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ENTERPRISE RESTRUCTURING AND PRIVATIZATION

Building in the Hungarian Ministry of Finance Capabilities to Privatize through Employee Ownership

Background

An important part of the GOH (Government of Hungary) privatization strategy is employee ownership of a significant percentage of the shares of privatized state-owned enterprises (SOEs). This objective was enshrined in the election platform of the ruling Democratic Forum party. It is backed by the GOH political commitment to powerful employee organizations which were instrumental in the struggle for liberation from Communist rule, and which insist on the employees ending up with a significant personal stake in the privatized SOEs.

Unlike Poland and Czechoslovakia, whose governments envision broad-based distribution of shares in privatized SOEs to all citizens free of charge through a coupon scheme, the strategy in Hungary has been to (1) channel ownership to the companies' own employees, and (2) have the employees pay for it. To help the employees pay for the shares, the GOH strategy includes share price discounts, credit facilities and tax advantages. Existing GOH legislation enables employees to purchase 10% of SOE shares for cash at discounts of up to 90%. Employees may purchase on credit further tranches at a 50% discount, as long as the total discounts amount to no more than 15% of the SOE net asset value. The GOH expects significant employee ownership to increase the employees' motivation and result in higher productivity and profitability.

Thus Hungary is the first CEE country to make serious strides towards involving the employees as stakeholders in privatization, and its experience is likely to have important repercussions in other Central European countries and in the Soviet republics.

The GOH has presented on Nov. 26, 1991 to the National Assembly the "Act on the Employee Shareholding Program" to encourage employee share ownership. The Ministry of Finance (MOF) had taken the lead in formulating this Act. Promulgation of this Act is expected by January 1992. This will make Hungary the first country outside the US and UK to have specific legislation to promote employee ownership.

Meantime, many SOEs targeted for privatization are demanding ownership stake for their employees. For example, the 2000 employees of the Herend porcelain factory are currently negotiating with a British bank a syndicated loan for a 100% employee buyout. At the Monor State Farm, the management demanded the consultants (Coopers and Lybrand/Chemonics) to prepare plans for a 30% employee buyout. Thus numerous precedent-setting transactions are under way, and employee ownership is at present a high-priority subject.

The MOF has requested technical assistance of the C&L/Chemonics team in designing mechanisms for implementing and supervising employee ownership. The C&L/Chemonics team is uniquely qualified to offer such technical assistance. A senior Chemonics employee (formerly principal consultant on the USAID-financed 30% employee buyout at the \$150 million Alexandria Tire Company, Egypt) - along with experts of the Hungarian "Share Participation Foundation", which will form part of the proposed C&L/Chemonics team - acted as advisors to MOF on formulation of the employee ownership legislation. The U.S. experts proposed on the team have extensive experience in the specific subjects in which assistance has been requested by the MOF.

ARTICLE 1. - TITLE

Project: Indefinite Quantity Contract for the Enterprise Restructuring and Privatization Project for Central and Eastern Europe.

Number: EUR-0014-C-00-1058-00

Title: Building in the Hungarian Ministry of Finance Capabilities to Privatize through Employee Ownership.

ARTICLE 2. - OBJECTIVE

The objective of the technical assistance is to provide the MOF with the capabilities for implementing a significant employee ownership program as a component of privatization. As a result of the technical assistance, MOF will have:

- a. a set of feasible options for financing employee ownership in Hungary, including the design of an ESOP loan guarantee fund if such fund is determined to be desirable for financing employee ownership;
- b. a definition of the necessary institutional framework for supporting employee ownership in Hungary - the roles to be played by different GOH agencies and other entities;
- c. model bylaws and statutes necessary for implementation of the employee ownership legislation currently under consideration;
- d. drafts of additional legislation (e.g. fiscal legislation) necessary to promote employee ownership;
- e. assistance in implementing a training program for the relevant officials, management and labor leaders in the aspects necessary for promotion, management and supervision of employee ownership programs; and

- f. generic systems for implementing in an employee shareholding organization (1) a system for managing the employees' accounts and (2) a system for employee communications.

ARTICLE 3. - STATEMENT OF WORK

The technical assistance interventions necessary to achieve the objective stated in Article 2 above can be divided into two phases:

- a. Phase I - preparatory activities for supporting the implementation of the employee ownership program;
- b. Phase II - supporting the implementation of the employee ownership program.

Phase I activities can take place either before or after promulgation of the employee ownership legislation which has recently been submitted to the National Assembly, while Phase II activities will be carried out after the promulgation.

The above objectives of the technical assistance could be accomplished through the following activities in the six fields enumerated in Article 2:

- a. Activities related to the financing of employee ownership (all of these activities can take place in Phase I):
 - (i) determine the feasibility of a guarantee fund and/or other risk-sharing arrangements which would encourage commercial banks to finance employee share purchase. In particular, assess the advisability of setting a joint guarantee fund for employee ownership loans, other privatization loans, and small enterprises, vis-a-vis setting a special guarantee fund for credits to employee ownership. Examine the possibilities to increase the effectiveness of a guarantee fund, e.g. through (1) financial leveraging and (2) limited guarantees. If the guarantee fund is found to be feasible, indicate the organization (existing or new) most suitable for managing it.
 - (ii) prepare a review of all existing resources in Hungary, such as laws, programs and capital market situations which can be used for financing employee ownership;
 - (iii) conduct a comparative evaluation of experiences in financing employee ownership in other countries in order to determine their applicability to Hungary;
 - (iv) based on the above evaluation, formulate one or several strategies for financing in Hungary a significant program of employee ownership and design

models for financing employee ownership, with plans for their implementation. Such models could include, for example: (1) the GOH "taking back paper" from employee groups for installment payments of the employee shares, (2) employee groups using credit provided by the existing and forthcoming legislation for share purchase, (3) the GOH lending funds received from other investors in payment for their shares to employee groups for financing share purchase.

- b. Definition of the institutional framework for supporting employee ownership (this should take place in Phase I):
- (i) contact the relevant actors -
 - (1) public-sector entities such as the MOF, SPA, State Ownership Institute, Ministry of Labor, line ministries such as Agriculture and Industry, the Courts of Registration, the Central Bank, state banks, etc.;
 - (2) private-sector entities such as private banks, NGOs such as the Share Participation Foundation, labor organizations, professional groups such as the Associations of State Farm Managers and of State Industry Managers, Chambers of Commerce and Industry, etc.;
 - (ii) in consultation with these actors, define the role which each should play in an integrated program to implement employee ownership, and propose a pattern for the evolution of leadership roles over time;
 - (iii) specify the functions of the unit in MOF which will be responsible for managing the technical assistance to the employee ownership process.
- c. Design of statutes, bylaws and regulations pertaining to the establishment of employee ownership organizations: These activities should best take place in Phase II after the basic legislation has been promulgated, and could include -
- (i) model statutes for a generic employee shareholding organization;
 - (ii) guides for the Courts of Registration in interpreting the relevant legislation; and
 - (iii) other regulations pertaining to the registration and supervision of employee ownership organizations.

- d. Drafting of additional legislation and policies to promote employee ownership, e.g.:
 - (i) fiscal measures to encourage employee ownership (these should be developed in Phase II, to be used as inputs to the 1993 tax legislation); and
 - (ii) other policies to promote employee ownership, e.g. policies enabling employees to obtain shares in settlement of certain obligations owed them by the government (such as severance pay, pensions, etc.).

- e. Training of relevant officials, management and labor leaders in the management and supervision of employee ownership programs will consist of the following activities:
 - (i) development of training strategy and action plans, identification of target groups, preparation of standard explanatory handouts and training materials, and training of trainers (Phase I);
 - (ii) implementation of the training according to the above plans (Phase II); such training will include (1) general information to government, management and employee representatives who are interested in implementing employee ownership schemes, and (2) technical information to personnel of the Ministry of Finance, Courts of Registration and other persons involved in implementation of Hungary's employee ownership program.

- f. Design of generic systems systems for internal management of employee ownership organizations (Phase I) will consist of the following activities:
 - (i) design of a generic accounting/administration system for an employee ownership organization, which can be adapted by user organizations to their particular conditions; and
 - (ii) design of a generic system for information to employees regarding the employee ownership scheme in their company.

ARTICLE 4. - REPORTS/DELIVERABLES

The deliverables listed below shall be prepared in both English and Hungarian and presented to the Ministry of Finance. Copies of all reports shall also provided to AID/RME and AID/Budapest in accord with the terms of contract no. EUR-0014-C-00-1058-00, section C.3.(c)(2).

a.(Phase I): A prefeasibility study of a guarantee fund and other risk-sharing arrangements which could assist the flow of credit to empoloyee share purchase. The study will (1) outline the available options; (2) discuss worldwide experience with similar mechanisms; (3) evaluate the different options in terms of probable cost, availability of financing, effectiveness,

financial viability, and permanence; and (4) recommend the appropriate option for detailed design. (The study should not exceed 40 pages).

b.(Phase I): A report which will list all existing resources in Hungary, such as existing laws, programs and capital market situations which can be used for financing employee ownership, and evaluate their potential usefulness (not to exceed 15 pages).

c.(Phase I): A report evaluating experiences in financing employee ownership in other countries, including an analysis of their potential applicability to Hungary (not to exceed 10 pages).

d.(Phase I): A statement of one or several strategies for financing in Hungary a significant program of employee ownership, including model(s) for such financing, with plans for their implementation (not to exceed 20 pages).

e.(Phase I): An organizational design for supporting the expansion of ownership in Hungary, outlining the entities which should be involved, the responsibilities of each, and the areas in which different entities should assume leadership in different times (not to exceed 20 pages).

f.(Phase II): Model statutes for a generic employee shareholding organization (not to exceed 30 pages).

g.(Phase II): Drafts of other regulations, guides and position papers necessary to support employee ownership, made upon request of the competent authorities and in collaboration with them (various documents, total not to exceed 30 pages).

h.(Phase II): Proposals regarding tax and credit policies as well as other policies (e.g. pertaining to the use of severance pay, pension funds, etc.) to encourage employee ownership, formulated in collaboration with the competent authorities (not to exceed 20 pages).

i.(Phase I): A strategy and action plan for implementing training in employee ownership subjects to government officials, management and employee leaders (not to exceed 15 pages).

j.(Phase I): Standard explanatory materials (in Hungarian) for firms interested in establishing employee ownership plans regarding the operation of such plans, the legal aspects, the financing possibilities, and other relevant subjects. The materials will include an explanation of the program and employees' rights and responsibilities in language accessible to the average employee (various documents, totalling at least 30 pages).

k.(Phase I): Training of Hungarian trainers in subjects regarding employee ownership (at least 30 person-days of training given).

l.(Phase II): Technical training seminars held for personnel of the Ministry of Finance, Courts of Registration and other officials involved in implementation of Hungary's employee ownership program, as well as general information seminars for management and employee representatives (at least 300 person-days of training given).

m.(Phase I): A manual of a generic system for internal administration of the employee accounts in a typical company and for providing systematic information to employees regarding their ownership scheme (not to exceed 200 pages).

n.(Phase II): In case the Ministry of Finance requests a follow-on phase, work plans for such a phase. Likewise, plans for technical assistance in employee ownership to other bodies such as SPA or the State Ownership Institute which may request such assistance.

ARTICLE 5. - RELATIONSHIPS AND RESPONSIBILITIES

Technical directions during the performance of this delivery order will be provided by Mark Karns, ENE/RME or his designee in the AID/Budapest office.

ARTICLE 6. - TERM OF PERFORMANCE

a. The effective date of this delivery order is January 1, 1991 and the estimated completion date is August 31, 1992.

b. Subject to the ceiling price established in this delivery order and with prior written approval of the Project Manager (see Block No. 5 on the Cover Page), the contractor is authorized to extend the estimated completion date, provided that such extension does not cause the elapsed time for completion of the work, including the furnishing of all deliverables, to extend beyond 30 calendar days from the original estimate completion date. The contractor shall attach a copy of the Project Manager's approval for any extension of the term of this delivery order to the final voucher submitted for payment.

c. It is the contractor's responsibility to ensure that the Project-Manager-approved adjustments to the original estimated completion date do not result in costs incurred which exceed the ceiling price of this delivery order. Under no circumstances shall such adjustments authorize the contractor to be paid any sum in excess of the delivery order.

d. Adjustments which will cause the elapsed time for completion of the work to exceed the original estimated completion date by more than 30 calendar days must be approved in advance by the Contracting Officer.

ARTICLE 7. - WORK DAYS ORDERED

a. Work days - separated into Phases I and II

	<u>Functional Labor Specialist</u>	<u>Work Days Phase I</u>	<u>Work Days Phase II</u>	<u>Total</u>
1.	Fin. Planner/ESOP Spec/Team Leader	62	58	120
2.	Economist/Proj. Coordinator	17	13	30
3.	Fin. Planner/Guarantee Fund Specialist	25	0	25
4.	Mgmt/Labor Relations Specialist	40	40	80
5.	ESOP Attorney	0	30	30
6.	ESOP Communications spec. (Labor Relations Expert)	15	0	30
7.	ESOP Training Spec. (Mgmt/ Labor Relations Expert)	25	30	55
8.	ESOP Admin. Spec. (Fin. Planner)	20	0	20
9.	ESOP Systems Spec. (Fin. Planner)	30	0	30
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	Total	234	171	405

b. Work days and cost - total Phases I and II

	<u>Functional Labor Specialist</u>	<u>Work Days Ordered</u>	<u>Fixed Daily Rate</u>	<u>Total,\$</u>
1.	Fin. Planner/ESOP Spec/Team Leader	120	\$854	102,480
2.	Economist/Proj. Coordinator	30	\$508	15,240
3.	Fin. Planner/Guarantee Fund Specialist	25	\$854	21,350
4.	Mgmt/Labor Relations Specialist	80	\$847	67,760
5.	ESOP Attorney	30	\$848	25,440
6.	ESOP Communications spec. (Labor Relations Expert)	15	\$848	12,720
7.	ESOP Training Spec. (Mgmt/ Labor Relations Expert)	55	\$848	46,640
8.	ESOP Admin. Spec. (Fin. Planner)	20	\$854	17,080
9.	ESOP Systems Spec. (Fin. Planner)	30	\$854	25,620
		405		334,330
	Total			

c. Work days and cost - Phase I

	<u>Functional Labor Specialist</u>	<u>Work Days Ordered</u>	<u>Fixed Daily Rate</u>	<u>Total,\$</u>
1.	Fin. Planner/ESOP Spec/Team Leader	62	\$854	52,948
2.	Economist/Proj. Coordinator	17	\$508	8,636
3.	Fin. Planner/Guarantee Fund Specialist	25	\$854	21,350
4.	Mgmt/Labor Relations Specialist	40	\$847	33,880
5.	ESOP Attorney	0	\$848	0
6.	ESOP Communications spec. (Labor Relations Expert)	15	\$848	12,720
7.	ESOP Training Spec. (Mgmt/ Labor Relations Expert)	25	\$848	21,200
8.	ESOP Admin. Spec. (Fin. Planner)	20	\$854	17,080
9.	ESOP Systems Spec. (Fin. Planner)	30	\$854	25,620
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	Total	234		193,434

d. Work days and cost - Phase II

	<u>Functional Labor Specialist</u>	<u>Work Days Ordered</u>	<u>Fixed Daily Rate</u>	<u>Total \$</u>
1.	Fin. Planner/ESOP Spec/Team Leader	58	\$854	49,532
2.	Economist/Proj. Coordinator	13	\$508	6,604
3.	Fin. Planner/Guarantee Fund Specialist	0	\$854	0
4.	Mgmt/Labor Relations Specialist	40	\$847	33,880
5.	ESOP Attorney	30	\$848	25,440
6.	ESOP Communications spec. (Labor Relations Expert)	0	\$848	0
7.	ESOP Training Spec. (Mgmt/ Labor Relations Expert)	30	\$848	25,440
8.	ESOP Admin. Spec. (Fin. Planner)	0	\$854	0
9.	ESOP Systems Spec. (Fin. Planner)	0	\$854	0
	Total	<hr/> 234		<hr/> 140,896

ARTICLE 8.-ESTIMATED TOTAL COST

We estimate the total cost of the level of effort for phases I and II plus other direct costs is \$600,000.

ARTICLE 9.-USE OF GOVERNMENT FACILITIES AND PERSONNEL

The contractor and its employees or consultants are prohibited from using U.S. Government facilities (such as office space or equipment) or U.S. Government clerical or technical personnel in the performance of the services specified in the delivery order, unless authorized in advance, in writing, by the Contracting Officer. This specific delivery order does not authorize use of such facilities or personnel.

ARTICLE 10.-EMERGENCY LOCATOR INFORMATION

The contractor agrees to provide the following information to the Mission Administrative Officer on or before the arrival in a Cooperating Country of every contract employee or dependent:

- a. The individual's full name, home address, and telephone number.
- b. The name and number of the contract, and whether the individual is an employee or dependent.
- c. The contractor's name, home office address, and telephone number, including any after-hours emergency number(s), and the name of the contractor's home office staff member having administrative responsibility for the contract.
- d. The name, address, and telephone number(s) of each individual's next of kin.
- e. Any special instructions pertaining to emergency situations, such as power of attorney designees or alternate contact persons.

ARTICLE 11. - DUTY POST

The duty post for this delivery order is Budapest, Hungary and Washington, D.C.

ARTICLE 12. - LANGUAGE REQUIREMENTS

There are no language requirements under this delivery order.

ARTICLE 13. - ACCESS TO CLASSIFIED INFORMATION

The contractor will not have access to classified information.

ARTICLE 14. - LOGISTIC SUPPORT

The following will be provided by the Ministry of Finance as requested by the consulting firm: occasional work area, access to documents and key personnel, and modest logistic support. The contractor is responsible for providing all other logistic support.

ARTICLE 15. - WORK WEEK

The contractor is authorized up to a six-day work week with no premium pay while in Hungary.