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FINAL REPORT

PROGRAM FOR INTENSIVE ENTERPRISE SUPPORT

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INTRODUCTION

This document is intended to serve as the final report on Bain and Company's Program for Intensive Enterprise Support (USAID Contract CCN-0005-C-00-3108; Task Order 17-0115-KPMG). The project began on April 4, 1995 and ended on June 21, 1996. The report is divided into four broad areas. The first area gives background on the project; the second gives an overview of the activities performed in the course of the project; the third area focuses on the deliverables; the fourth area deals with lessons learned for future projects designed to support privatized enterprises.

I. BACKGROUND

A. General Situation

With the exception of so-called "leased enterprises," the privatization of 13,000 medium to large enterprises began in Russia with the corporatization and privatization decrees of July 1992, continued through sales of shares to workers collectives, and was followed by sale of shares for vouchers beginning in December 1992 and finishing in June 1994. In addition these enterprises continue to sell blocs of shares for cash. The enterprises transferred to the private sector were ill-prepared to function in a transitional market economy. Training in, exposure to, and in-depth understanding of western financial, marketing, management and analytic concepts and techniques were minimal at all levels of enterprises. Enterprises were, in addition, plagued by high inflation, by the dislocations of supply and demand characteristic of a transitional economy, and by a constantly changing tax and regulatory base that was not particularly friendly to business and whose interpretation and enforcement at local levels was often arbitrary. The change in ownership had brought about increased pressure for change at some enterprises on the part of financial investors, but ownership and power lay for the most part with the upper management of enterprises and their employees.

B. Overview

1. Restructuring work

Since Russia did not possess either the institutional infrastructure nor adequate human and financial capital resources to support large scale enterprise restructuring, the Russian Government believed it necessary to provide technical assistance to privatized medium- and large-scale enterprises and to develop the institutional infrastructure necessary for the rehabilitation of these enterprises in order to compete in the marketplace. With these goals, the Russian government requested the United States Agency for International Development (USAID) to assist in the design and funding of a multi-faceted program of post-voucher privatization assistant that included:

1. the Russian Privatization Center (RPC) Grant

2. funding of certain start-up responses and an expatriate business advisor for Local Privatization Centers
3. International Executive Service Corps
4. commercial law reform
5. financial management legal and regulatory assistance, capital markets, asset sales and the restructuring of medium-to-large enterprises.

It is the restructuring of medium to large enterprises which was the focus of the Program for Intensive Enterprise Support, whose main goal was to commence addressing, on a limited but significant scale, pervasive problems of Russian enterprises, to document successful and "standard" approaches and solutions to them and to transfer know-how to managers and Russian consultants. The objectives were to provide for overall restructuring assistance, general strategic advice, the realization of specific enterprise level operational improvements, and the implementation of specific investments and development projects.

2. Project Rescheduling, Reduction, and Redefinition

Bain had planned to begin work at enterprises after a four to six week selection process. Given the number of enterprises interviewed and visited, eight weeks were necessary for the first round of selection process, and the process itself was organized efficiently by the Russian Privatization Center. Ratification of the initial choices was not, however, to come until July, so no enterprise work could be begun in the second quarter of 1995. Since the resources approved for the project did not allow us to work at all the enterprises simultaneously but required teams to work consecutively, Bain requested a 2-month zero-cost extension of its contract to June 30, 1996.

Due to funding cuts and internal USAID debates about P.I.E.S., the contractors were informed in January that each contractor would most probably do one less enterprise. This was not finally decided by the RPC and USAID for Bain's work until February 18. A proposal to reduce the P.I.E.S. restructuring budget and to codify the marketing work done by Bain for P.I.E.S. and the financial work done by Braxton/Deloitte Touche into a Toolkit was developed by Bain, RPC, USAID and Braxton/Deloitte in March 1996. This was approved, with the Toolkit being performed under a separate task order retroactive to March 1996. This latter task order was extended through September 30, 1996.

3. Staffing

Bain staffed P.I.E.S. fully from the permanent staff of its Moscow office, which has been working in Russia for Western corporate clients and international aid agencies since 1990. The only non-permanent Moscow employees were one Russian national who had been in the employ of Boston headquarters for two years who was seconded to P.I.E.S. for six months; six technical industry experts; and a Russian accountant who was an employee of Bain's joint venture partner in Moscow. Total level of effort was 4685 man days (as opposed to the contractual obligation of 4480) broken down as 1060 expatriate days and 3,625 Russian national days.

Bain teams, made up of Moscow based consultants, would commute to the regions for 3-4 days each week. As part of the conditions of participation in the program, the enterprises provided lodging, local transport, and board. Enterprises also provided the staff with an office in their headquarters building which were furnished by the enterprise and which the consultants outfitted with telefax, copier, computer, and printer.

4. Cooperation with the Local Privatization Centers

Both USAID and the RPC desired the active participation of the local privatization centers so that the contractors could benefit from the input and so that the centers would develop a better understanding of the restructuring process and increase their level of technical expertise. The location of Iletsk-Sol and PAZ--2 hours away from the centers--made intensive participation difficult, although representatives from the centers came to every presentation, participated in meetings with the RPC in Moscow, and were extraordinarily supportive in terms of the roll-out seminars. The Orenburg center even aided us in finding people to conduct customer surveys for the Saransk lighting factory. The Saransk privatization center seconded one employee, Nikolai Tsyganov, to work on customer and production analysis with the Saransklabel team, and the center director was very helpful in giving insight into the political developments in Mordova and at the enterprises. Their support for our seminars was also unstinting.

II. PHASES OF ACTIVITY

A. Selection

1. Process

Out of a total of 120 enterprises that applied to receive consulting assistance, it was planned that 18 would be able to receive such assistance. Bain & Company was to work with 5 enterprises (one of which was to be a "large" enterprise requiring more resources than the others), Carana/Arthur D. Little with 5, and Braxton/Deloitte & Touche with 8.

The second quarter 1995 was devoted to selecting enterprises that would participate in the Program of Intensive Enterprise Support, and indeed most of the enterprises that participated in the program were interviewed and visited at this time. The Russian Privatization Center and USAID approved a list of 8 participants in early July 1995, after which the consulting firms, together with the RPC, decided on the initial assignment enterprises to the consultants. A reserve list was in place for the second and third rounds of enterprise selection which took place in September and November 1995. Because of the financial condition of several of the enterprises at that time, it was decided to interview more enterprises in January and a final selection was made in February 1996.

The Russian Privatization Center, USAID, and representatives of each consulting firm participated in an enterprise selection process comprising three phases:

a. Initial Screening

The Russian Privatization Center, based on a review of the 120 applications presented the participating consultants with a list of 60 enterprises, together with full copies of the

applications and a series of operating and financial performance measures. Each consulting firm ranked the attractiveness of these potential participants and produced its own ranking of the thirty most attractive enterprises. These "Top Thirty" lists were compiled independently by the consulting firms, with the express purpose of developing different methodological approaches to the initial screening. All participants then met to negotiate a consensus "Top Thirty" short-list of enterprises, the managements of which were invited to Moscow for the next stage of the screening process.

b. Moscow Interviews

The "Top Thirty" enterprises were interviewed in Moscow by representatives of the RPC, USAID and the consulting firms. This was an opportunity to gauge management's competence, commitment to the project, and realism of expectations, as well as a forum in which to push for further details on the respective enterprises. Detailed interview write-ups were submitted on each occasion together with a recommendation on whether to pursue a site visit.

Bain representatives attended the Moscow interviews of the following enterprises in Moscow: Arnest, Belka, Dalpolymetal, Elvo, Fayans, Iletsk-Sol, Impuls, Iskoz-Tver, Kantex, Kuban, Kurgankhimmash, Lisma-Sels, Magnitogorsk Sewing Factory, Manotom, Miaselectro, Novokuibeshv Petrochemical Plant, Omsk Construction and Design Bureau, Orenburgmoloko, Orenburgsantechmontazh, Osvar, Pavlovo Autobus, Planeta, Plastik, Proletarian, Saransk cable, SAVMA, Sayanmramor, Sibelast, Stavropol Meat Factory, Temp, Transvit, Uralredmet, Volzhskprod mash, Zavod 411GA, Zlatoust Metallurgical Plant

c. Site Visits

Site visits were made to those enterprises that the consensus of the participants continued to rate as interesting. These visits were coordinated by the Local Privatization Centers of the respective regions and allowed an on-the-ground review of manufacturing facilities together with the opportunity to collect further data on the enterprises.

Bain participated in visits to the following companies: Arnest, Stavropol; Belka, Kirov; Elvo, Pskov; Fayans, Konakovo; Iletsk-Sol, Orenburg; Iskoz-Tver, Tver; Lisma-SELZ, Saransk; Manotom, Tomsk; Orenburgmoloko, Orenburg; Osvar, Vladimir; Pavlovo Autobus, Nizhny Novgorod; Plastik, Tula; Saransk kabel, Saransk; Sayanmramor, Khakassiya; Stroifarfor, Rostov-on-Don, Temp, St. Petersburg; Transvit, Novgorod; Uralobuv, Ekaterinburg, Volzhskprod mash, Mari El.

On conclusion of the site-visits a recommended list of enterprises was presented for the approval of the board of the Russian Privatization Center and USAID. The approved enterprises were then allocated by agreement between the consulting firms, with due consideration given to the consultants' preference and relevant experience.

d. Recommendations

Of the enterprises interviewed and visited, Bain recommended Arnest, Belka, Iletsk-Sol, Sayanmramor, Transvit, Saranskabel, Iskoz-Tver, Orenburgmoloko, Fayans, Osvar, Lisma-SELZ, Stroifarfor, Uralobuv, and Pavlovo Bus (as the best of the large enterprises).

e. Industry and Company Research

In support of the enterprise selection Bain undertook aggressive research of the industries and enterprises involved. Activities included: literature searches of national and local publications and brokers reports, interviews with industry experts and trade associations, collecting information from statistical bodies, and searching economic and commercial database surveys. This research greatly added to the information available in the standard application materials of the enterprises, and provided valuable insight into industry trends and key questions within Russia, as well as providing further background on the enterprise and managers under review. Thus briefed, Bain sought to maximize the value of the interviews and site visits by focusing on the emerging key issues.

Throughout the selection process this information was made available to the Russian Privatization Center, as well as to the consulting firms who began working with specific Russian enterprises in the third quarter 1995.

2. Selection Criteria

Throughout the selection process Bain's consistent criteria for selection were: 1) the degree to which management actively sought to participate in the program; 2) realistic expectations of management for the project; 3) an assessment of the fundamental attractiveness of the industry sector and its prospects against a background of a severe economic recession; and 4) an assessment of the actual operations of the specific enterprise and the degree to which improvements were possible given the resources and time frame of the project.

B. Enterprise Work

1. Enterprise Profiles

a. Iletsk-Sol

Iletsk-Sol is a salt mine and processing facility in the Orenburg region, 2 hours by car south of Orenburg in the town of Sol-Iletsk. It has two mine shafts and employs 1600 people. It is the major employer in the town of Sol-Iletsk (population 23,000). The enterprise has a capacity of 560,000 tons of salt per year, was operating at 84% of capacity in 1995, and produces a high quality industrial and food salt. Sales were approximately Rbl 67.1 billion in 1995. While it is a profitable enterprise, the mine facilities are antiquated and one of the two mine shafts was scheduled to be condemned as of January 1997 which would cause a reduction of capacity to 275,000 tons.

A team headed by Thomas Reiter, consultant, and the associate consultants Vladimir Bernstein, Katya Troitskaya, and Stanislav Marulin were on sight 3-4 days a week from August 9 through January 31. At various times they were supported by the associate consultants Alexander Gorbunov (financial analysis), Irina Shinkaryova, and Andrei Bobrovsky (supplier search), and Andrew Kaufman (market sizing model). The team's work was under the overall supervision of John Tokolish, Manager, who was normally on site for two days once every two-three weeks. Presentations were given on August 9, October 5, November 13, December 13, 1995 and January 31, 1996. Follow up visits took place on March 15 and May 30, 1996. Consultations were held with the management in Moscow in April 1996 about potential investors.

b. Pavlovo Bus Factory (PAZ)

Pavlovo Bus Factory (PAZ) is a manufacturer of small buses in the town of Pavlovo in the Nizhegorodskaya oblast, a 2 hour automobile ride from Nizhny Novgorod. It had traditionally dominated the suburban public transportation market and was relatively successful in breaking into the private corporate transport market. It employs 8,000 people in what is essentially a one-company town. Production capacity is 12,000 buses annually; in 1995, 7,700 buses were produced. Sales for the first 9 months of 1995 totaled Rbl 340.7 billion. By the time the project began, the enterprise was selling 80% of its goods for barter and its bank account was attached by the local tax authorities, causing the management to funnel sales through a sales affiliate.

A team headed by Sergei Savchenko, senior consultant, Victoria Moshashvili, consultant, and the associate consultants Mikhail Radik, Vsevolod Rozanov, Ekaterina Agapova, and Elena Livitskaya began work at PAZ on August 16, 1995. The work was under the overall supervision of John Tokolish through October 1995, when responsibility for the PAZ team was taken over by Thomas Shannon, Vice President. The team was on site three to four days a week until March 1996, beyond which time work continued by Sergei Savchenko and Victoria Moshashvili until May 1996. Presentations took place on August 16, October 3, November 14, 1995, February 20 and April 29, 1996. A follow-up presentation was held on July 31, 1996. The team was lodged in the vacation facility owned by the factory about 30 minutes from the enterprises.

c. Saranskabel

Saranskabel is a producer of a wide variety of power and telecommunications cables located in Saransk, the capital of Mordova. It employs 1600 people. In 1995 it produced 19,580 tons of cable, operating at 38% of capacity. Revenues were Rbl 129.1 billion. Saranskabel was a relatively prosperous enterprise who faced an uncertain future because of increased competition and had been talking with foreign equipment manufacturers without coming to a decision on a course of action for investment. It is notable for the order in which the facilities are kept and the extreme centralization of authority in the hands of the General Director as well as the weakness and relative seniority of the second-tier managers.

A team headed by Yuri Mashintsev, Consultant, and including associate consultants Aleksei Karavaikin, Alexander Gorbunov, and Andrei Li, began work at Saranskabel on September 9, 1995. They were joined by associate consultant Konstantin Zubanov in November 1995. The team and their direct supervisor Ben Burman, Manager, were on site 3-4 days per week until March 15, 1996. Presentations took place on September 9, November 2, November 9, December 6, 1995, February 10 and March 15, 1996. The team also provided support to investor presentations in April 1996, and follow up visits took place in April and July 1996.

d. Saransk Electric Lamp Factory (SELZ)

SELZ is a producer of incandescent and fluorescent lamps also located in Saransk, the capital of the Republic of Mordova. It employs 4,031 workers. It produced 17.4 million fluorescent and 132.3 million incandescent lamps in 1995, operating at 46% and 71% of capacity, respectively. Revenues in 1995 were Rbl 114.9 billion. SELZ was originally part of a lamp making conglomerate that included another producer of lamps in Saransk with more modern equipment. The companies were split up in 1991 which left SELZ dependent on the other lamp factory, now its competitor, for filaments. In addition, the company had embarked on a large capital expenditure program in 1995 that it financed with short-term bank credits. After a quick investigation of the financials after the project kickoff, it was clear that the company was, in fact, bankrupt because it could not make interest payments.

A team led by Tom Reiter (later replaced by Sergei Baida) and including Ekaterina Rudelson, Consultant, and associate consultants Vladimir Bernstein (later replaced by Katya Troitskaya), Philip Yalovega and Irina Shinkaryova began work on February 9, 1996 and were on site 3-4 days per week until June 21, 1996. The team was supervised by John Tokolish, who spent 2-3 days per week on site. Presentations took place on February 9, March 14, April 17, April 25, May 29 and June 20.

2. General Preparation

Parallel to the selection process, Bain began to pull together materials from its Moscow office, as well its worldwide network, that could be used on P.I.E.S. These included a compilation of data request forms and report templates that it could use for the diagnostic phase of the project. The aim here was to be able to "hit the ground running" once enterprise selection took place. Bain also performed extensive research into accounting and tax questions and organized a seminar--at its own expense--to insure a high quality of financial analysis once work with enterprises began. It also made use of its experience in Poland privatizing the cable industry by pulling together sample investment memoranda that could serve as models the Russian enterprises with which it would work.

3. Kick-off Presentation

Bain began immediately pulling together information from databases and literature searches throughout its international network and within Russia, as well as conducting industry interviews, to prepare presentations of two to three hours in length for top enterprise management that would: 1) explain the goals and plans of the P.I.E.S. project; 2) demonstrate what similar consulting projects had brought to other firms in their industries around the world; and 3) present initial hypotheses for work plans that would serve as discussion points to get management's input into the project planning process. It was very important to show the Russian enterprises that their consultants had "done their homework" and to establish a professional relationship with the first contact. It was also important to show the enterprises, who had never worked with consultants before, what types of work consultants could do for them. Presentations were made to the boards of directors as well as top department heads, and on average 25 people attended the presentations.

4 . Enterprise Diagnostic

Work began after the kick-off presentation with a 2-3 month diagnostic designed to give the consultants a thorough understanding of the enterprise in order to enable them to develop strategic recommendations as well as an implementation program for those recommendations. Each diagnostic consisted of the work streams listed below. The allocation of resources between workstreams was decided by Bain, the client and the Russian Privatization Center based on the needs and requests of the enterprise. The following is a brief description of the activities that normally took place as part of the diagnostic.

a. Industry/competitor analysis

Production and capacity utilization data was purchased from the State Statistical Bureau (Goskomstat) and analyzed. Ministry and industry officials were interviewed to understand the comparative positions of producers within the industries, as well as to understand current and potential developments. Literature searches were performed to understand current trends in the West as well as to gain an overview of the Russian market, especially with regard to competitor activity.

b. Market/customer analysis

Questionnaires were developed and surveys of up to 400 customers per enterprise were performed and analyzed. Enterprise data bases were reformatted to allow for analysis of customers by region, industry, level of sales, payment terms, etc. Models were developed, incorporating project survey results, interviews with industry experts, and research association studies, in order to forecast demand. These were crucial in proving to management that enterprise investments--especially those designed to increase capacity--were out of line with market needs and therefore not justified.

c. Marketing/distribution analysis

Customers, retailers and distributors were interviewed to determine customer, wholesaler and retailer buying habits (most important retail outlets, most reliable and

effective distributors). Distributors were interviewed to understand competitor promotion and advertising practices in order to adopt their competitors' more successful policies.

d. Cost analysis

Depending upon the emphasis at the plant, this could range from an analysis of existing cost information to determine what should be the focus of the enterprise's cost cutting activities -to- the construction of a computer model that derived costs from actual market prices, production levels, and usage rates, displaying a Russian income statement, a Western cash flow, and a Russian balance sheet that allowed for projections. Particularly effective was the use of break-even analysis to demonstrate the burden of high fixed costs, fixed costs being defined in various ways to reflect Russian reality (all labor or social asset costs).

e. Supplier analysis

Enterprise data was analyzed to understand where overdependence on too few suppliers might indicate that the enterprise was neglecting less expensive supply opportunities.

f. Liquidity/Financial/Accounting analysis

Financial statements, cost data, and statistical reports were analyzed in order to present to the enterprise a true picture of their cash flow. The effect of barter on the cash flow of the enterprise was analyzed, and for Saranskabel and SELZ a computer model was developed to show at what level of sales barter caused the enterprise to go cash negative. At PAZ, Bain consolidated the financial data of the enterprise and its trading subsidiary in order to give an accurate picture of the true cash flow of the enterprise.

Together with its accountant and lawyer, Bain examined some of the accounting and tax issues at the enterprises and identified areas where changes could either reduce taxes or prevent tax fines, such as the treatment of VAT on barter transactions, altering contract wording of major transactions, and adopting and applying consistent accounting policies, particularly with reference to inventory write offs.

g. Social assets analysis

At each enterprise the legal status and financial drain of social assets was analyzed in order to demonstrate the necessity to reduce costs in this area. At Ilets-Sol Bain conducted a survey of 300 employees to measure their approval of social expenditure line items and what they would like done differently.

h. Information and Financial Systems Analysis

Bain had originally included \$25,000 per enterprise in its budget for the acquisition of computer hardware and software for the upgrade of financial systems. When the P.I.E.S. budget was reduced, USAID informed Bain that these items would not be approved even though they had been in the original budget. By this time, however,

Bain had identified the needs at its enterprises and put together, after a survey of several Russian software manufacturers, proposals and workplans for software and hardware purchase, installation and training that would have improved the financial reporting of the enterprises.

i. Organizational structure/human resources analysis

Bain followed very much the requests of the individual managements in this area, which in most cases were limited to improving the organization and paper flows in the sales, marketing, and finance departments. This was done by mapping information and paper flows, as well as--in the case of marketing departments--identifying customer complaints and proposing corrections. SELZ requested Bain to analyze the division of responsibilities among the top management, and Bain responded by mapping the production planning process and conducting a series of interviews with top managers to understand the existing problems. The installation of a group to monitor barter transactions required the mapping of information flows between sales, finance and supply departments.

j. Manufacturing analysis

The Bain consultants did substantial work here in preparation for the visits of the production technical experts. This ranged, depending upon the enterprise, from mapping of the production process and identifying trouble spots to detailed analysis of the production process and conducting in-depth interviews to identify root causes of production bottlenecks, breakage and defective end products. The technical experts were used to help design process improvements as well as to reinforce Bain recommendations.

k. Legal analysis

Bain's staff lawyer in each case assembled a standard set of corporate documentation--privatization, environmental issues, corporate governance documents--for analysis. The purpose was to identify for the information memorandum issues of interest to a potential investor, to identify for the company any problems in its legal documents, and to help the companies bring their legal documents--especially their corporate charters--in line with Russian legislation. The companies especially appreciated assistance in the organization of shareholders' meetings. Improved standard sales contracts were normally designed for different transactions that protected the enterprises' interests while at the same time making the enterprises appear more professional to their customers. Contract registration was normally organized for the enterprise.

5. Identification and invitation of a technical expert

Bain had committed in its proposal to bring production experts with direct industry experience to each of the enterprises in which Bain was to work. It was foreseen that these could be outside subcontractors. As soon as Bain knew which industries it would be working in, it began the process of selecting a technical expert with manufacturing experience in the

appropriate industry. This began normally by contacting American industry associations, as well as consultants with relevant experience in the Bain network, to obtain the names of possible candidates. After receiving names, and sometimes resumes, from the industry associations, we contacted the experts by telephone to speak with them about the project, and to determine their qualifications and interest. With the exception of the PAZ consultants, who came for one week each, the industry experts came for two weeks a piece; they each submitted a technical report at the end of their assignment. The technical experts were:

Iletsk-Sol

Lawrence Thielgard, a 38 year veteran of the International Salt Company where he served in senior production and engineering positions at 4 salt facilities

PAZ

Ned Einstein, President of Transportation Alternatives, a consulting firm specializing in transportation system and vehicle design; Harry Einstein, of the same firm, with expertise in the tool and die industry; and Steve Kraus, an expert in bus and truck design and testing.

Saranskabel

Bobby Rowland, an independent technical consultant to the cable industry who was a 26 year veteran of the Southwire Company, the second largest producer of power cables in the U.S. He possessed experience in all aspects of the cable manufacturing process as well as new business development.

SELZ

Kevin Gallimore, a 36 year veteran of General Electric in senior manufacturing positions, including 2 years at the General Electric Tungstam facility in Budapest.

6. RPC Consultations

Before the monthly presentations, Bain met with representatives of the RPC in Moscow to go through the presentations and to discuss the progress (and problems) of the work. These were particularly helpful when the RPC could call on its previous restructuring experience to indicate what had or had not worked at another enterprise. These meetings were usually attended by representatives of the local privatization centers.

7. Implementation

Implementation, in the context of a technical assistance project, can take various forms depending upon the enterprise and the task. In P.I.E.S. activities included:

- a) Following through on one of the recommendations as a pilot to demonstrate to the company that a particular recommendation was feasible. Bain had made a recommendation to upgrade PAZ's distributor network and demonstrated how this could be done by identifying and negotiating with distributors in the Yaroslavl and

Volgograd regions. At Saranskabel Bain provided heavy support to a customer conference where customers not only reinforced the Bain recommendations about marketing and sales improvements but also signed contracts totally about \$20 million.

b) Putting together the necessary internal paperwork to make sure that an administrative decision is publicized and obeyed. A recommendation by consultants is more easily implemented if you provide all the paperwork--such as an administrative order, an organizational chart, and job descriptions, to a general director to sign off on. We did this whenever possible at each enterprise.

c) Internal lobbying for implementation. This can mean several one on one meetings with all members of the board of directors as well as second and third tier management in order to gain consensus. Reduction of an investment program or prevention of a dividend payment fall into this category of activity.

d) Designing a schedule and monitoring that the schedule is kept. Work plans are easily ignored if they are not monitored. Bain would often organize meetings regarding the reorganization of marketing departments presided over by the appropriate deputy director, in order to monitor progress.

e) Training of employees. This is not only formal training, which will be discussed below, but demonstrating such things as focus groups, which are actually very interesting to the enterprise, are easy to replicate, and are a good tool for market research.

f) Transmission of information memoranda and introductory calls to investors as well as meetings with potential investors. This is obviously limited by the readiness of a good deal. Bain had originally allocated more resources to this, but only one of our enterprises had a shoppable deal and we supported that as much as the foreign partner and Saranskabel wished. In addition we also provided introduction to members of the Moscow investment community to Iletsk-Sol as well as coaching PAZ management on meetings with foreign bus manufacturers.

g) Fine tuning of recommendations once implemented. For example Bain had identified a potential tax saving at Saranskabel and held follow-up meetings with the company's auditors to explore the issue further.

h) Putting in place a work plan. For all recommendations, even where Bain was not planning to devote its efforts during the implementation phase, this was done.

C. Rollout seminars

1. Preparation of Material

Together with the local privatization center, Bain identified topics from the P.I.E.S. work that would be interesting to a local audience and then prepared about 4 hours of presentation

material. The topics chosen varied with each region and were incorporated into the subsequent Toolkit project.

2. Seminars

These were held in the capital cities of the regions where P.I.E.S. work was taking place. The local privatization centers supported Bain on the logistics of inviting between 15 and 20 enterprise directors, organizing a facility and arranging for follow-up. The seminars were one-day affairs with breaks for lunch.

3. Follow up consultation

Bain consultants were made available to enterprises for 2 hour consultation sessions within 1-2 weeks after the initial seminar presentation. These consultations were held at the local privatization centers.

III. SUMMARY OF DELIVERABLES

As defined by the USAID Task Order, the deliverables were:

- To deliver four medium-to-large enterprises that are restructured and are operating along competitive western standards.
- A minimum of 30 managers, who as a result of this training are now administering enterprises utilizing new technology and management practices in a highly competent manner.
- To deliver to USAID and RPC, in both English and Russian, all relevant restructuring materials which are developed pursuant to the scope of work of this Task Order, and all company related briefing materials.
- Submission to USAID and RPC of the training materials developed under the Task Order, which include fully developed management texts, articles and generic training materials in Russian and English.
- A minimum of four manager-level training seminars for other enterprises which are not participating in the direct restructuring assistance of this Task Order (this may include the LPC's and Russian consulting firms not participating under the Task Order, as appropriate).
- This was supplemented by the RPC with the requirement that an Information Memorandum/Business Plan be produced for each enterprise as a culminating document.

A. Restructured Enterprises

The objectives of the task order were to "provide for overall restructuring assistance, general strategic advice, the realization of specific enterprise level operation improvements and the implementation of specific investment and business development projects." The following is a summary of the major achievements at each enterprise under P.I.E.S.

1. Iletsk-Sol

- a) The company has revised its marketing strategy based on an analysis of market demand and present customer base. It identified the most important customer relationships in terms of size of sales as well as the customers least vulnerable to competition. Especially critical for the company was to design a strategy to maintain its most important client relationships in 1997, when the mine must produce at 45% of capacity due to reconstruction, so that it would be able to revive its sales volumes with a solid base when the mine was back at full capacity. The company is focusing on its local regional market, large distributors and the food industry. Bain profiled an American fertilizer producer in a similar situation to demonstrate to the company its range of possibilities.
- b) The company radically revised its investment plans, originally in the \$50 million range, to a level that it could afford (\$1-2 million) and that would not increase capacity beyond present levels. The market sizing model demonstrated to the enterprise that there was no salt deficit in Russia but rather overcapacity. The enterprise is now negotiating with two German suppliers for equipment for the reconstruction.
- c) The company reorganized and enlarged the sales department by five employees, reconstructed offices for the expanded sales department, and upgraded the telephone network for them.
- d) The company is using a list of 8,500 potential industrial customers as the basis for a telephone sales campaign. It is using a reformatted receivables database to analyze customer payment history.
- f) Barter has been limited to only those goods that the company uses in the production process.
- f) The information flows within the accounting department and between the accounting and sales departments have been simplified, freeing up resources to perform analysis of financial and cost data, as well as eliminating inconsistencies in the previous cost analysis system.
- g) Standard contracts have been written, the legal department was restructured, and the proper organization of a contract register was instituted.
- h) The corporate charter was rewritten to conform with new Russian legislation.
- i) The company was provided with tax and legal advice to reduce the liabilities for tax fines (changing the procedure for recognizing revenue from barter transactions, for computing tax for sales of goods below cost, and correcting the internal procedures for handling cash).
- j) Recommendations were made for revival of the enterprise's preventative maintenance schedule.

2. Pavlovo Bus Factory (PAZ)

a) The enterprise has called a halt to its \$80 million renovation program to expand its production capacity and build a new paint shop. To assess the investment, we estimated the demand for small buses by the year 2000 to be 12,000, far less than the current industry capacity of about 30,000 (18,000 at KAvZ and 12,000 at PAZ). With such demand levels, PAZ would have to capture 100% of the market before it would need expansion. Further we demonstrated that there were no reasonable scenarios where the investment in the paint shop would provide attractive returns.

b) Bain developed a marketing strategy focusing on the development of the corporate transport segment in part through continued development of the PAZ distribution system. Historically PAZ only had a 30% share of the corporate transport segment vs. an 80% share of the public transport segment.

c) Bain identified the accelerated development and improvement of PAZ's dealer network as key for its survival in the future. It was PAZ's dealer network that distinguished it from its previously very strong competitor. The network, established in 1992, was selling 40% of the buses in 1995. To continue this development PAZ needs to add dealers to uncovered regions and substitute current dealers in the regions that are underperforming. Bain performed a pilot project, searching for and identifying a new dealer in the Volgograd region. This approach was then tested in Krasnodar by a joint Bain/PAZ team.

d) Bain has also developed an "ABC system" that would be beneficial to both the dealers and the plant. The ABC system provides a discriminatory discount system to three categories of dealers (A, B and C) based on their performance. The dealers were segmented based on four parameters: number of buses sold, barter vs. cash, prepayment vs. credit, and in case of credit, number of days outstanding. A separate discount is given for each of the parameters based on the dealer's performance the previous quarter; the discounts may be combined. New contracts were written to reflect the ABC system.

e) Bain introduced the concept of leasing to PAZ management and detailed the potential benefits to both PAZ and customers of using leasing as a financing mechanism. It also highlighted the opportunity to work with customers to develop commercial routes (using leasing) and thereby create sales opportunities for PAZ. One result of this initiative is that PAZ has provided 5 buses to a Moscow based company to pilot a commercial route project.

f) Bain developed a plan for the development of a spare parts supply system and technical service network.

g) A new incentive program for the sales department, recommended by Bain to increase cash sales, was approved by the PAZ management and the Human Resources Department was instructed to implement it.

h) The sales and marketing department was reorganized. Bain worked with the management to consolidate sales related activities which had been distributed across multiple departments. It also created a marketing department responsible for promotion, market research and future dealer development. It also developed an in-house database for use in customer satisfaction surveys and targeted sales campaigns.

i) In the cost accounting area, normative costs and allocation of fixed costs were adjusted to reflect actual usage rates.

j) Recommendations were made to reduce the workforce by 25-35% ,in part through attrition.

k) Support was given to rewrite the company charter in accordance with new stock company law

3. Saranskabel

a) The marketing department was reorganized and charged with market research, competitor monitoring, and new revenue generation responsibilities. A more senior manager was appointed to run it and a separate department for advertising was created. The deputy head of marketing was placed on an intensive marketing training program in the U.S. The development of new marketing materials and the successful funding of a three day conference with key customers was organized, at which contracts valued at \$20 million were signed or confirmed. An extensive survey took place of customer needs, and a sales drive targeted at a database of 300 prioritized potential customers was designed. The activation of former customer who had not made purchases in the past year was highlighted as a major target.

b) Manufacturing scrap cost reduction through altering scheduling and change over practices was implemented. These should save over \$100,00 per year in copper and plastic head waste scrap. The changes require only minor investments with paybacks of less than 3 months.

c) There was a reduction of unscheduled downtime and bottlenecks accomplished through a combination of minor investment in new die sets, better lubricant filtration systems and synchronizing line drive motors. The resulting productivity increases of up to 70% during the high demand summer months could translate into additional profits of between \$0.3-1.2 million

d) Proposals were made for a significant reduction in outstanding liabilities for tax penalties and the instigation of an aggressive tax minimization policy based on legal financial engineering and a standardization of accounting policy. One tax break of \$275,000 was legitimized through the revision of contract wording.

e) Barter control systems and the underlying economics--especially tax and cash implications--of current trading terms have been analyzed at the request of the General Director. New management information flows to properly control and account for these trades were designed.

f) A review was conducted of management information systems and recommendations made to purchase specific western financial control and reporting software. A detailed inventory of software was recommended, together with workplans for the establishment of a LAN at the plant and training of all personnel.

4. Saransk Electric Lamp Factory (SELZ)

a) A marketing and sales strategy was designed for the enterprise. Department stores, household products stores, and rural distribution outlets were identified as key retail outlets for incandescent lamp buyers, and a strategy was developed to target these distribution channels. In addition, the commodity nature of the product--both incandescent and fluorescent--lent itself to the organization of a sales force along regional lines, instead of the haphazard approach that the company was using.

b) A hiring freeze was implemented to immediately manage down head count through attrition and reduce costs.

c) Quality control of inputs to the manufacturing process was improved in order to reduce scrap rates and hence reduce costs

d) Processes were designed to reduce production costs through the reduction of scrap by constantly identifying, analyzing and correcting sources of breakage in the production process. Recommendations were made to improve both preventative and continual maintenance

e) A detailed computer model of business profitability and cash flow was developed and handed over to the plant finance department, which was trained on the spreadsheet program Excel and on how to manipulate the spreadsheet.

f) The sales department was increased by 10 people through internal hiring and a sales campaign based on a regional sales strategy was developed with the company.

g) The company is now using standard contracts drafted by Bain to streamline the sales-to-receipt payment cycle.

h) Recommendations were made to reorganize senior management, giving one deputy director total responsibility for production (it was spread among four people), dividing responsibilities between the Chief Bookkeeper and the Economics Director along traditional western lines, and to increase the role of marketing and sales in developing production plans. A case study of western lamp production planning procedures was provided to the enterprise.

i) Recommendations were made to eliminate dividends and freeze all capital expenditures to reduce the interest burden. These have only been partially implemented.

j) Recommendations were made to consistently adopt the LIFO method of accounting for inventory, instead of FIFO, thus giving a truer picture of profitability at the enterprise and to reduce taxes (under LIFO the enterprise would have shown a loss, which would have given a true picture of the enterprise and would have substantially reduced the tax burden).

B. Trained Managers

At Iletsk-Sol all materials discussing the financial analysis, investment program and marketing strategy of the enterprise were presented to the Board of Directors made up of 9 people and to the second tier management group of 25 people. Training in investment project analysis was given to the chief economist. Sales and marketing training was provided to 9 employees of the sales and marketing staff.

At PAZ the Bain team leader worked intensively with the 4 key managers at the enterprise in addition to giving its investment, production, and marketing strategy presentations to 15-17 board members. Sales and Marketing training was organized for 13 employees.

At Saransklabel all major presentations discussing analysis, methodology and recommendations were given to the 10 most senior managers at the enterprises. Discrete presentations were given on Competitor and Customer Analysis in front of an extended management group of over 40 managers. Twelve employees on the sales, marketing, financial and economics staff were in attendance at training sessions on Market Research, Advertising and Promotion, New Sales Lead Generation, Cash flow and Barter Analysis and Sales Call Practices.

At SELZ, in addition to using the presentations to the 5 key board members as a training opportunity, the team worked intensively with the finance director and the head of the planning and marketing departments. Internal marketing seminars were held for 8 marketing employees and sales training was given for 23 employees. A finance seminar was held for over 35 employees of the finance and accounting departments.

C. Delivery of Relevant Restructuring Materials

1. All kickoff, diagnostic, interim, and final presentations made to the enterprises were delivered to the RPC and to USAID. These give examples of, and methodology for:

- market sizing methodology
- customer, retail, and distributor surveys and analysis
- competition and industry analysis
- production bottleneck analysis
- production cost reduction analysis
- legal analysis, including contract drafts, contract register design
- accounting analysis, giving an overview of common mistakes in accounting and reporting
- organizational structure and production planning procedures

2. A financial project model, in written form and on diskette, was delivered that focused on investment projects

3. An integrated production cost/financial model was delivered in written form and on diskette, focusing on an enterprise as a going concern. This model allows the projection of production costs, a Russian income statement, a Western cash flow, and a Russian balance sheet.

4. A model was developed that demonstrates how an enterprise can determine its point of "barter break-even," i.e. at what percent of sales barter is no longer profitable

5. Four information memoranda were developed which can be used as templates for other enterprises

D. Training Materials

Within the framework of enterprise work, Bain teams developed a number of training modules that it has made available to the RPC and USAID. These are:

- 1) A 7-day course in Marketing and Sales with the submodules
 - Market Research
 - Competitor Analysis
 - Promotion
 - New Lead Generation
 - Sales Training, with emphasis on client retention and telephone sales and service techniques
- 2) Financial Statement Analysis
- 3) How to Analyze Barter

The lion's share of codification of P.I.E.S. work for training was removed from the P.I.E.S. task order and put in the aforementioned Toolkit task order.

E. Manager Level Training Seminars

Originally Bain was slated to perform one seminar for each region in which a P.I.E.S. enterprise was located. Since Bain was working with two enterprises in Mordova, the RPC gave permission to give only one seminar there. This was felt to be reasonable, given the number of seminars that Bain would be conducting under the Toolkit task order, including one in Mordova.

1. Orenburg

On January 24, Bain gave a seminar on market sizing models--why they were necessary and how to develop them--to an audience of 15 enterprises directors and local officials. The seminar was given by John Tokolish and Mikhail Radik, and was very well received according to the feedback forms distributed.

A week later, John Tokolish, Tom Reiter and Vladimir Bernstein held individual consultations with 5 Orenburg enterprises who had signed up at the seminar the previous week. While one enterprise was interested in constructing its own market sizing model, the other enterprises showed great interest in how they should segment their customers and organize marketing and sales efforts. It was the feedback from the consultations that gave impetus to Bain's proposals for developing a marketing toolkit, with a module devoted to organizing for sales and marketing.

2. Nizhny Novgorod

At the request of the local privatization center, instead of delivering an in-depth seminar on a particular aspect of marketing or finance, Bain delivered an overview of its work at PAZ, detailing its approaches, methodology, and the results.

3. Republic of Mordova

For Saransk, Bain delivered a two-part seminar for 12 enterprises on June 11. It delivered the "Organizing for Sales and Marketing" presentation and materials developed for the Toolkit task order as well as a presentation specifically developed for Saransk, "How Western Investors Look at Russian Financial Statements."

On June 25 John Tokolish held consultations for four Mordovian enterprises on the Marketing and Sales module. Of particular interest to the participants were more details on how to estimate the size for marketing and sales departments as well as on sales employee incentive programs.

F. Business plan/Information memorandum

The information memoranda for each enterprise were written with the most important audience for the enterprise in mind, so that some had an investor focus, others an internal management focus. All four were comprehensive documents prepared in English and Russian and given to the company on diskette so that they could continue refining them as their enterprises developed.

1. Iletsk-Sol

An information memorandum profiling the company was prepared as the first part of an investment memorandum for the mine shaft reconstruction project. A spreadsheet template was developed for the company to use once it finalized its investment plans, since the technical (and hence the financial) plans for reconstruction of the mine shaft had not been finalized at project end. The information memorandum was shown to a number of investment funds in Moscow who expressed interest in working with the company when the investment project was finalized.

2. Pavlovo Bus Factory (PAZ)

Based on the analysis performed, Bain has written a comprehensive investment memorandum, in English and Russian languages. This memorandum will allow PAZ to court foreign investors for potential joint ventures. Several foreign investors have already indicated an interest in PAZ, specifically in local assembly projects.

3. Saranskabel

The preparation of a detailed information memorandum--including market demand forecasts and competitor analysis--and a financial model was developed to test the business viability of a proposed investment project. The project was presented to several investment funds in Moscow and abroad. The potential foreign partner of Saranskabel invited Bain to give to road show presentations in Helsinki in April. Interested investors have been introduced to plant management and toured the facilities.

4. Saransk Electric Lamp Factory (SELZ)

Due to the improbability of attracting investment to a company with the financial difficulties of SELZ during the time frame of the project, the information memorandum was designed as a comprehensive business plan that analyzed all aspects of the company and incorporated--and reinforced--all recommendations made during the project. Although designed for an internal audience, the memorandum was given to the company on diskette so that it could eliminate any controversial items should it decide to circulate the memorandum to financing sources.

IV. LESSONS LEARNED

In the course of P.I.E.S. Bain consultants interviewed over 30 enterprises, visited over 20, worked at 4 enterprises, delivered seminars to over 40 enterprises and gave additional consultation to 10 enterprises. The following observations are based on that experience.

A. Selection

1. Clarity of project definition is essential before selection starts. The decision must be made whether the aim of the project is enterprise work as success story or enterprise work as controlled experiment for use as training case studies. The appropriate message then has to be delivered to the local privatization centers, who need to have a better understanding of what makes a good project and where restructuring resources are worth applying.
2. The net has to be cast widely. The number of enterprises at the beginning of the process will have a direct effect on the number of acceptable enterprises at the end of the selection phase.
3. By the second round of selection, it was clear that the consulting firms felt they could accomplish more with solvent enterprises, yet there were very few left in the process. This argues that solvency and basic demand for enterprise products need to be a more important criteria in the early phases of selection.
4. General director involvement and commitment are key. Second tier management is not enough. Based on our experience the power in enterprises is still concentrated to a great degree in one person, and if he is not engaged, there will be great difficulties, no matter how interested the second tier management is in making a success out of the project.

B. Enterprise Work

1. Project Design and Organization

- a. The longer the project duration, the greater the chances are for acceptance of recommendations. Unfortunately recommendations do not, in the Russian context, implement themselves; one needs to push them. This is what invariably suffers when a project is short. The consultants do not get the chance to demonstrate how a strategy will be effective, as the PAZ team was able to do for distributor development.
- b. Diagnostics should be shorter and ergo less ambitious to allow for strong support of a few deliverables
- c. Restructuring without money must be understood to be a limited exercise. The consultants do not really have an immediate carrot, and the medium term carrot--outside financing--was in short supply in the pre-election period. The only potential stick they have is to stop working at the enterprise, but the P.I.E.S. selection process did not really provide a list of enterprises to go to for 2-3 months should one of the originally selected enterprises prove recalcitrant.
- d. The expectation of an improvement in revenues given the continued decline in the Russian economy makes a project focusing on revenue growth very difficult to quantify. A success in Spring 1996 may in reality be the minimization of a revenue fall rather

than an increase in revenues. Cost reduction is more easily quantified in the current environment.

e. There should probably be more experience sharing between project subcontractors as well as between RPC projects. The contractors' meetings begun in January proved useful. Regarding information sharing between RPC projects, the PIES contractors could have used much of the educational material developed under a previous contract instead of reinventing the wheel; the material was distributed only after Bain, for example, had developed much marketing and sales material on its own.

2. Operating in the Russian Economy

a. Most enterprises have a generic set of problems with perhaps one or two twists that differentiate them from other enterprises.

b. Production tends not to be efficiently managed: scrap rates are unnecessarily high, even considering the age of equipment. Most companies do not bother with preventative maintenance, and do not have systems in place to constantly analyze and reduce scrap. The management of a constant drive for production cost cutting is uniformly inadequate.

c. Most enterprises have an investment plan which is either beyond their financial capacity, designed to add production capacity when industry overcapacity exists, or is misconceived with regard to actual consumer preferences.

d. Each enterprise has a barter break-even point, beyond which it is cash negative, no matter how good the profit and loss statement looks. Most companies need support in analyzing this.

e. Corporate governance and many financial disciplinary mechanisms are not working. Enterprise directors continue to get financing from banks and local authorities, even though they are technically bankrupt. Dividends are sometimes declared when the companies have a negative cash flow (for example at SELZ). The lack of discipline affects the better enterprises, because they are not rewarded by seeing their inferior competitors go out of business. Hence many conventional competitive strategies do not work when some competition is irrational, i.e. dumping is taking place intentionally or because of an incorrect pricing policy.

f. A frozen bank account will lead to all sorts of distortional behavior, since it makes no sense for the company to try to attract cash into the company since the bank or the court has decided who gets what funds and in what order. The tax system, with its emphasis on revenue and asset based taxes, as well as its disallowal of many expense items, has the same affect.

g. Not many companies at this point are able to get out of the doom loop of having taken out debt to finance salaries or incomplete investment programs. Bankruptcy is still, however, rarely used to force restructuring.

h. Social asset transfer to municipalities are difficult to implement without financial assistance. The issue of social asset responsibilities is normally shouldered by the wealthier of the municipality or enterprise. A social asset survey at Iletsk-Sol revealed that employees were willing to see social support cut in exchange for increased wages or for reduced but direct payments. This solution falters at the present in Russia because it requires cash, and companies are cash short because of barter.

i. While computerization is increasing, and enterprises are improving their data bases, they need assistance in order to link databases and to make their reports more user friendly. Enterprises probably need training in spreadsheet building and modeling. One very real enterprise need that is not addressed by the market is a medium-priced MIS packages. Most companies need a scaled-down version of SCALA or PLATINUM but cannot afford them.

j. Rural distribution is still not particularly effective, as we have found in our work at SELZ.

3. Effectiveness of Approaches at Enterprise Level

a. Owners with a purely financial interest in the company often are the most receptive audiences for consultant recommendations. We established a very strong relationship with the voucher investment fund at Iletsk-Sol, for example.

b. Boards of Directors whose members lack the most elementary management skills, especially time and process management skills, will not be able to continue implementation independently. We had great success with the Marketing Director at SELZ and the Commercial Director at PAZ, both of whom showed an ability to manage a meeting and understand how to push the process of change forward.

c. Much time is spent proving the obvious. It was obvious that all of our enterprises had unjustified investment (and dividend plans), yet we were forced to spend a lot of time displaying the direness of their financial situation.

d. Legal support is a valued contribution. The support of our lawyer was sought after, especially in preparation for annual meetings and corporate charter changes. In addition, contract rewriting and organization of legal documents was an area where most companies needed support and were glad to get it.

e. Managements are more interested in answers and are not particularly interested in participating in the process. Bain's approach is always to get the managers involved in designing process, but when a director is going from one crisis to another, he is more interested in being told what he should do.

f. Most enterprises need an increase in the sales force and this can also be accomplished by hiring within an enterprise. We have seen throughout the project sales departments that do not have enough people to man the telephones, let alone travel to regions to talk either to distributors or to customers.

g. Marketing is extraordinarily weak and training needs to be given not only to marketing departments but to entire boards of directors so that they understand that organizations must be marketing driven. There is still a confusion between marketing and sales, and much planning is still driven not by a marketing department but by a production department.

h. There is not much success with finding alternative suppliers. Most companies that we have seen have been actually rather good about examining potential alternative suppliers; they tend to be locked into existing relationships, however, because these arise due to the willingness of the present suppliers to accept barter.

i. Pre-project preparation is worth it. We were able to establish credibility by having researched our enterprise and its industry, both in Russia and the West, before we began work at the enterprise.

k. Accounting pointers and tax advice is welcomed by enterprises, where the general level of accounting expertise is still very low.

C. Rollout Seminars

a. Enterprises need more than 1-2 weeks to fill out the exercises in the training material.

b. The combination of Russian and Western presenters with Russian experience gives a good balance to the audience. The enterprises are skeptical of Western prescriptions; it is an easy way to excuse the enterprises for not having undertaken some of the measures described in the seminars. On the other hand, there is also skepticism about the depth of experience of Russian consultants, so that the Western consultant often adds credibility to the material, especially if one is talking about investment.

c. Enterprises like being talked to straight, without a lot of varnish. Particularly effective are not "prescriptive" presentations, but "negative examples," i.e. what other enterprises have done that is ill-advised. These seem to hit home more.

d. Enterprises also seem very interested in finding out what Western investors want and expect, again by "negative example." Fully an hour of questions was devoted to this in Orenburg.