight the particular issues and problems facing VTW and other privatized SOEs, and to distinguish them from the common problems facing all enterprises. These distinctions are important since conventional business approaches may not be applicable for certain problems unique to former SOEs. In those cases, special approaches may be required.

There may also be some aspects of the Vladimir case that are unique to that company, different from other typical former SOEs. These points should be identified so as to avoid attempts to replicate approaches that may be uniquely applicable to Vladimir's circumstances.

Representative Problems Typically Facing any Business

- Cost compression

- Keeping tight payment controls

- Being demanding with suppliers
- Trying to boost sales
- Finding access to the cheapest source of capital
- Equipment modernization
- Work force downsizing

Common Problems Facing Privatized SOEs

- Changing the corporate culture
- Becoming more efficient
- Living with more competition
- Becoming more customer oriented
- Financial restructuring
- Reducing the work force
- Cutting back on social services

Ways in Which Vladimir Case is Somewhat Unique

- Former CEO resigned in frustration.
- The presence of two significant outside investors, who are also represented on the Board.
- New CEO has extremely strong management qualifications, and he has previous work experience at this company.
- CEO from outside, elected on platform to make painful changes to make the company more competitive.

- CEO has access to international financial and marketing networks, which is atypical for Russian CEOs.

- The size of VTW, the scope of its social sphere, and the impact of restructuring on the community are very large, even by Russian standards.

6. How does the mass privatization help in this change?

The purpose of this question is to show that in case of privatization decision-making system becomes more responsive to environmental challenges.

- Provides effective incentives system for the management.

- Introduces flexible system of establishing strategy/goals.

- Provides more realistic performance measures.

- Changes competitive environment -- opens new opportunities with suppliers, buyers, capital providers, investors.

- Establishes (in longer term) more liquid capital market.

- The company is fully independent economic entity responsible for it's own performance.

- Shareholder's wealth is directly dependent upon the economic performance of the company.

- The Board of Directors is elected and directly responsible to the General Meeting of Shareholders.

- The large portion of the financial rewards for CEO is comprised from the stock-option plan, which would rise in value in direct proportion to the profitability of the company.

- Interests of the employees of the company are fairly represented, since about 40% of the shares of the company are in the hands of the personnel.

7. If you were Mr. Bakaleinik and were preparing the restructuring plan for VTW, what measures would you take to transform the company into a viable private company? In your restructuring plan, which issues need to be tackled right away, and which ones could wait for another year or two? Would you seek an alliance from a foreign investor?

Changes Required to Transform the Company

The first question is the decision focus of Case A: How do you restructure the company to make it a viable private company. It should be clear from the case that changes in many areas needed to be introduced. No simple, one-step change could transform the company. Several fundamental changes would be needed in the short and medium term:

- Redressing the company's liquidity crisis through debt refinancing.
- Modernizing the accounting system through the introduction of new software, hardware, and technical assistance.
- Energizing the marketing activities through the appointment of a new marketing director along with a substantial increase in staff. New distribution and financing networks were also being planned.
- Introducing tighter payment controls through shorter repayment terms for buyers.
- Becoming more demanding with suppliers by introducing more competitive forces to the procurement of goods and services purchased outside of the firm.
- Finding investment capital to modernize equipment.
- Reducing the work force.
- Cutting back on social services by spinning off housing, kindergartens, and farms etc. to the workers or to municipal services as relevant.

Issues That Need to be Tackled Right Away

The second question challenges students to identify urgent problems areas which are critical to the short-term survival of the company. The following issues are probably the most pressing ones which require immediate action:

- Stabilizing the company's financial situation.

- Energizing the marketing activities.
- Modernizing the accounting system.
- Introducing tighter payment controls.

Issues That Can Be Tackled Over the Next Year or So

The other issues, while important, are less critical to the short-term survival of the company and probably can be tackled over the next 6-12 months:

- Becoming more demanding with suppliers.
- Finding investment capital to modernize equipment.
- Reducing the work force.
- Cutting back on social services.

Foreign Versus Local Investment

This question encourages students to consider the role that foreign strategic investors can play in the post-privatization restructuring of enterprises.

The potential benefits to VTW from attracting foreign investment would be increased access to:

- capital;
- management expertise;
- technology;
- and marketing channels.

VTW management also found some drawbacks to bringing in a foreign investor in the near term:

- No foreign investors had yet expressed any interest.

- VTW management wanted to first make improvements in the company's sales performance and profit/loss situation.

- By improving VTW's financial situation, VTW management hoped to place the company in a stronger negotiating position with a foreign partner.

- VTW management felt that the establishment of their own distribution network would be a key asset which could be used to attract a foreign partner.