Deloitte Touche Tohmatsu

PD-ABN-186

Program for Intensive Enterprise Support (PIES)

Final Report

Submitted by:
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Submitted to:

USAID/Moscow
USAID/ENI/PER/NISP

RUSSIAN PRIVATIZATION CENTER

July 8, 1996

Deloitte Touche Tohmatsu International

1. PROJECT OVERVIEW

This section provides an overview of the PIES project, a general description of the methodology employed, and a summary of the project's accomplishments.

1.1. Project goals and tasks

In early 1995, USAID and the Russian Privatization Center engaged Deloitte Touche Tohmatsu International to implement Task Order 16-0114-DTT, "Program for Intensive Enterprise Support (PIES)," under the Privatization of Civilian and Defense Industries contract. The PIES project has been a key part of USAID's multi-faceted program of post-voucher privatization assistance.

PIES is an intensive enterprise restructuring project. However, the project's goals extended beyond enterprise-level assistance to include the roll-out of lessons learned and successful methods to a much broader audience of Russian enterprises. The main objectives of the project were:

- To provide the following types of restructuring assistance to 7 (originally 8) medium-sized enterprises:
  - General strategic advice
  - The realization of specific enterprise level operational improvements
  - The launching of specific investments and business development projects
  - Achievement of "bankability," that is, the ability to secure medium to long-term finance in line with strategic corporate development requirements
- To document successful and "standard" approaches and solutions to the pervasive problems of Russian enterprises
- To transfer technical and managerial skills and know-how to Russian managers *and* consultants

From the beginning of the project, we were asked to focus our efforts on achieving real, concrete, positive effects at the enterprises such as:

- Radical reorganizations
- Introduction of new, efficient management processes
- Introduction of new management information and accounting systems
- Introduction of new technologies
- Cost reductions
- Productivity enhancements
- Profitability and or/sales increases
- Attraction of outside investment

Our success in achieving these and other concrete enterprise-level effects is documented under "Summary of Accomplishments," below.

Rollout

The rollout of lessons and effective practices to a broader audience of Russian enterprises subsequently became the focus of an entirely separate task order, also being implemented by Deloitte Touche Tohmatsu International. Under Task Order 19-0132-DTT, "Business Toolkit for Russian Enterprises," we have created and field tested six detailed training seminars for enterprise managers, in areas we have identified as critical to improving the performance of

Russian enterprises. The seminars each contain "tools" that enterprise managers can employ to implement the ideas presented. The following toolkit seminars were developed by Deloitte Touche Tohmatsu:

- Cash & Working Capital Management
- Cost Management
- Management Reporting Systems
- Obtaining Finance / Corporate Finance
- Product Portfolio Management
- Restructuring an Organization's Finance Department

These seminars have been field-tested in several regions throughout Russia, with highly positive results. Consequently, we are currently negotiating with USAID to extend the task order, to create two additional seminars, and continue the dissemination of all of the seminars. More detailed accounts of Task Order 19-0132-DTT are available in the deliverables specific to that project.

Multiple clients and their roles

As is typical for many development consulting projects, the PIES project had multiple clients. USAID served as the donor client, providing funding for the project. (NOTE: individual enterprises were required to share certain project-related costs, such as room and board for the consultants, local transportation for consultants, office space on-site, and secretarial support.) The USAID mission in Moscow also provided technical direction to the project at key stages.

The Russian Privatization Center served as the main technical managers of the project, and as one of the project's beneficiary clients. The RPC managed the enterprise selection process, and approved all of our diagnostic recommendations before delivery to the enterprises. Further quality control, facilitation, and logistical support was provided by the various Local Privatization Centers in the regions in which our enterprises were located.

The final beneficiary clients were, of course, the enterprises themselves. We provided intensive assistance to the following seven enterprises:

Enterprise name	Location	Industry
Almaz	St. Petersburg	Shipbuilding
Belka	Slobodskoy	Fur garments
Uralredmet	Ekaterinburg	Rare-earth and other metals
Fayans	Konakovo	Ceramic dishware
Uralelectro	Mednogorsk	Electric motors and starters
Plastik	Uzlovaya	Industrial plastics
Uralobuv	Ekaterinburg	Footwear

1.2 Basic Approach to Restructuring

We have applied the same standard enterprise work plan to each of our seven enterprises, tailoring it where necessary and appropriate to the specific needs of the company. The work plan itself can be seen in Appendix A, and a brief written explanation follows.

Phase One - Initial Assessment and Diagnostic Review

We began each project with an intensive Initial Assessment, during which the teams held a series of high level meetings with the general director and other key enterprise managers. The purpose of these meetings was to present the team members and the project, agree on operating procedures and logistics, and identify the most pressing needs of the enterprise by performing an initial data collection.

This was followed by an 8-10 week Diagnostic Review, during which a full team of consultants analyze all of the company's operations in detail. The Diagnostic Review typically included the following components:

- *Financial Review:* thorough analysis and translation of company balance sheet, cash flow, liquidity position, overall profitability, cost structure including cost/margin by product
- *Market Review:* extensive research on domestic and international market opportunities, major trends, competitor profiles, and customer profiles/purchasing criteria
- *Technological Review:* benchmarking of technological capabilities, production processes, efficiency and resource use against "best practices"
- *Organizational Review:* efficiency analysis of all key business processes, benchmarking against "best practices," review and analysis of social infrastructure and non-core production assets

The teams then synthesized their diagnostic findings into a set of strategic options for restructuring. The options were then evaluated, using financial projections and other standard evaluation tools, by the consultants in conjunction with key enterprise managers. The chosen strategy resulted in a set of specific recommendations for measures necessary to implement the strategy in all four of the areas noted above.

Phase Two - Implementation

During the Implementation Phase, the role of our consulting teams transitioned from intensive analysis to targeted support and assistance for enterprise management. The phase began with the consultants working closely with managers and staff of varying seniority to write specific action plans for implementation of the restructuring strategy, typically through targeted working groups, formed by enterprise management. The action planning process typically resulted in 20-25 detailed plans, including concrete timetables for realization and resource allocations.

The remainder of the implementation phase consisted of additional, targeted technical assistance with the realization of the action plans over a period of 3-4 months. Our activities during this phase varied according to the needs of each enterprise, but commonly included assistance with: design of restructured key process flows; new financial management and management information systems; writing business plans to attract/secure new financing; building and organizing new marketing and sales forces; and reorganizing shopfloor layouts.

Staffing Strategy

We found our optimal staffing mix to include both senior and junior consultants, Russians and expatriates, and industry experts as needed. Approximately half of the consulting effort was provided by Braxton Associates, the corporate strategy consulting division of Deloitte Touche

Tohmatsu. The remainder of the effort was provided by Russian financial specialists from Deloitte & Touche CIS in Moscow, and international development specialists from the ILA Group--the prime contractor. We found this combination of strategy, finance, language, and generalist skills to be highly effective.

1.3 Summary of Accomplishments

Early on during the PIES project, we worked with USAID to develop a project work plan according to a new format being used throughout the agency. As this report marks the end of the PIES project, it presents an excellent opportunity to revisit the work plan in order to measure the results of our work, and summarize our accomplishments.

The work plan format measures our accomplishments on two levels: the provision of quality consulting services, and concrete outcomes as a result of those services. Concrete outcomes are summarized on the first two pages of the work plan, while our consulting services are summarized in the Outcome Implementation Statement on the final three pages of the work plan.

Measuring positive outcomes is critical to measuring the project's success in meeting USAID's programmatic targets and indicators. In the case of PIES, USAID's main goal is to increase quality and/or reduce production costs at firms receiving US-funded training, technical assistance and equipment. This goal is embodied more concretely by two targets: actual declines in the real costs of products, and increased sales of main products. In our work plan, we have identified a number of concrete outcomes which indicate a contribution toward meeting these targets. On the first two pages of the work plan summary, we have indicated which of those outcomes have been met, and by which enterprises. It should be noted that each enterprise has different needs, and will achieve results at a different pace. Therefore, it is not surprising to have a scattering of outcomes across the enterprises.

In Appendix B we provide details of each outcome. Below are some highlights and observations:

- Perhaps the most dramatic outcome that we have achieved across the board is the commitment from top management to support the implementation of our restructuring recommendations. This has occurred even in the face of some difficult choices, including headcount reductions.
- We have achieved significant results in the area of organizational restructuring. Across the board we have been able to recommend and oversee implementation of redesign of organizational structures. Of particular note has been our success in the redesign of the finance and marketing functions.
- Where appropriate, we have succeeded in convincing management of the need to identify and eliminate unprofitable product lines. In the case of Uralredmet, this amounted to a radical program that was absolutely necessary to ensure short-term survival.
- Regarding marketing, we have been quite successful in getting enterprises to expand their market horizons, both domestically and internationally. On the domestic front, for example, Belka is implementing a new system of regional sales agents that will increase penetration throughout the Russian market. Internationally, a number of enterprises have greatly increased their participation in international fairs, and now do so with a much improved understanding of how to meet the needs of export customers.

- Attracting investors and financing can be a long and difficult process for a Russian company. However, several of our enterprises have been able to attract new financing very quickly on the strength of the restructuring plans developed in conjunction with the PIES consultants. None of the PIES enterprises were in a strong position to gain outside financing when we began working with them.
- Building on our successes during the Financial Management Assistance project, we have continued to improve the financial management practices of all of the PIES enterprises, by implementing modern accounting and management systems. This includes a uniform coded inventory system at Belka, completely redesigned financial processes at Uralredmet, activity-based costing at Almaz, and a cash flow forecasting model now being utilized by Uralobuv.

The Outcome Implementation Statement details the consulting services that we provided to each enterprise. As shown on the Statement, each of the PIES companies received a thorough diagnostic review, which included detailed assessments of their product lines, technological capabilities, domestic and international market opportunities, organizational structures, key business processes, social assets, cost structure, and financial position. Each enterprise received a diagnostic report which laid out a restructuring strategy and specific short, medium and long-term recommendations for implementation. Subsequently, each enterprise received technical assistance with the development and implementation of specific action plans.

Summary of Accomplishments
(using USAID Work Plan Format)

Project Name: PIES

Program Objective: Stimulate development of private sector enterprises

Country: Russia

Provider Name: Deloitte Touche Tohmatsu ILA Group Ltd.

Activity Number: 16-0114-DTT

Span of Workplan: 4/1/95 - 7/7/96

Enterprises Key	
1	Almaz
2	Belka
3	Uralredmet
4	Fayans
5	Uralelectro
6	Plastik
7	Uralobuv

Indicator:	Increased quality and/or reduced production costs at NIS firms that have received U.S. funded training, technical assistance, & equipment							
Target:	Real costs of principal products (i.e. significant share of enterprise sales) decline by 1996 (end of task order)	Enterprise						
	Marketed volumes of top quality products at assisted firms increased	1	2	3	4	5	6	7
Outcomes:	6 enterprises restructured corporate organization and management structure reflecting the relation of the enterprise to its markets							
	5 enterprises identified more profitable product lines and closed non-profitable lines							
	7 enterprises introduced new technology							
	7 enterprises developed or expanded marketing networks							
	0 enterprises successfully negotiated with outside investors and performed investment transactions as a result of these negotiations							
	3 enterprises increased their credit facilities with banks							
	Top management of 7 enterprises is committed to implement recommended changes							
	4 enterprises set up/began to set up a new partnership or JV							
	6 enterprises received major new orders securing medium term viability							
	? enterprises saw profitability increase substantially	Must await results						
	7 enterprises introduced modern management and cost accounting systems							

7A

OUTCOME IMPLEMENTATION STATEMENT

Category	Completion Date	Enterprise						
		1	2	3	4	5	6	7
RESOURCES								
Task Order Budget: $5.6 million	7/8/96							
Level of Effort: 5120 days								
COMPLETED & EXPECTED OUTPUTS - Tasks								
Phase One - Initial Enterprise Assessment	2/1/96							
Initial enterprise assessment, based on review of available materials on enterprise and industry, and interviews with enterprise management, conducted and findings presented to management of 4 firms.								
Phase Two - Detailed Diagnostic Review - Strategic	4/1/96							
Companies receive a complete Product Review, establishing technical characteristics, production requirements, closest competitor analogues, history and profitability of all recent and proposed products.								
Companies receive a Technological Review, assessing enterprise design and technological capabilities against "best practice in the world"								
Companies receive a Market Opportunity Evaluation, based on likely local and global demand, likely market share, customer buying processes, position vs. competitors, product adaptation possibilities and alternative product possibilities								
Technology gaps and initiatives required to close them are identified								
Productivity gaps and initiatives required to close them are identified								
Market opportunities and strategies for addressing them are identified								
Strategic blueprint addressing product markets, productive capability, cost-effectiveness, and competitive position is created								
Phase Two - Detailed Diagnostic Review - Organizational	4/1/96							
Internal processes are mapped in terms of efficiency, speed and accuracy, covering each key management activity: marketing, design, manufacturing, finance, overall corporate, and strategy development								
Gaps in capabilities and processes against "reference" western competitor are identified								
Strategic blueprint addressing and prioritizing changes required to internal management processes and structure is created								

Phase Two - Detailed Diagnostic Review - Financial	4/1/96	
Balance sheet, profit & loss, and cash flow are analyzed		
Sales, costs and profit forecasts, based on financial analyses and proposed strategies, are performed		
Phase Three - Development of Restructuring Plan	4/1/96	
Short-term intervention program is constructed, including initiatives needed for stabilization (e.g. costs, financials, sales)		
Medium-term build-up program is constructed, including initiatives need to build core competencies in line with strategy (e.g. technology, cost, financing, organizational)		
Long-term repositioning program is constructed, including identification of new products/markets, additional core competencies to build, long-term organizational changes and capital investment		
Phase Four - Implementation and Handover	7/8/96	
Action plans written		
Review workshops organized to monitor plan execution		
Implementation of enterprise restructuring plans is handed over to IESC executive		
Other Key Tasks	7/8/96	
Enterprises' social assets are surveyed, including analysis of size, costs, transferability and disposability		
If appropriate, enterprises receive assistance in seeking investors, negotiations with investors, preparation of investment documentation, transaction implementation and closure		
5 manager-level training seminars are organized and held. Training materials are distributed to managers of more enterprises		N/A Spun-off into Task Order #19
8 enterprises are chosen for participation in the PIES project		Budget rescinded for 8th enterprise
USE OF OUTPUTS		
Site 1: Almaz Shipbuilding, St. Petersburg	6/1/95 to 3/25/96	
Site 2: Belka, Slobodskoy	8/14/95 to 5/3/96	
Site 3: Uralredmet, Ekaterinberg	9/4/95 to 5/15/96	
Site 4: Fayans, Konokovo	10/25/95 to 5/31/96	
Site 5: Uralelectro, Mednogorsk	1/15/96 to 7/8/96	
Site 6: Plastik, Uzlovaya	2/5/96 to 7/8/96	
Site 7: Uralobuv, Ekaterinberg	2/20/96 to 7/8/96	
OUTCOME ACHIEVEMENT		
See previous page for summary of Outcomes. Details available in Appendix B.		

2. LESSONS LEARNED

The experience of the PIES project suggests a number of lessons learned. During the PIES project, consultants worked with companies in a wide range of industries and regions, with varying styles of management, and differing relationships with shareholders. Thus, although the project related to only a small number of companies, patterns emerged that are applicable to a wide range of enterprises in Russia. The PIES project has set a baseline of expectations for the problems which enterprises in Russia typically face, and how best to deal with them. Having this baseline will enable future enterprise restructuring projects to analyze an enterprise's strategic position quickly and accurately, and to devise effective strategies for improvement. This section outlines those lessons, explores the sources of difficulties for today's Russian enterprises, and explains our general approach for addressing them.

2.1 Summary of major lessons learned

Lesson One - The Soviet legacy has left enterprises poorly structured and positioned

Most Russian enterprises have problems which stem from inadequacies in organizational structure and management practices inherited from the Soviet period. These structural problems and deficiencies in basic business processes left many enterprises unable to cope with the shock of transition to a market economy. The consulting teams have identified a syndrome endemic to Russian enterprises in need of restructuring. Enterprises experience plummeting sales and a liquidity crisis (or a reduction in working capital), which when coupled with an unchanging or worsening cost structure and the lack of an effective pricing policy, can threaten the enterprise's very existence. The enterprises lack the financial means to correct their decline in competitiveness, unless they undertake radical change. Restructuring must therefore address each aspect of the syndrome: establishing an effective marketing and sales function with a strong distribution network, creating a market-oriented organization capable of generating attractive and cost-competitive products, introduce market-driven pricing processes that truly reflect customers' expectations and product value, organizing financial activity to manage cash and working capital effectively, making the necessary preparations to attract investment, introducing management systems to monitor, control, and optimize the cost structure, and making the difficult decisions to achieve major cost reductions.

Lesson Two - The problems of Russian companies can generally be addressed by three restructuring strategies

The D&T/ Braxton consulting teams have identified a series of strategies that can help bring enterprises out of crisis and put them on the path of increased competitiveness and sustainable growth. Although the time frame of the project has been too short to judge the ultimate profitability of businesses that undertake restructuring strategies, already significant improvements have been observed at enterprises that have implemented the recommendations of the project teams.

The restructuring strategies must, however, be tailored to the enterprise's particular position: the PIES teams have identified three major types of strategies appropriate for the position of enterprises in particular types of situations:

- ***Turnaround.*** Enterprises on the verge of bankruptcy need to implement radical turnaround strategies immediately. A turnaround strategy could entail shutdowns of major parts of the business, other cost reductions, rigorous cash management, and short-term revenue generation.

- ***Unstable.*** Other enterprises may be unstable but without such an imminent threat of a shutdown; these require short-term revenue generation strategies. These strategies involve an increased focus on the most profitable product lines and the rationalization of secondary activities, efficiency improvements in production, and efforts to expand into new markets.
- ***Short-term stable.*** A third type of enterprise may be stable in the short term but would benefit from a medium-term repositioning strategies to correct longer-term problems. This is primarily oriented toward preparation to target new markets, improve performance, and preparing for longer-term investments. A distinct type of restructuring strategy, therefore, is appropriate for a particular type of firm, given its strategic position.

Lesson Three - Training in basic business skills is essential for successful restructuring

Training in a number of basic business skills is essential for enterprise staff to implement recommendations for restructuring. The PIES project teams have endeavored not only to identify recommendations, but also to work with enterprise management and transfer the know-how necessary to put these ideas into practice.

Lesson Four - Effective change management is essential to assure the success and continuation of restructuring efforts

An effective change management process that is suitable for enterprises operating in the Russian environment increases the likelihood that recommendations will be implemented, and that enterprise restructuring will continue even after the completion of the consulting project. Change management involves not only establishing a constructive relationship between consultants and management, but creating a self-sustaining process within the enterprise to overcome obstacles, solve problems, and create lasting solutions. Establishing a change management process has been integral to every project, though success in restructuring depends a great deal on management's commitment to restructuring from the outset.

Lesson Five - Shareholders can facilitate restructuring

Supportive shareholders can facilitate restructuring. Indeed, in some cases, active shareholders can force change from the outside over the objections of management. Conversely, when shareholders fail to provide support, management may hesitate to make the tough decisions necessary, or may even face obstacles to doing so.

Moreover, shareholders may be able to draw lessons from successful restructuring at one enterprise and utilize the information to promote change at other enterprises in which they have a stake. This role, though just beginning, may be important in disseminating the lessons learned among private enterprises in Russia.

Lesson Six - Enterprise selection efforts should concentrate on measuring management commitment and financial condition of the company

In setting up enterprise restructuring projects such as PIES, enterprises should be selected to participate which have significant management commitment to change, and which do not have such a severe financial crisis as to preclude the possibility of a successful project. Management commitment is essential for insuring cooperation with consultants and for guaranteeing that restructuring suggestions will be implemented. While technical assistance should be provided to support struggling enterprises, limited resources should not be expended on enterprises with little chance of survival, at the expense of companies that could use the assistance to become viable in the long run.

Overall, the PIES Project suggests that enterprises struggling to survive the transition to a market economy in Russia face similar problems, and the experience of PIES suggests a number of strategies for implementing restructuring successfully. Despite the unique features of the Russian environment, Western consultants can make a positive impact in helping Russian enterprises devise strategies, reorganize corporate structures, and gain the skills necessary to cope with these challenges. It is perhaps too early to measure the positive results of restructuring strictly in financial terms. What is clear, however, is that each of the enterprises participating in the PIES project has defined a strategy for repositioning to survive the economic transition and prepare for long-term profitability, reprogrammed its organization to become more market-oriented, enhanced the quality of its staff through training in essential business skills, and in general taken the first steps necessary to become stable, market-driven companies.

2.2 The Soviet legacy

All enterprises inherited a number of deficiencies as a result of their development in the centrally planned economy of the Soviet period. A systematic examination of the failures of the Soviet system is clearly beyond the scope of this report, but some important areas deserve to be highlighted.

Marketing & Sales

The first group of deficiencies is related to the weakness of the marketing and sales function, when it exists at all. These deficiencies can be summarized as follows:

- Lack of market research capability
- Lack of aggressive sales force
- Lack of an independent distribution network
- Lack of market analysis skills
- Lack of a consistent market-oriented process for product portfolio management
- Lack of market forecasting methodology and inadequate role in production planning
- Lack of ability to determine pricing in a market environment
- Lack of service mentality or a focus on customer requirements
- Lack of capability in merchandising, advertising, and other promotional activity

In the Soviet system, enterprises traded primarily with state intermediary organizations, through ministries and other state structures, or through nationally organized state trade fairs Large sales forces and independent distribution networks were not needed. The volume of purchases of a company's products by state distribution organizations was largely predetermined during the course of state planning every year. Moreover, the Soviet economy was a shortage economy, with too few products supplied to satisfy the level of demand at state-mandated prices, so consumers and industrial purchasers had little alternative than to purchase essentially whatever was supplied and available. The purchase of a company's products therefore was virtually guaranteed, provided they met state norms. Consequently, companies had little need to be concerned about competitiveness or customer satisfaction.

Likewise, production activity and product characteristics tended, on the whole to be production- rather than market-driven. The Soviet system provided incentives for maximizing production, fully utilizing equipment, employing a maximum of labor resources, and utilizing whatever material inputs were available. There were no market signals forcing companies to adjust products and production processes to satisfy consumer tastes, minimize costs, and generally respond to customer needs. As a result, Soviet enterprises neither developed the market research functions to gather market information, nor took the steps necessary to respond to changing market demands.

Finance

Another legacy of the Soviet period is the lack of an adequate finance function:

- Accounting systems developed for tax reporting and not for informing management of operations and results
- Lack of effective cash budgeting
- Lack of ability to assess the level of cash/barter operations and insure that the enterprise maintains an adequate supply of cash
- Lack of ability to effectively collect debts (receivables) and credits

In the Soviet system, enterprises did not have all of the financial functions necessary to operate independently, and many financial functions were provided by state banks or other state agencies. Enterprises served various public functions and received state subsidies, and therefore part of their financial activity was treated as public budgetary activity. Enterprises faced no hard budget constraints; in fact the measure of success or failure was primarily the achievement of material output targets relative to the state plan rather than generation of profit. Accounting statements were used essentially for calculating tax obligations, which, as in the West, created a bias toward minimizing tax obligations rather than providing an accurate description of activities to managers. As a result, enterprises failed to develop sophisticated managerial accounting systems with detailed information on accounts, product profitability, cash forecasts, variance analysis, and a host of other analyses. These analyses are essential for making managerial decisions in a market economy.

Cost control & efficiency

Enterprises also inherited from the Soviet period a lack of market-oriented, cost-minimizing production processes. This includes the following:

- Orientation of production toward meeting state specifications, rather than market requirements or demands
- Distortion of cost structure under market prices, resulting from previous subsidy of inputs (e.g. energy)
- Development of product models insufficiently linked to production/market needs
- Excessive upstream vertical integration

- Production-driven planning with orientation toward operating at maximum capacity, irrespective of market requirements
- Incentives to increase/retain staffing and not to produce efficiently; lack of Western efficiency benchmarks

Enterprises were required first and foremost to follow state guidelines for production and achieve material output levels according to state plans. Consequently, cost-engineering remained undeveloped. Typically product designers worked in relative isolation, without cost guidelines or market-influenced design specifications. The costing process began only after prototypes were already developed: first direct costs were calculated, then indirect costs for the workshop and for the factory as a whole were added, and finally the cost was multiplied by a predetermined percent profit to arrive at a price. Some adjustments might be made afterwards, if the price appeared to be uncompetitive (or in the worst cases, adjustments might come later only after the products were introduced and sales were found to be lacking). In any case, enterprises did not follow a targeted price model, in which prices are determined first, by researching the market, and then products designed to insure that costs are minimized. Russian firms did not determine profit (or contribution to fixed costs) utilizing marginal, avoidable, or full absorption costing models, as is typical in developed market economies.

Many enterprises also were excessively vertically integrated. In-house production ranged from foundries and energy supply to tool-making and machine repair. Many of the intermediary goods or services produced at the PIES enterprises would have been contracted out or purchased by an analogous Western firm.

Aside from the major structural inefficiencies in costing mentioned above, the cost structure of Soviet enterprises was distorted relative to similar companies facing world market prices, due to subsidies and price controls on key inputs. This cost structure turns out to be suboptimal in a market environment, once subsidies and price controls are lifted.

Efficient production was also hindered by conflicting power bases among departments within the organization. Production departments tended to be the most powerful, with the Chief Engineer frequently assuming a role second only to the General Director, so product selection, determination of product characteristics, establishment of production plans, and other key decisions were driven primarily by the production department rather than by marketing and sales. While centralized planning required enterprises to supply a consistent minimal level of production, enterprises functioned more efficiently by maintaining full production capacity. When economic reform began, however, true market demand determined what was purchased. Moreover, during the difficult transition period, consumer and industrial purchasing power dropped, and enterprises quickly found themselves with huge reserves of unpurchased inventory, unable to generate the revenue necessary to cover the costs of maintaining production of previous levels and lacking the "free market reflex" of responding by liquidating these inventories at reduced prices. Unfortunately, many managers retained their Soviet-era commitment to maximizing output, lacking the necessary data or knowledge of market processes to convince them to change their course.

One should also note that enterprises frequently received greater budget allocations and other support in proportion to the number of people employed by the firm. This created an incentive for overstaffing. Measures of productivity were unimportant, while the primary emphasis was on meeting targets set in the state plan.

Organization

Additional problems concern organization, management, and personnel

- Excessive centralization of management, with too many departments reporting to the General Director
- Burden of social sphere on the enterprise cost structure
- Lack of incentives to maximize quality and/or sales performance
- Lack of initiative from below, and lack of trust by top management to delegate tasks

2.3 The shocks of economic transition

All enterprises faced a number of external shocks with the collapse of the centrally planned economy. State entities that had previously provided directives, information, subsidies, supplies, and distribution disappeared almost overnight. While some of these agencies assumed new forms, not all enterprises were adept at maintaining contacts. At the same time, new market institutions were only gradually evolving to take on the roles that state administrators had fulfilled, such as guaranteeing the enforcement of contracts and overseeing the collection of debts.

Now enterprises suddenly had to face market forces. Competitiveness became an issue, and many enterprises were unprepared to face competition on price, quality, servicing, distribution, and a whole host of other factors that influence customer behavior in a market economy. On the supply side, enterprises had to abruptly assume responsibility for obtaining their own production materials, and adjust to the fact that suppliers were raising prices to market levels. Simultaneously, financing became expensive and investment became market-driven, based essentially on generating an adequate financial return, rather than on political or social criteria.

The turbulent macroeconomic conditions of post-Soviet Russia also made economic transition difficult for enterprises. High and unstable levels of inflation discouraged investment and made planning difficult. The collapse of domestic production and the decline in personal consumption meant that Russian enterprises had to compete in smaller, fragmented domestic markets.

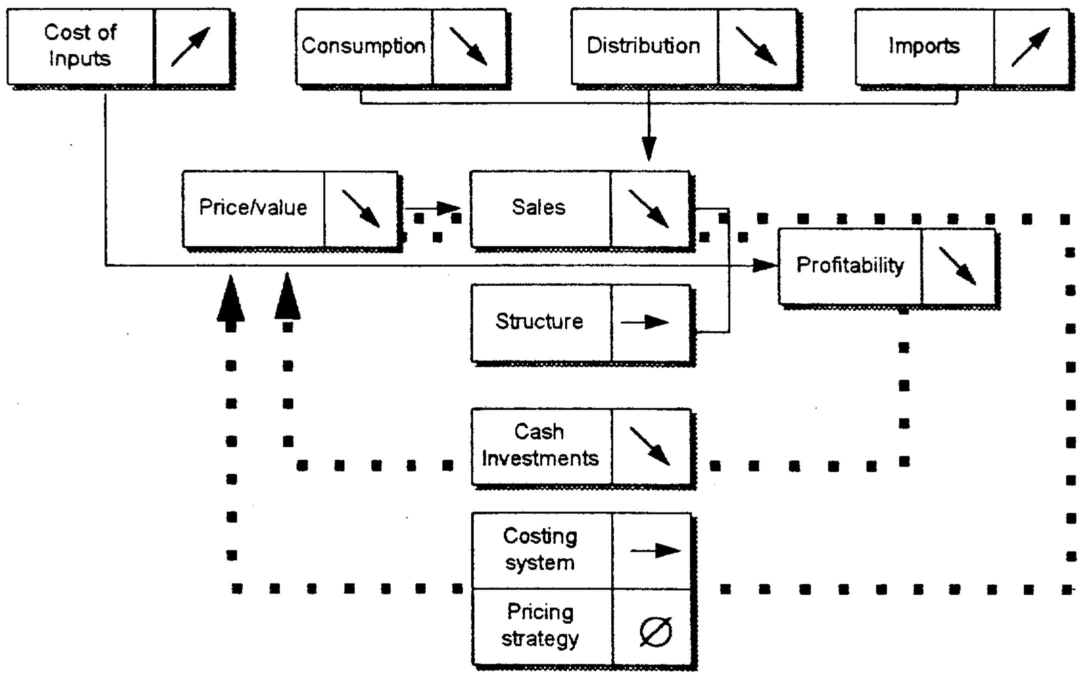
In addition, Russia opened its doors to imports, lifting Soviet-era trade restrictions. Domestic industry, shielded for so long from the international market, suddenly had to compete against high quality producers from Europe, Japan, the US and other developed countries, as well as low-cost manufacturers from the Far East, South Asia, and the Middle East.

Some additional external shocks had a disproportionate impact on certain industry sectors. The rapid rise in energy prices, for example, had a severe impact on such energy-intensive industries as machine-building and ceramics. The decline in military production had a particularly adverse effect on shipbuilding and the rare earth metal industry, and virtually all enterprises in the PIES project experienced some decline due to decreased purchasing by the military. Some consumer goods sectors, such as Russian footwear, suffered much more from heightened competition due to a flood of imported goods in comparison with such industrial sectors as high-performance motor starter manufacturing

2.4 Strategic position

During the course of the project, the PIES team developed an understanding of how the problems and organizational deficiencies inherited from the Soviet period and the external shocks of economic transition combined to impact Russian companies, resulting in the need for major enterprise restructuring. To generalize, the external shocks combined with the company organizations' internal failings have cast the enterprises into a clycle of plummeting sales and declining competitiveness. This dynamic is captured in the following diagram:

Russian enterprises have been caught in two vicious circles, with declining competitiveness and plummeting sales



The diagram shows that the shock of declining domestic consumption, the collapse of distribution channels, and the increased competition from imports caused an initial slump in sales. This decline was compounded by the failure of the enterprises' costing systems to adapt to the new conditions and the lack of a market-oriented pricing strategy (the outer loop). Enterprises lacked an accurate understanding of their products' costs and therefore did not take steps to minimize variable costs, reduce fixed costs, or to readjust product portfolio and product volumes to maximize profits. Many enterprises also continued to set prices in order to cover total costs with a predetermined profit margin. The lack of a competitive cost structure combined with a market-oriented pricing strategy therefore squeezed many products out of the market, especially when they faced competition from low cost imports. With prices set too high, the price/value ratio of many Russian products made them uncompetitive, leading to further declines in sales.

At the same time, enterprises did not typically react to dramatically falling sales by making proportionate cost reductions, whether in equipment, general and administrative overheads, direct and indirect staffing, or social sphere expenditures. At the same time, in many industries, the cost of inputs increased. The result was that the enterprises' profitability plummeted as well (the inner loop). Reduced profitability meant that enterprises lacked the internal resources to finance investments necessary to improve the value or competitiveness of their products, maintain steady on-time production schedules, etc. This had a negative impact on the denominator of the price/value ratio, again leading to a decline in sales.

Of course, the actual strategic position of various enterprises differed depending on circumstances. In the PIES project, Fayans, Uralredmet, and Uralobuv were enterprises in crisis. Sales had plummeted, and a high proportion of remaining sales were paid for in barter, which introduced hidden costs. These enterprises could not fully cover operating expenses, and severe cash shortages led to problems in covering cash expenditures, such as purchasing materials and paying wages, thereby adding to the hidden expenses now piling up. The bank accounts of these companies were frozen due to failure to pay creditors, and debt burden continued growing. Major product lines became unprofitable, but product portfolio was not adjusted accordingly. These enterprises suffered most from the spiral of falling sales and declining competitiveness.

Other enterprises, such as Belka and Plastik were not yet on the verge of bankruptcy, as was the former group, but were nevertheless unstable. Operating costs at these enterprises were covered, but working capital shortages existed and the companies needed debt relief or rescheduling to remain viable. The enterprises had strong core competencies, but rationalization and redirection was required in order to implement a sustainable strategy.

Finally, Almaz and Uralelectro appeared stable in the short term but required restructuring to insure long-term stability. Cash flow and working capital were positive but declining. The enterprise had sufficient resources to conduct short-term cash operations, but lacked funds to make long-term investments. Also, the causes of the overall lack of long-term profitability demanded attention. Here too, though the core competencies were basically sound, enterprises needed to eliminate some peripheral businesses, make performance improvements, and increase focus on marketing core products.

2.5 Strategies for Change

Each enterprise in the PIES project required measures to halt the decline in sales and improve competitiveness. For every enterprise, therefore, the strategy devised aimed to strengthen selling activity and sales reach, achieve cost reductions, increase the quality of financial management, and attract financing for new investments. Nevertheless, the strategies were specifically tailored to the current position and desired future position of each of the enterprises.

Enterprises in Crisis: Turnaround Strategy

Enterprises in crisis require an urgent turnaround strategy. This can be summarized as follows:

- Stop the hemorrhaging of cash
- Identify and eliminate nonviable product lines
- Identify areas for potentially major cost reductions
- Identify short-term revenue generation opportunities
- Reschedule debt

- Identify and prepare to serve new markets over the medium term

The first priority is to avert the disastrous consequences of a liquidity crisis. In the short-term, radical measures such as temporary shutdowns, a shortened workweek, and/or cutting back to one or two product lines may be necessary. At a minimum, enterprises should take the following measures to gain control over the outflow of cash:
- Focus on products that generate cash, and stop or eliminate unnecessary activities that consume large amounts of cash
- Actively collect receivables, taking legal action if necessary, or factoring where appropriate
- Reduce barter transactions
- Sell excess inventory
- Dispose of unneeded assets
- Cut back activity to sustainable levels
- Rationalize and restructure debt

Improving cash management is essential even for simply maintaining operations in the short term.

The next step is to eliminate uncompetitive products and focus on core production. This involves combining market assessment with profitability analyses and a judgment about the enterprises' core production competencies. Products should be judged based on marginal costing analysis to identify the products that provide the largest contribution to fixed costs (it may be the case that no products cover total costs, since enterprises in crisis often have excessive fixed costs). Since these enterprises do not have ready capital to invest in new production, emphasis must be placed on profitable, salable products which utilize existing capacities.

Major cost-cutting is also required. When entire product lines are unprofitable, shutting them down generates major reductions in equipment and workspace needs, so maintenance costs can be reduced and unneeded assets can be leased out or sold. Energy, material and labor costs may be reduced, whether through the elimination of a product line or simply via improving the organization of production. Rationalizing product lines may also result in the elimination of a technical process which may reduce expenditures on the associated R & D and engineering, in addition to the costs mentioned above. Increasing the efficiency of production and creating incentives for employees to increase productivity also helps to achieve significant cost reductions.

The enterprise must also find ways of gaining a quick infusion of cash. Finding a buyer for existing stock built up in inventory is one alternative. When cost reduction measures have freed up production capacity, rent or sale of facilities and/or equipment may be another source of funds. In the meantime, the enterprise may also seek to attract short-term financing to cover operating expenses until additional cash infusions from sales can be realized.

At the same time, enterprises in crisis must find a way to stave off creditors. Frequently, putting together a credible restructuring plan is sufficient to permit the rescheduling of debt. In addition, enterprises may be able to convince state or local authorities that the company is deserving of guarantees, subsidies, loans, tax relief, or other benefits to enable it to effectively restructure.

Although most of the above are short-term measures, an effective turnaround strategy would also include plans for medium term growth. At Russian enterprises undergoing restructuring, this involves building an effective marketing and sales department, expanding the distribution network, improving the processes of product portfolio management and new product introduction, devising competitive strategies for pricing, and implementing effective cost management. In later stages, the company may also be able to attract new investment

Case examples

Uralredmet substantially reorganized its financial department to gain better cash management capabilities, and has succeeded in rescheduling its debts and gaining new debt financing. It also has cut back its major cash-draining activities and is focusing resources on its most profitable area, the production of master alloys. The new focus, combined with improvements in production technology, divestment of social assets, and the spin-off of peripheral activities should achieve substantial cost reduction. Meanwhile, improved sales efforts have won the company several major contracts. Uralredmet still must continue to find ways to gain relief from federal tax burdens and identify sources of finance to purchase raw materials. Nevertheless, through its turnaround strategy, Uralredmet is no longer in danger of an immediate closure, and it is on the path toward greater stability.

At Uralobuv, a short-term plan was designed and implemented to combat the liquidity crisis. This has involved temporarily restricting production to specialized shoes (for industrial and government customers), a product which the company produces competitively and for which the terms of payment are better. At the same time Uralobuv has undertaken to collect unpaid receivables, factor debts, and attract short-term financing. The medium-term strategy is to focus on heavy shoes and boots (for retail markets as well as for industrial and state customers), expand sales efforts, reduce costs (through the rationalization of production, reduction of social assets burden, and other organizational improvements), and sell off excess inventory and equipment. The enterprises' liquidity position has already improved slightly as a result of the short term program, and the other measures are only just beginning to be implemented.

At Fayans, the major effort of restructuring assistance was to design an "adaptive control" management information system, which would enable management to match differentiated quality levels in different products with market demand in order to maximize sales while minimizing costs. At the same time, the enterprise has taken steps to increase its ability to conduct domestic and foreign sales.

Despite its apparent liquidity problems, the company refused technical assistance in the sphere of financial management, and did not accept suggested measures for production scheduling to decrease costs. Instead, the enterprise continues to rely on its own, seemingly ineffective, methods to combat its worsening liquidity crisis. The enterprise also continues to experience temporary and often unexpected shutdowns and is attempting to stave off creditors and attract financing on its own (in particular by lobbying local authorities).

Unstable Enterprises: Short-term Revenue Generation Strategy

Unstable enterprises must take a number of measures to put themselves on a more stable financial footing. These include:

- Identify new markets with realistic short-term potential and prepare to serve them
- Identify and position for long-term markets, eliminating product lines without mid- to long-term potential
- Eliminate inefficiencies and reduce direct and indirect costs
- Negotiate lower-cost financing
- Prepare for investment over the long term

Identifying and preparing for new markets requires enhancing marketing and sales activity, enlarging the distribution network, and insuring that the pricing strategy maximizes the effectiveness of the product range. New revenue can often be realized by simply increasing efforts on these activities with existing products.

Over the medium to long term, the enterprises can target new markets with new product lines. In addition to the marketing and sales activity mentioned above, this includes tailoring the product portfolio to the given markets, cutting unprofitable product lines, and making new investments to improve competitiveness.

At the same time, many of these unstable enterprises are pursuing unprofitable activities. Careful assessment of the profitability of different product lines, combined with an analysis of the competitive environment and production capabilities will indicate which product lines should be discontinued. Although cutting back production is painful, it not only reduces costs but increases marketing and investment focus on the more viable areas of the business.

Unstable enterprises can also benefit from efforts to reduce inefficiencies and cut direct and indirect costs. There are frequently opportunities to economize on materials and energy and to utilize labor more efficiently and productively. When major product lines are discontinued, the excess space and equipment can be rented or sold. Social sphere assets may also be transferred or commercialized.

Unstable enterprises are typically in need of new financing. In the short term, financing will most likely take the form of debt. A convincing restructuring plan can increase the opportunities for obtaining these loans. Over the long term, the enterprise may seek a strategic investor. A strategic investor can offer not only an infusion of cash, but also technology, know-how, access to new markets, and other benefits

Case examples

At Belka, the enterprise strengthened its marketing/sales department and began a more aggressive marketing and sales campaign to regain old customers and enter new markets in major metropolitan areas around the country. The design department has been developing new models to target key consumer groups while unprofitable products are being withdrawn. By the beginning of this year, Belka had already made substantial reductions in its workforce and shifted to a three-day work week. As a result of recommendations by the consulting team, it has begun introducing a new bonus plan which should result in gains in productivity and quality. Finally, the enterprise is putting together a business plan to attract outside investment.

At Plastik, the enterprise has strengthened its marketing and sales department and bolstered its relationships with key customers in the automotive sector. With the help of the consulting team, it has identified new customers and potential distribution partners in Europe that may generate new sales. Plastik is considering the shutdown of major product lines (stirol, wallpaper) in which the company is not competitive. Further cost reductions are anticipated from the consolidation of warehouse space and other improvements in production efficiencies. The General Director has hesitated to undertake major cost base restructuring for political reasons, including the uncertainty connected with the national presidential election and his own reelection in July. Two outside investment groups are each separately beginning to buy shares, with the intention of purchasing a significant stake in the enterprise via a hostile bid; however, the current shareholders view these purchases skeptically, and it is doubtful that a takeover by either group would result in any substantial new investments for the company.

Short-term Stable Enterprises: Medium-term Strategic Positioning

Enterprises that are currently stable have less urgent short-term needs than the unstable companies. To maximize long-term returns, stable companies should take the following steps in the short term:

- Identify and prepare to target markets with long-term growth and profitability
- Make performance improvements and correct production inefficiencies
- Conduct investor search to provide additional capital, improve competencies, and expand sales reach.

Although core product lines may be essentially profitable, the changes in the domestic economic environment typically demand that Russian enterprises seek new customers, domestically and internationally. Moreover, short-term stable Russian enterprises need to develop the sales and marketing expertise necessary to react to changes in customer needs and to exploit new markets proactively.

The same range of cost-cutting activities pursued by less financially stable enterprises may be justified for short-term stable companies to enhance their profitability and growth over the medium to long term. This may even include the removal or reduction of some minor product lines.

Attracting investors is important for providing capital for medium- to long-term growth. In addition, strategic investors may provide a wide range of synergies including improved production techniques, increased sensitivity of designs to market requirements, access to sources of finance, and links to an external distribution network.

Case examples

At Almaz, the medium-term positioning strategy involved strengthening the marketing department and further exploring new international markets, such as the markets for high-speed ferries and steel and aluminum ship hulls. The sale of excess materials, rental of excess facilities and introduction of small new product lines, such as street kiosk structures generated some cash to meet short-term needs. More significant strategic repositioning involved the introduction of a specialist yacht building line to develop an outfitting capability relevant to other areas of the shipbuilding business. At the same time the enterprise continued to take steps toward improving quality assurance, pursuant to its effort to achieve ISO 9000 certification. Estimating and planning procedures have been introduced to eliminate production inefficiencies, and restructuring of the financial and purchasing departments should increase their operational effectiveness. Further cost reduction is being pursued via more efficient warehouse space and selling off enterprise-owned housing. The enterprise has entered discussions with Damen, a potential joint venture partner, which may be interested in subcontracting some work. Such a partnership was valuable to Almaz to gain exposure to commercial practices, improve production and technical capacities and know-how, improve management techniques, and provide access to foreign markets.

At Uralelectro, the company has initiated a program for strengthening and expanding its network of dealers to bring its products to new markets. In the meantime, the sale of excess materials has already generated additional funds for working capital. Management has decided to create separate business units for starters, motors, components, and consumer goods, with the goal of strengthening their competitiveness and ability to react quickly to changing requirements. Some of the peripheral activities, such as components manufacture, should be rationalized to reduce costs in later stages of restructuring, but this has not yet taken place. Cost reductions will be achieved by metering energy usage by cost center, and through improved quality and process control systems in the aluminum foundry and other areas of manufacturing. Improved financial reporting, combined with the new organizational structure should result in improved cost management as well. Finally, Uralelectro has begun negotiations with potential joint venture partners to bring in new technology, open additional markets, and bolster its weaker business units.

2.6 Skills Needed For Change

Any effective restructuring plan involves the enhancement of organizational capabilities, and therefore demands that management acquire new skills. Training, therefore, is likely to be essential for implementing any plan for change. This section outlines the specific areas and types of skills training that we have found to be the most important for Russian enterprises. They have been divided into three basic categories: Finance and Accounting, General Management, and Marketing/Sales.

Finance & Accounting

Skills training in finance and accounting can improve the operational capabilities of Russian enterprises in three areas: (i) adopting more sophisticated management reporting frameworks, (ii) understanding financial reporting frameworks (including international alternatives such as GAAP) and their uses, and (iii) increasing the ability of staff to relate financial indicators to operational realities.

Russian enterprise managers are used to preparing financial accounts that meet legal requirements for computing tax obligations. They typically are not familiar with management accounting.

Effective utilization of management information involves: (i) collecting representative and useful data, (ii) synthesizing and analyzing this information into a form that is useful and (iii) interpreting the output. Some Russian enterprises have had varying degrees of exposure to detailed management information and differ in their ability to develop sophisticated analyses of this information. At present, few Russian companies are well developed in their ability to interpret these analyses to make critical production, financing, investment, and other operational and strategic decisions.

Training in this area tends to follow a virtuous circle of developing increasingly accurate and detailed information, undertaking more sophisticated analyses, and making better-informed decisions. Once companies have seen the benefits of a management information system that allows them to make basic operational decisions from reports, such as determining optimal production volumes from break-even analysis or assessing the profitability of major business units by developing more detailed accounts, then they may take the next steps: to collect better data, conduct more sophisticated analyses, and utilize this information to make more complicated managerial decisions. The problem is that even making the first step, collecting useful data and synthesizing it into a useful form, is a non-trivial exercise.

Summary Table 1 - Finance and Accounting Skills

Skills
• Understanding of basic financial frameworks and their uses ⇒ Statements ⇒ Ratios • Understanding of management reporting frameworks ⇒ Business unit accounts ⇒ Financial projections ⇒ Performance measures • Ability to organize accurate and timely operational information ⇒ Costing information ⇒ Sales information ⇒ Purchasing information • Interpreting management information
Uses/Outputs
• Management decision-making • Cost management • Pricing • Performance monitoring and analysis • Asset utilization • Business planning • Investment analysis • Financial projections • Valuations

Management accounting and financial accounting techniques have developed in Western companies to help them survive in a customer-oriented environment. Russian enterprise managers need skills training in the most basic financial analysis techniques used by Western managers, including:

- Financial statements (balance sheet, income statement, cash flow)
- Categorization and measurement of costs
- Business unit accounts and cost-by-product analysis
- Break-even analysis

- Gross and net margin calculations
- Financial ratio analysis
- Identification of the key variables that drive company performance
- Managing working capital and cash by budgeting

These basic analyses will improve management's ability to perform key fundamental tasks and to make key economic decisions for improving the performance of the enterprise.

At the next level are a set of slightly more sophisticated analyses that seek to answer more strategic questions. These include analyses to :

- Optimize product mix through marginal or full-absorption costing
- Allocate resources toward new investment projects based on IRR or other calculations
- Provide input to pricing decisions
- Value future income streams through discounted cash flow analysis
- Generate realistic projections of financial statements to develop effective business plans and attract finance.

To summarize, Russian companies face training issues to improve their ability to collect and analyze data, and interpret the results for a range of analyses. Of these skills, interpretation is by far the most challenging for Russian managers, who previously have had merely to fulfill centrally designed plans, rather than to develop their own plans for their enterprises' development.

To come to a new level of competence, Finance and Accounting staff in Russian enterprises need to comprehend fully the meaning of the numbers with which they work. This implies a basic level of understanding of how market-oriented business processes are linked throughout the business cycle of purchasing and production through to sales and investment, which could be taught to members of financial departments so that double-entry clerks become financial and business analysts. While new analyses can be taught relatively easily, teaching staff members to think beyond the numbers to the implications of financial analyses for management decision-making is a more difficult and longer-term issue.

General Management

Restructuring an enterprise requires management skills in order to succeed, particularly in the difficult political and socio-economic context of post-privatization Russia. Many of these skills are new to Russian managers, and the PIES project teams have sought to provide them with on-the-job training throughout the implementation phase of the projects. Managers can continue to use these project planning, monitoring and change management skills to improve the enterprise's performance subsequent to restructuring as well.

Summary Table 2 - General Management Skills

Skills
• Project planning • Change management / communication skills • Control ⇒ Budgeting ⇒ Collections • Negotiation skills including consensus achievement • Presentation skills • Leadership development skills
Uses/Outputs
• Customization and implementation of Management Information Systems • Organizational restructuring ⇒ Finance department ⇒ Marketing/sales departments ⇒ General restructuring • Cash and Working Capital management • Business planning • Obtaining finance • Winning new customers

Restructuring Russian enterprises is often challenging, due to significant resistance to change on the part of the workforce and frequently important members of the management group, as well. Successful implementation depends upon tightly-managed, controlled and monitored projects with clear direction from top management. This requires basic project management techniques such as work planning (including budgeting, Gantt charts, and resource allocation), and change management techniques that facilitate clear communication. These skills will be important whenever new practices or structures are introduced. We have found the most common examples to be:

- Introduction of new information systems and accounting systems more reflective of actual business activity
- Redesign of business processes
- Organizational restructuring, particularly the introduction of new financial management, marketing and sales structures.

Subsequently, these management skills can be applied to the everyday operations of the company, particularly in the areas of cash and working capital management.

Russian managers also generally require training in basic negotiation and presentation skills. These skills are relevant in many areas, but most notably to business planning, attracting finance, and winning new customers. All three of these areas may be critical to implementation of a restructuring plan and to long-term improvement in an enterprise's competitiveness.

Marketing & Sales

As previously noted, the concepts of marketing strategy and using a targeted sales force are unfamiliar to most Russian enterprises. Improvement requires the development of a marketing sales skill set that includes sales techniques, product analysis techniques, and market research skills, all of which are needed to assess and effectively respond to the market.

Summary Table 3 - Marketing & Sales Skills

Skills
• Product performance analysis • Market research and competitor analysis • Sales skills • Merchandising and promotional skills
Uses/Outputs
• Improved Product Portfolio Management • Plans to win new customers • Market strategy formulation • Business planning

As basic elements for improving their Marketing/Sales skills, Russian managers need to be able to:

- Identify customers' needs and expectations
- Assess the performance of each product from a market perspective
- Size and forecast markets and assess their strategic potential
- Identify segments and target those that are both attractive and fit well with the competencies of the company to meet the market's needs
- Understand how a targeted market can be approached in terms of the offering, the channel, pricing policy and promotion activity.

Managers can be taught market research techniques, such as the use of questionnaires and focus groups, and can begin follow frameworks for assessing the attractiveness of markets and identifying the keys to competing in these markets effectively. These skills pave the way for successful business planning and market strategy formulation. Furthermore, they are integral elements in product portfolio management, to be combined with the financial skills noted above.

Managers must also learn to implement marketing strategies and business plans effectively, which requires the ability to meet revenue targets. In the increasingly competitive Russian market, as well in international markets generally, this requires solid sales and merchandising skills. One of the key areas to be addressed is the establishment, often from scratch, of efficient distribution systems. These may either be direct, through direct sales efforts led by product managers or account representatives, or indirect, through wholesalers and agents. Russian managers need to develop the skills to create and manage these networks.

2.7 Change Management

The above discussions have in detail the forces that have influenced the development of Russian enterprises and brought them to their current state of affairs. The major historical, political and macroeconomic forces that have shaped these enterprises have created an environment that presents challenges to the introduction of new international management ideas and efforts to effect radical change. Change management practices that have stimulated successful, significant, and measurable change therefore deserve special attention.

Doing business in Russia, perhaps more than anywhere else, requires the building of strong interpersonal relationships with business partners. This element of business culture must be taken into account when attempting to introduce new ideas and effect significant change in Russian enterprises. In the context of management consulting, particularly involving major foreign providers of consulting services, the key to building relationships is establishing trust. Trust, unfortunately, can be hard to come by, given the dozens of foreign consultants and business people who have come and gone, many with fleeting promises of cooperation, investment, and partnership. Furthermore, the current political climate in Russia features a growing number of politicians and political groups who call into question the West's intentions toward Russia and its development. The combination of these factors can make the process of winning trust highly challenging.

We have found that the following measures have increased our ability to establish trust with our Russian counterparts:

- ***Early wins.*** It is essential to demonstrate professional excellence early on in the project. Companies are not interested, and often unwilling, to let consultants perform weeks of analysis resulting in fancy, often cryptic outputs. Identifying one or two areas of obvious assistance where consultants can help achieve results quickly while general diagnostics are being performed can demonstrate the effectiveness of assistance and help to build trust. For example, consultants can often advise on negotiating finance with banks, or identifying potential new customers through early results of international market research. Or, there may be simple technological improvements which can be made at low cost. Achieving such positive results early shows that the consultants are truly working for the benefit of the enterprise, and capable of providing tangible benefits. In short, the implementation process can begin early on in the project. Often it is worthwhile to make an early decision to implement what appears to be a sensible project, before completing a full diagnostic analysis of the company. The search for early wins, however, should not derail the development of an overall restructuring strategy which should drive the full implementation process later on in the project.

- ***Presence on-site and frequent high-level contact.*** Significant physical presence is essential to building trust, as are frequent (preferably daily, and at the very least weekly) meetings with top management to brief them on results, answer any questions, and incorporate their suggestions for directing further work. In cases where the teams met with the General Director only infrequently, they found it much more difficult to build a solid relationship, and implementation became much more challenging as the diagnostic did not have the full support of management.

- ***Russian nationals and Russian-speaking content.*** It is vital that restructuring teams include significant participation by Russian nationals and Russian-speaking expatriates. Working without an interpreter allows consultants to delve much more deeply into the intricate details of a company's operations, and allows interviews to take place in a much more informal, open atmosphere. By working intensively with middle management and other staff, consultants not only gain access to extra information, but also build relationships with the employees who will be the actual implementers of any restructuring program.

- ***Attention to detail.*** Of course, consulting teams should always be thorough in their work, but in the case of Russian enterprises, it is helpful to be particularly detailed in the presentation of the project team's arguments. Most managers, excluding perhaps the most skeptical or ideologically opposed, will be convinced by well-thought out arguments backed by solid quantitative analysis and real-world examples. While this is true anywhere, in Russia managers want to see a greater level of detail in the analyses backing major conclusions and recommendations than elsewhere. It is often effective to present and validate arguments over time, taking advantage of frequent meetings with top management to present conclusions as they are developed.

If a high degree of trust and respect can be built during the diagnostic phase and formulation of the restructuring strategy, it is highly likely that implementation will proceed with few managerial roadblocks. It is key to get top management on board with a project team's recommendations, as they will then provide a strong impetus to their implementation at all levels of the enterprise. A number of implementation tactics can be particularly valuable:

- ***Transfer "ownership."*** It is essential that, during implementation, ownership of the restructuring project is fully transferred from the consulting team to the enterprise employees themselves. The stage should be set for this transfer early on during diagnostic work, by building relationships at all levels of the organization, and by involving key staff in any "quick win" opportunities for which they will share credit. Once implementation begins in earnest, the employees themselves must feel that they are in control, and responsible for the successful realization of projects. The consultants should take on a role of technical support where most needed, and help top management find agents of change in the organization.
- ***Detailed action plans.*** An excellent medium to ease the transfer of ownership is the action planning phase. Here consultants can work closely with enterprise staff to develop action plans for each planned implementation project. However, the plans should actually be written by the enterprise staff themselves, with advice and input from the consultants. Furthermore, the plans should be as detailed as possible, including specific staff responsibilities, progress indicators, milestones, and due dates. This amounts to actually teaching complex project management to two or three hierarchical layers of the firm, recognizing that they will need this skill throughout their future development.
- ***Working groups.*** Often it is useful to encourage the formation of working groups, each given responsibility for a major area of implementation, and subsequently all of the implementation projects which fall within this area. Such working groups keep the implementation process orderly, and provide an excellent structure for consultants' assistance. Furthermore, they create semi-permanent fixtures that will likely continue to exist even after the consulting engagement has ended. This increases the likelihood of follow-through with implementation, and provides a framework for future changes and improvements.
- ***Communication.*** An internal communication effort (with enterprise personnel) and an external one (with clients, suppliers, and potential partners) must be launched from the start of the implementation period, describing the key features of the strategy and the first quick wins. As in any Western firm, these communication efforts are essential components of the cultural change process.

2.8 Corporate Governance

During the PIES project, the focus of the consulting activity has been on working with management, with only peripheral contact with shareholders. Nevertheless, the project teams have had sufficient contact with shareholders that some preliminary conclusions can be made about the effect of private shareholders on enterprise restructuring. In short, shareholders that have an interest in improving an enterprise's position can facilitate enterprise restructuring. Conversely, the lack of supportive owners can make restructuring more difficult.

Bioprocess, the major shareholder of Almaz played a critical role in supporting enterprise restructuring at Almaz. Almaz management was initially hesitant to accept the recommendations of the PIES project consulting team, particularly regarding changes in organizational structure and consolidation of operations. After discussions with the consulting team, Bioprocess used its influence with Almaz management to accept and implement consultants' recommendations, and management ultimately agreed to implement almost all of the suggested measures. Bioprocess is also committed to continuing to actively support restructuring efforts at Almaz, whether by supporting new consulting projects, if the opportunity arises, or continuing pressure on management if necessary.

The shareholders of Uralobuv also took a direct interest in the improvement of the company through enterprise restructuring. One major group of shareholders assigned their own group of consultants to begin creating a computerized management information system, and they will assist the company in the use of the computerized cash model developed by the PIES consultants upon the completion of the project. The Uralobuv shareholders also asked to be briefed on the restructuring proposals, and have been generally supportive of the recommendations.

At Uralredmet, many of the top managers of the company own significant shareholdings in the enterprise. This was a factor in their willingness to listen to the team's analysis of the company's situation, and subsequently, their willingness to undertake radical and painful changes. The ability to equate the enterprise's performance with the top management's personal interests was clearly beneficial to the project.

In some cases, shareholder relationships can work against measures to improve enterprise profitability. For example, at Fayans, it was necessary to renegotiate an arrangement where the majority owner of the enteprise was also its export distributor, and was taking excessive margins on export products. General Director has been negotiating to change the situation by allowing Legimpex to pursue export sales only on a commission basis.

On the other hand, the case of Fayans indicates the potential role for private ownership to play in the transfer of information and know-how related to enterprise restructuring to a wide range of enterprises. When the consulting team at Fayans discussed plans for instituting a production planning system of adaptive control, the parent company not only applauded the measures but asked if they could implement a similar system at the other enterprises in which they have a stake.

One other company where corporate governance may become an issue in the near future is Plastik, which has become a target for investment companies that appear to be interested in a takeover. Over the past few months, Derzhava, an investment company, increased its ownership from 3% to 4.5% with the possible intention of making hostile takeover. At other companies, Derzhava has overhauled management as soon as it gained a controlling stake, albeit with unconvincing results as to enterprise performance. In recent weeks, another company, Olma, has purchased 10% of the company from current and former employees. Its intentions are unknown. While management is nervous about the prospect of increased outsider control, it is not yet clear whether a takeover, if it is accomplished, would have a positive or negative impact on enterprise restructuring.

The other shareholders in the PIES projects have played a less active role in overseeing management, although they have been generally supportive of restructuring. At Belka, the General Director himself is the major shareholder, and has been instrumental in implementing reforms. While Uralelectro committed itself to becoming an open joint stock company as a precondition for receiving technical assistance, and the shareholders recently voted to begin this process, for now it remains a closed joint stock company with majority ownership by employees, so corporate governance has not been a major issue.

On the whole, then, private owners have been generally supportive of enterprise restructuring, although they do not always play an active role in forcing management to restructure. One should also bear in mind, however, that the above represents a snapshot of corporate governance over a limited period of time. Fayans, Uralobuv, and Uralredmet have active new directors who replaced less reform-minded predecessors. The participation of shareholders must have been instrumental in their appointment.

On the other hand, enterprises are generally suspicious of opening ownership to outsiders. Uralelectro very much fears that becoming an open joint stock company would lead to negative outside control, similar to the concerns now felt by Plastik management. Uralobuv has a system in place to buy back employee shares on an individual basis specifically to discourage "irresponsible" sales to outsiders. The more significant test will come in the future, if and when the enterprises seeking investment find a strategic investor, that requires a large share of the enterprise voting stock and active participation in direction of the company.

2.9 Enterprise Selection

The focus of this section has been on lessons learned about the challenges that Russian enterprises face, the restructuring strategies that can help enterprises overcome these challenges, and tools and approaches that are necessary or useful for implementing these restructuring strategies. Establishing the preconditions for a successful technical assistance project for enterprise restructuring, through effective site selection, also deserves mention.

Choosing the best candidates to receive assistance is a key challenge to any enterprise restructuring project. A well-structured and implemented site selection process will greatly increase the chances of a successful project, and will avoid a significant strain on the budget for assistance. Poorly-implemented site selection may result in unsatisfactory results at the enterprise level, and a waste of financial resources.

The challenge of effective enterprise selection is to make an accurate assessment of a company, normally based solely on an application, an interview, and a one-day site visit. Given these limitations, it is important to focus screening efforts on a smaller number of key success/failure factors, rather than attempting to collect a mountain of incomplete information on all aspects of the enterprise. The experience of the PIES project suggests two key factors that increase the likelihood of a successful project, and which can be measured with a fair degree of accuracy within the usual budgetary and time limitations of the site selection process.

- ***Commitment of top management to change.*** This has probably been the single most important success factor in the entire PIES project. It is clear that many Russian companies must rapidly initiate significant changes in their strategic direction, and the way they operate and organize themselves. If the top management of a company is not willing to accept the need to make these sorts of radical changes, there may be little of concrete value that outside consultants can do. At the same time, even companies in desperate turnaround situations have a decent chance for survival when their management is willing to implement difficult changes immediately. This was clearly the case at Uralredmet, where the General Director personally took the lead in selling the radical restructuring program to the rest of the managers and enterprise staff.

- ***The degree of financial crisis.*** It is common for today's Russian enterprises to face financial crisis of some order of magnitude - one of the major roles for a consulting team is to help bring the company out of that crisis. Nevertheless, some enterprises are so deeply mired in crisis that the chances of any productive results from restructuring assistance are very slim. Specifically, a company's liquidity crisis may be so severe that it is unlikely to meet its financial obligations and avoid closure during the period of the project. In such situations, there is usually little that consultants can do immediately to save the company.

Enterprise selection efforts should focus on these two areas. Of course, the opportunity must also be taken to achieve a general familiarity with the enterprise's product line, history, and current problems. Management commitment should be tested thoroughly, by asking questions regarding their expectations of the project, their willingness to reduce headcount and/or shut down production lines, and to provide resources to support the consultants (housing, transportation, office space, meals, etc.). On the financial side, if possible, one financial analyst should spend the day of the site visit meeting with the senior financial manager, and to the greatest extent possible, get a picture of the company's current liquidity position and all major financial obligations coming in the next few months - particularly commercial obligations. These two areas should then receive priority when assessing the enterprise as a whole.

2.10 Conclusion

Through their work with a number of enterprises, the PIES consulting teams have identified a number of patterns that Russian enterprises most often face, that result from the legacies of the Soviet period and from a failure to manage the difficult transition to a market economy. Understanding these lessons from the outset shortens the period required for diagnostic assessment, since consultants can enter a project with expectations based on previous experience on restructuring projects in Russia. Moreover, the PIES teams have developed strategies that can be applied to a range of situations that most enterprises in Russia face. The teams have also identified a set of concrete skills that should be taught during enterprise restructuring. This know-how transfer is essential for a successful restructuring project. Project teams have found that implementing various types of change management strategies can insure that the technical assistance provided during a limited period has long-term results.

In short, the experience gained during the PIES project will decrease the time necessary to identify necessary strategies for improvement, increase the effectiveness of implementation, and maximize the ultimate benefits of restructuring assistance for enterprises.

The experience of the PIES project suggests several new paths for future technical assistance. First, the skills needed to implement enterprise restructuring and run market-oriented businesses are needed by a wider base of Russian managers. The Deloitte Touche Tohmatsu team has already developed a "toolkit" of essential analytical and management techniques that are suited to the Russian context. Seminars based on these modules will assist in the development of a skilled cadre of Russian managers.

Second, restructuring assistance appears to be needed in hundreds, and perhaps thousands of medium and large enterprises throughout Russia. To make this possible, a greater enterprise contribution (i.e. a cash investment from the company's own resources, if necessary backed by a government or donor loan), is necessary. A greater enterprise stake would insure that management is more committed to working with consultants and implementing recommendations for restructuring. Enterprises are typically unable to pay immediately for the full range of consulting services required for restructuring. Accordingly, donor agencies, notably the World Bank, are developing or considering various schemes to fund partially enterprise resturcturing assistance through on-lending techniques. As the financial position of enterprises improves and the willingness of major shareholders to pay consultants to increase the value of their shareholdings grows, the commercial demand for enterprise restructuring assistance will increase, along with the ability to pay for the required services, gradually reducing financing required from government-supported technical assistance programs.

3. ENTERPRISE SUMMARY - ALMAZ

3.1 Description Of The Enterprise

Location

The company is based in central St. Petersburg on two sites, both with a full range of shipbuilding facilities. Additionally, it owns some real estate in the St. Petersburg area.

Lines of business

Small, fast, military and commercial craft made from aluminum and steel.

Major products

The enterprise can produce of a range of ships, focused on small, fast types:
- Fast patrol vessels (FPBs)
- Large military hovercraft
- Catamarans for ecological monitoring of water quality
- SWATH passenger ferries with aluminum hulls
- Aluminum and steel yacht hulls

The company's intention was to build a market position primarily around SWATH-hulled fast ferries. Previous production of steel furniture and galvanized products had ceased before the PIES team's arrival.

Employment at the beginning of the assignment

At the start of the project, Almaz employed 1,700 people. This fell to approximately 1200 employees by the end of the project.

History of the enterprise

Almaz was established as a builder of small naval vessels in 1901. Until the early nineties it was a state-owned military ship yard, building small fast attack craft of several types. It was subsequently privatized (1991) and began to develop a small range of non-military vessels.

Asset Value

The asset value was assessed as: (US$ millions)

Year	Fixed Assets	Current Assets
1993	28.5 million	5.8 million
1994	27.2 million	11.7 million
1995	27.7 million	8.7 million

Profit and Loss

Annual turnover has been up to US$ 15 million annually, almost entirely for Russian customers. However, this income has reduced in 1995, primarily because of the failure of the Government to pay for a series of ships which are under construction.

(figures in $US millions)

Year	Income	Expense	Net Profit
1993	10.3	5.5	4.8
1994	13.7	12.0	1.6
1995	1.9	2.1	(0.2)

Ownership Structure

The major shareholders are Bioprocess, based in Moscow. Employees and management hold the majority of the shares not held by Bioprocess.

3.2 Description Of Assistance Provided

Dates of assistance

The enterprise was the first to fake part in the PIES project, with work on-site commencing in May 1995. There were effectively four stages in the project:

- *Preliminary visit* (May 1995) to review the enterprise
- *Diagnostic phase* (June - August 1995) to identify problems and opportunities
- *Action Planning* (September - October 1995) to prepare action plans for change
- *Implementation* (November 1995 - May 1996), implementation of action plans by enterprise management with limited intervention by PIES team.

Staffing

Preliminary visit :
John-Eric Bigbie (PIES Technical Director)
George Bruce (Industry Expert)
Vladimir Kim (Strategy Analyst)
Alexander Senkevich (Financial Analyst)

Diagnostic Phase
John-Eric Bigbie (Technical Director)
George Bruce (Industry Expert)
James Maude (Financial analyst)
Alexander Senkevich (Financial analyst)
Graham Povey (Financial & MIS analyst)
Paul Lewis (Team Leader)
Vladimir Kim (Strategy Analyst)
Ian Hendy (Strategy Analyst)
Christina Weaver (Organizational analyst)

Action Planning
Paul Lewis (Team Leader)
George Bruce (Industry Expert)
Ian Hendy (Strategy Analyst)
Alexander Senkevich (Financial Analyst)

Implementation
George Bruce (Industry Expert and Team Leader)
Alexander Senkevich (Financial Analyst)

James Maude (Financial Analyst)

Initial Assessment

The initial visit provided a snapshot of the enterprise, and highlighted key concerns :

- Very low productivity by international standards
- Low standards of finish in outfitting of ships
- High manning levels, particularly in indirect workers
- A poor standard of buildings and equipment
- A major new shipbuilding construction hall (known as the Elling left unfinished due to poor cash flow)
- An untidy site, presenting a poor image to prospective customers.

However, the initial visit did highlight the strength that the enterprise had at construction of aluminum structures, most notably hulls

Diagnostic Analysis

The diagnostic phase confirmed the initial impressions, identified the problems in more detail and suggested opportunities for Almaz to pursue.

Production

A review of the technical capabilities was performed. In general the yard was assessed at being around 14 years behind a typical Western competitor in terms of its development. In particular the following were noted :

- Performance at a level less than 50% of typical western shipyards (in terms of labor productivity, amount of rework and time to build)
- Substantial under-utilized areas of the two sites
- Substantial underutilization of equipment

However, in contrast :

- The quality of finished hull production was very high
- There was experience of aluminum work, which is in demand and short supply in Western Europe
- There were concrete plans to achieve certification to ISO 9000 quality standard
- Almaz had some experience in commercial ship construction
- Furthermore, there was experience of small scale yacht building for western owners.

Finance

A review of the financial strength of the enterprise, including conversion of Russian accounts to GAAP, pointed out that while the financial results were not disastrous, the financial position was deteriorating rapidly. In particular :

- Cash flow rapidly becoming negative
- Accounts receivable growing. Almaz had several government contracts that had not been paid in recent months and there were little chances for further payments.

Marketing/Strategy

We conducted a review of the international markets for each of the main product groups (fast ferries, fast patrol boats, and workboats & yachts) and an assessment of the capabilities of the Almaz Marketing department. This led to the conclusions:

- Almaz possessed a limited international marketing effort (with some knowledge of the purchasers in the machete and current trends), but with no structured approach to screening leads, meaning that many poor leads were being pursued at significant loss of management time
- The market for their traditional product - fast patrol boats - had been in a serious decline and research confirmed the outlook was poor at best for further orders, with a number of serious Western competitors competing for these
- The fast ferry market promised significant growth opportunities, but improvements to Almaz's outfitting capabilities would have to be made before Almaz could consider sole sourcing a fast ferry
- There were opportunities to act as a subcontractor to western builders in large hulls for yachts and larger workboats, whilst Almaz might consider sole manufacture of smaller types.

Organization

The organizational review looked at staffing and key processes in almost every function within the company

- Staffing significantly out of line with western practice both for direct staff and administrative labor
- An unstructured procurement process, being implemented by two managers who fought for scarce resources
- A confused and complicated materials ordering, storage and retrieval process
- A slow and over-engineered planning process used norms for materials and labor that bore little resemblance to the actual expenses. The planning function as such was performed by staff in many different departments
- Beyond all these factors, we were concerned that management held a highly inflated view of the enterprise's capabilities.

Recommendations

At the completion of the diagnostic phase, a presentation was made to the enterprise management, along with RPC, LPC and USAID personnel.

The presentation identified a number of key findings, action on which would be designed to move Almaz into a position to gain work from western shipowners.

The key project areas and objectives were :

Asset Management

- Disposal of surplus assets, along with redundant materials and scrap to improve short term cash flow and the image both for staff and overseas clients
- Rationalization of equipment and plant, to free up space

- Making the best use of assets available, including the new construction hall.

Marketing

- Strengthened marketing department, for identified target sectors (yachts and workboats, FPBs and fast ferries)
- Short-term focus on the workboats market : a new sector for the enterprise, except for the previous construction of two ecological monitoring craft, but one where short term contracts might be feasible
- Furthermore build position as supplier of yacht hulls: an area with limited potential, but where Almaz had a track record of export sales
- Continuous attempts to make contacts in the fast patrol market to try to influence purchasing decisions for future to be coupled with pressure on Rossvoorozheniye to allow Almaz to sell military vessels overseas independently
  Development of an outfitting capability so that Almaz would be able to participate in the fast ferry market.

Production

- Introduction of simple, self-help aids to production, to improve performance
- Development of finishing and outfitting capability, specifically to increase longer term prospects of higher added value work. (This project subsequently developed into the production of complete yachts rather than simply hulls for others to finish)
- Improve the performance and, crucially, time to build for ships through a series of linked projects. These would address quality at a work place level to reduce work, planning and feedback, performance measurement and material supply to the work areas.

Reorganization

- Make reductions in indirect staff, and review the skills base across the enterprise
- Reorganize production workshops along stages in the manufacturing process instead of by type of material
- Establish a new planning function divided into long-term strategic planning, medium term tactical planning and day to day planning.
- Reorganize the finance departments to improve information flow and control.

A proposal to retrench the enterprise to a single site, saving operating costs and improving the opportunities for better performance was rejected by the senior management.

Types of implementation work conducted

Action Plans Developed

Following the completion of the diagnostic, there was a short hiatus, while the management and shareholders decided to progress to later phases. It was apparent that the enterprise was going into loss, so that immediate action was required. The preparation of the action plans commenced in September, and the various projects were identified. For each action plan project :

- The need for the plan, objectives and key steps were agreed with the Almaz staff

- A senior member of Almaz management was identified as a sponsor
- Staff and other resources to carry out the plan were identified
- The outcomes and timescale were also agreed.

The completed plans were compiled into an overall action plan, which was then discussed with the management team at a formal meeting.

- The PIES team presented a recap of the diagnostic
- The PIES team presented the overall objectives, in terms of performance
- The individual Almaz managers presented the plans for which they took ownership
- The set of plans was agreed, subject to small amendments which were made later.

Implementation of the various plans was commenced in October, with the majority under way during November.

The PIES team representative in St. Petersburg maintained a watching brief, and acted as a conduit for progress and problem reporting.

The PIES Team Leader made periodic visits to review progress with the action plan managers and staff. Visits were made in November, December, January/February.

A number of examples of *ad hoc* assistance were provided during the period of the project. These were related to the development and implementation of the action plans, but were provided as required to assist specific initiatives by Almaz.

- Credit and other checks on several possibly partners and shipowners
- Identification and procurement of market research information
- Identification and procurement of technical information to assist the development of new products
- Information on shipbuilding contracts and related matters
- Reference material on staff development
- Information on competitive performance rates
- Advice on advertising and placing editorial material in the trade press
- A review of the information provided by the technical department to production.

Reports, plans and seminars delivered

Diagnostic Phase

During the diagnostic phase a number of seminars were held for Almaz management and staff to highlight areas for short term improvement.

- Estimating methods
- Planning for shipbuilding
- Market Research
- Marketing methods

Other meetings were held with senior management, to identify and discuss some of the key features that inhibited good performance

- Manning levels in comparison with western practice

- Organization structure in comparison with western equivalents

The diagnostic phase finished with a full diagnostic presentation

Action Planning/Implementation

A set of 26 Action Plans was developed by managers of the enterprise with consultant assistance.

3.3 Accomplishments Of The Enterprise

During the implementation phase, the enterprise made a number of the changes proposed, and achieved a degree of internal re-organization. The capabilities of the Marketing department were significantly improved. Further more, improvements were made in the use of the enterprise assets.

A number of the initiatives were in planning prior to the PIES project, notably the move to achieve certification to ISO 9000. The recommendations of the PIES team reinforced these, as well as providing an impetus for new, related initiatives.

The main accomplishments during the project period were:

Reorganization

- Financial departments restructured into a single department
- Two purchasing departments merged into a single structure
- Development of a specialist yacht building unit, using a redundant store
    - Recruited new staff with skills in yacht production
    - Recruited new staff with sales experience
    - Designed and produced purpose built jigs and equipment
- Almaz conducted a review of its skills base available to the enterprise, as a basis for restructuring and retraining.

New sources of revenue

- Identified alternative products to improve short term cash flow
    - Built steel and aluminum structures for street kiosks
    - Completed the outfitting of these products.

Production

- Revised the estimating and planning processes on a pilot bases
    - Applied a simplified estimating procedure to the kiosks
    - Planned the work on a more realistic basis
- Developed plans for further improvements, based on target western performance rather than centralized, former Soviet, norms
- Improvement of the quality of the processes and products
    - Implemented a quality assurance system, which was due for assessment by the certifying organization in June 1996

- Conducted a pilot project to review causes and welding distortion and identified new procedures to avoid distortion in future
- Identified additional projects to further improve quality in key areas

- Reviewed the information provided by the technical department to production.

Marketing and Promotion

- Completion of substantial market research
  - Identification of four target markets
  - Detailed analysis of those markets
  - Identification of key customers
  - Identification of competitors and of potential partners.

- Strengthening of the marketing department
  - Training and recruitment
  - Appointment of English-speaking staff
  - Development of teams for each of the target market sectors.

- Development of a higher profile for the enterprise
  - Attendance at exhibitions, conferences and trade shows
  - Advertising in selected journals, based on analyses of readerships
  - Placement of editorial material in the trade press.

Asset Management

- Surplus materials and equipment were identified for disposal
- Spare buildings were leased to other companies to generate income
- Plans were developed for the sale of housing owned by the enterprise.

3.4 Change Management Process Established

The process of change management proved to be a challenge. The reluctance of some management to adopt new ideas, allied to the over-optimistic self-image of the company, were major obstacles. At a middle management level, there was a greater enthusiasm for new ideas. Furthermore, at a more junior level there was a greater degree of realism among a small group of managers/engineers.

The change process was managed by the senior management of the enterprise. To a large extent, the General Director maintained personal control of the process. Regular briefing sessions were held for the General Director, on progress and future intentions. The process of change and progress being made in individual areas of management responsibility were additionally discussed with the relevant manager.

At key points in the project, formal meetings were held with the enterprise management team, to secure collective agreement to the developments to date and to co-ordinate actions.

At a ***working level***, the change was managed on a project by project basis.

A relatively small number if managers were able to take on the action plans and make progress immediately. Others needed to be instructed directly by a superior before any action was taken.

During the diagnostic analysis a group of younger managers, drawn from each main department of the enterprise, was identified who were sympathetic to change. This group was identified as a potential vehicle for change, and briefings were held to explain and promote the change process. The impetus was lost during the gap between diagnostic and action plan development, but the group could be useful as a vehicle for further change.

3.5 Prospects For The Future

Although the world shipbuilding market is generally depressed, there are a number of buoyant niche sectors, including high speed ferries. Almaz has identified this niche, and in cooperation with the AGAT design bureau is attempting to penetrate the market. There is also a demand for sub-contractors to build ship hulls in both steel (where the market is driven by cost) and aluminum (where quality and a shortage of skilled labor are the issues).

Almaz can produce hulls of good quality, and has a significant cost advantage over other European producers. Although the level of technology is relatively low, and much of the equipment is old, Almaz *is* in a position to compete. Over time, a modest investment in new equipment will be required. A major asset is a new, large covered shipbuilding hall, which is close to completion and which is sufficient to build all classes of fast ferries.

However, the planned transition from military to commercial shipbuilder has been jeopardized by the failure of the government to pay for work in progress. This has removed the cushion of cash flow from the series of patrol vessels, which would otherwise have underpinned the company during the transition period. Similarly, any opportunity to showcase the high technological capability has been removed by the end of government funding for the hovercraft program.

The enterprise has made a number of marketing initiatives, of which the mast important is a potential joint venture with Damen Group (of the Netherlands - a major builder of small ships and an experienced user of sub-contractors). The next negotiation with Damen is due on June 10th.

The enterprise must survive in a very competitive environment, where over capacity, supported by government subsidy, is the norm. Almaz has the overriding advantage of low labor cost, allied to adequate quality. Provided that Almaz can develop the ability to deliver to the short timescales that are required by the commercial market, then a commercial reputation for the company can be developed.

The shipbuilding industry is one where long timescales are normal for contracts, and lead times prior to contract award and can be measured in months or years. The industry is also one which is very conservative, and where new concepts and new shipbuilders (in terms of the international market) take a long tame to be accepted. The key problem for any newcomer to the market is funding during the long gestation period of contracts, and the process of persuading shipowners that the capability to produce a quality product to time and budget is available.

A good outcome for the company would be an initial contract for a hull, which if successfully completed will lead to further sub-contracts and a long term relationship. This will lead to improvements in performance, which will allow Almaz to remain competitive as costs rise.

The further development of Almaz's capabilities, including being able to compete for more added-value work, e.g. outfitting, will take time, but is an achievable long-term goal.

In the shorter term, opportunities to take orders for yachts (subject of an important initiative) and workboats are being sought, and these should provide a small income while the larger contracts are identified and won.

4. ENTERPRISE SUMMARY - BELKA

4.1 Description of the Enterprise

Location

Belka is a located in the town of Slobodskoy, in the Kirov region. A secondary production facility is located in the nearby town of Pervomaiski.

Lines of business

Belka has traditionally produced two major product lines:
- Fine fur garments
- Sheepskin garments

Each category is further subdivided into products for children, men and women. There are also special kinds of customers such as railroads, and "force ministries" (ministry of defense, ministry of internal affairs) which primarily purchase sheepskin products with high quality standards but low fashion content.

Major products

Types of fur used:
- Rabbit
- Mole
- Astrakhan wool
- Mink
- Squirrel
- Sheepskin
- Blue Fox
- Ermine

Types of garments produced:
- Men's, women's and children's coats
- "Special" coats for defense ministry
- Men's, women's and children's hats
- Men's semicoats
- Fur collars
- Fur plates

Employment at the beginning of the assignment

Belka employs around 2700 people, down from 3300 in 1994 and 4200 in 1992.

History of the enterprise

Belka was founded over 100 years ago, and many of its buildings are 60-70 years old. During the Soviet period, Belka was considered a city-supporting factory, and it continues to maintain significant social sphere assets as a result.

Over the years Belka has developed a reputation for producing high quality fine fur products. However, since privatization took place the company has faced an increasingly difficult environment. This has resulted in diversification into garments other than fine furs, and an increase in sales of "special clothing" to the defense industry. Specifically, in the last few years, Belka has become an active producer of sheepskin garments. The reasons for this shift reflect the difficulties that have plagued Belka:

- As a "city-supporting" enterprise, Belka has social responsibilities to the local community where job opportunities are scarce. Sheepskin provides an opportunity for high volume production and therefore keeps more people employed.
- The general economic decline in the country has resulted in decreased purchasing power throughout the population. Sheepskin garments are cheaper than fine furs, and therefore more salable.
- Lower purchasing power has dampened the demand for fine fur, which forced Belka to diversify its client base. Sheepskin is well suited for the warm and practical clothing demanded by Belka's new customers, such as the Ministry of Defense, railroads, and oil companies.
- A growing scarcity of working capital; lack of cash necessary for purchasing expensive fine furs.
- Declining fur animal farming in Russia due to economic problems and hence, difficulties in fine fur procurement.

In parallel to this diversification, Belka has reduced its production of fine furs. For example, Belka used to process up to 3 million squirrel pelts a year. Today this number is just several hundred thousand.

Asset value

As of April 1996, Belka's fixed assets were worth RU 269 billion, and current assets were worth RU 60.9 billion.

Profit & Loss

Year	Sales	Net Profit
1994	RU 44.7 bn	RU 9.9 bn
1995	RU 75.9 bn	RU 15.2 bn
1996 (1st q.)	RU 21.9 bn	RU 5.3 bn

Note that Net Profit follows Russian accounting standards, so certain expenditures on social sphere items and some interest charges are not deducted.

Ownership structure

Entity	Ownership
Employees	32.2%
Physical persons	54.8%*
Legal entities	10.9%
JSC Belka	2.2%

*Note that almost all of the shares in this category (over 50% of total company shares) are held by the Commercial Director of Belka and his brothers.

4.2 Description of Assistance Provided

Dates of Assistance

The PIES project team worked at Belka from August 14, 1995 to April 22, 1996

Staffing

Diagnostic Phase

Austen Wood - team leader	Leo Griffin - marketing & strategy consultant
Arkady Gerasenko - financial consultant	Svyatoslav Selivanov - financial consultant
Michael Hennessey - industry expert	George Loveday - industry expert
Alexander Ivakhnik - financial consultant	Stefano Bottoni - market research

Implementation Phase

Austen Wood - team leader	Leo Griffin - marketing & strategy consultant
Arkady Gerasenko - financial consultant	Svyatoslav Seliavanov - financial consultant
Alex Matveev - financial consultant	Florrie Charnaw - financial consultant

Initial Assessment

The PIES team arrived at Belka for the initial assessment on August 15, 1995. The week was spent holding meetings with the general director and key divisional directors, as well as visiting the important manufacturing and administration facilities. The assessment revealed some important initial findings and conclusions.

- Belka's financial situation could be equated to a form of US Chapter 11 bankruptcy. Their bank account was frozen, and suppliers and wages were being paid on a selective basis
- Recently, the Ministries of Defense and Internal Affairs had been placing large repeat orders for "specialty clothing", but the margins were small and payment schedules slow
- Belka's social assets were a significant financial burden, especially as a drain on the company's limited cash reserves. The company was operating a water treatment plant, a culture center and a children's camp
- General spirit of the employees seemed high, and the conditions for change positive
- Generally, the manufacturing operation appeared to be well run and kept

Diagnostic Review

The team's diagnostic review revealed a number of internal and external problems that were causing Belka's difficulties.

- The purchasing power of much of the population is too low to afford fine fur garments.
- Belka suffered from high excise taxes (10% to 35% depending on the garment), while Melita - Belka's major domestic competitor - benefited from favorable tax treatment by its local (Tatarstan) government.
- Lack of working capital due to difficulty managing working capital of a seasonal business (sales are concentrated in 6 months of the year while fixed costs and labor expenses are spread throughout the year), nonpayment by major customers, insufficiently active marketing and sales, lack of trade credit, and high commercial interest rates.
- Lack of raw materials, due to a number of reasons. The best squirrel pelts are sold by hunters for cash to foreign producers, particularly the Chinese. More generally, Russian fine fur animal breeding farms are in decline because of the lack of available financing. Sheepskin suppliers also require cash. All this leads to very high prices for fine furs.

- Large customers such as the Ministry of Defense and Ministry of Internal Affairs are causing long delays in payments. Slow payment patterns dilute the state regulated profit margin of 25% for government products.
- Belka's production was organized inefficiently: several similar workshops were operating while the utilization rate for each is very low; also Belka was wasting lots of expensive labor on sewing together small pieces of sheepskin into plates which have a limited use.
- Belka's bonus system did not result in the proper incentives. Bonuses were practically guaranteed, so workers were unprepared to face adjustments in their wages based on performance. Underlying incentives encouraged workshop managers to conceal true information and caused distortions in the company's reporting system. For example, an assembling workshop could be penalized for incurring costs outside its control, such as the cost of treating low quality materials, and rewarded for increasing labor-intensive production rather than maximizing output of salable products.
- Profitability was being calculated incorrectly, due to a failure to account for all of the plant's costs. Specifically, the costs of social assets, fines and penalties, interest rates, and inflation were not being considered. As a result, on paper Belka enjoyed a high profit of 28%, while at the same time it suffered from declining current assets.
- Belka did no proactive marketing. The sales department waited for customers to come. There was no brand differentiation and no brand name recognition in the market. There was no targeted sales force. Distribution throughout many regions of Russia was poor or non-existent. No marketing materials existed.
- Products were poorly styled. The portfolio didn't include fashionable clothes for children.
- Poor customer service.
- Poor knowledge of the market and customers. Belka failed to differentiate between wholesalers and retailers and used a non-discriminating pricing policy.
- Belka's exports to Europe were sold through a German agent with exclusive rights. The agent was not achieving much and Belka was incurring significant opportunity costs by failing to participate actively in the European market.
- Belka suffered from organizational problems due to inefficient management structure and lack of executive discipline.

Recommendations

Final recommendations based on the findings of the diagnostic review were presented to the top management in mid-November, 1995. The recommendations focused on turning the company from a production-oriented company into a marketing-driven one. These recommendations were augmented and amended during the further implementation stage of the project during January-February, 1996 and April, 1996. The major specific recommendations were:

- Establish a marketing department and appoint a new Marketing Director. Create a telemarketing function and an external sales force.
- Appoint regional sales agents who will work on commission and find local customers.
- Engage in public relations by publishing articles about Belka's products, and preparing promotional materials which can be used by the regional sales agents. Public relations should stress the point that Belka has a 100 year old history of fine fur garment manufacturing and is famous for its quality.

- Research the market and divide it into target groups (the team's proposed segmentation elder people, young men and women, young children, teenagers, special clothing). Develop brand names for each group (e g Cinderella for children's clothing)
- Break down the market by city size and try to ensure that Belka will penetrate each major market.
- Develop a list of market shows and fairs to be visited in order to gain access to new ideas and industry contacts.
- Introduce a new organizational structure with an emphasis on marketing and sales. Clearly define the duties and responsibilities of new staff.
- Implement a new managerial accounting system aimed at providing management with reliable information about production, sales and finance To this end:
  - Transfer workshop accountants to the central office and have them report to the Chief Accountant rather than the workshop managers
  - Employ variable and fully loaded costing to determine optimal product portfolio and resource allocation
  - Include all costs while calculating the "true" profitability of products and decide which products must be discarded from production.
  - Combine Finance and Accounting departments under the direction of the Chief Accountant, to improve communication and cooperation between the offices
- Identify the 300 largest companies in Russia and actively target them as potential customers for special or other clothing
- Develop a discriminating pricing policy for different volume buyers (wholesalers vs. retailers).
- Introduce a uniform coding system which would track all products in production, warehouse and sales. This system should facilitate the ordering process by the customer. The code must incorporate information on product style, target group, type of fur, color, etc.
- Create a committee to study utilization of various production facilities and ways of rationalizing production processes - for example, combining tanneries.
- Introduce a new bonus system (modeled on the US "Scanlon" plan) aimed at rewarding people for quality, quantity and ideas To this end:
  - Establish a "speak-up" program where people could tell management their ideas and suggestions. Place special suggestion books in workshops
  - Appoint a bonus system supervisor to whom workers could talk in case of a problem
  - Conduct regular meetings with the workers and make them believe that their well-being depends totally on the results of their work. Workers should be rewarded at three levels: personal, workshop and total factory.
- Develop training programs for all sales and support staff.
- Extend the selling season by introducing new items compatible with Belka's production facilities: men's and women's sweaters, slacks, unlined jackets, etc
- Expand gross and net margins commensurate with competitive and other market factors, quality and service.
- Revive non-active accounts in the northern and north-east regions and develop new accounts in that area. Business in those parts of Russia that used to play a large role in Belka's activities but it is almost non-existent today as a result of the collapse of old state-led distribution networks.

Types of analysis conducted

During the diagnostic review, the consultants employed various tools including personal interviews, documentation analysis, production facilities tours, desk top research.

At least once a week, consultants met with the General Director to discuss both current and strategic issues. Extensive interview sessions were held with the representatives of:

- Accounting Office
- Financial Office
- Planning and Economic Department
- Production Department
- Sales Department
- Procurement Department

With some of the departments, consultants met on a regular basis (Accounting, Planning and Economic); with others - only several times to get the information needed (Export Sales). The purpose of these meetings was to get up-to-date information on the current developments and better understand underlying processes and procedures.

The financial analysis of the enterprise was based primarily on data available from the accounting and financial departments. Some information was drawn from conversations with the General Director, Director of Economics and Finance, Head of the Planning Department. The financial analysis produced a forecast cash flow statement and profitability analysis on the basis of variable and fully-loaded costing.

Production facilities tours were used to better understand the layout, utilization, obsolescence of production buildings and equipment, workforce employment, production procedures, as well as to comment on the quality of various garments and tanned skins.

Desk research was employed to:

- Identify current market trends in the fur business both in Russia and worldwide
- Study current laws & regulations concerning various aspects of the fur business
- Study the potential market in Russia from the standpoint of size and accessibility.

Types of implementation work conducted

The majority of the team's recommendations were accepted by top management. To assist them in implementing these changes, regular meetings were held with the General Director, Head of Labor and Wages Department, Marketing Director, Head of Planning and Economic Department, Chief Accountant. The team provided specific assistance on the following topics:

<u>Marketing & Sales</u>

- Setting up a marketing department and defining functions of sales, telemarketing, promotion and advertising
- The types of people and skills needed to operate the new functions
- Proper incentives for sales agents
- Organization of export sales
- A system of "checks and balances" via cooperation and competition between various units of the company

- Establishing clearly defined product lines older people. young men and women, children, specialized clothing. Determining guidelines for developing new brand names
- Labeling
- Pricing strategy for different customers. Designing the sales order process
- Business plan writing

Finance & Accounting

- Establishing a new managerial accounting system
- The difference between statutory and managerial accounting systems.
- The difference between "paper profit" and real profit (Western system of accounting for all the costs before determining the net profit).
- Understanding the impact of the inflationary effect on the replacement cost of raw materials and the need to account for it in the process of making managerial decisions.
- The difference between variable and fixed costs.
- Direct product costing.
- Allocation of fixed costs and its role in determining the profitability of product lines.
- Ways of ensuring the accuracy and reliability of data.
- Current asset management, cash flow reporting, inventory management, and aging of accounts receivable

Organizational

- Introducing a new organizational structure designed to emphasize the leading role of marketing in the company's present and future.
- Division of duties and responsibilities.

Production

- The need to divide production into tanning and garment manufacturing and have them report to different directors (Commercial and Production).
- Designing and implementing a new bonus plan, and instructing managers in its use via examples of Western companies (Lincoln Electric Company) that have utilized the system.
- Customizing the system for Belka's needs.
- Using people as a key factor in ensuring the high quality of products.
- Addressing the importance of gaining workers' trust in management. Managing the bonus plan.
- Setting up the unified coding system, and the role of the computer department in designing and implementing the system. The meaning of the code and its importance in keeping track of production and sales, facilitation of the product ordering process.

Reports, plans and seminars delivered

- Diagnostic review presentation
- List of key operational, financial and other parameters which need to be presented to the General Director and Marketing Director on a daily or weekly basis.
- Pricing policy memorandum. Discounts for various volume buyers. Sales agents functions and remuneration principles

- New organizational structure chart.
- Current asset management memorandum
- Managerial accounting principles. Example of Belka's tanneries
- Memorandum on the allocation of general and administrative expenses.
- Research on import regulations concerning fur garments.
- List of Russian cities by size. Proposed structure of market segmentation
- Lincoln Electric Company case. Articles on the Scanlon bonus plan. Bonus plan principles
- Methodology on calculating variable costs of products
- Business plan draft.
- Suggestions about the new catalogue issued by Belka.
- Other documents dealing with "tactical" issues of the company

4.3 Accomplishments of the Enterprise

The enterprise has undertaken serious steps in implementing consultants' recommendations. This process is continuous, and it appears impossible to restrict changes to certain time limits. Many of them are actively taking place. Where possible, the time is indicated.

- In the opinion of the consultants, the only person in the company capable of performing the responsibilities of the Marketing Director was the Production Director. Despite the disbelief of the General Director at the beginning of the project that she would ever agree to give up her area to start a completely new function of the company, on March 25, 1996, she officially became the Senior Marketing Director
- Other organizational changes took place after long discussions with top management in search of an optimal structure that would accommodate new functions of the marketing department and re-allocate old responsibilities. The Commercial Director gave up the sales function (which was placed under marketing) and assumed raw material procurement (due to his experience and connections in this area), as well as tanneries. The production department was left only with garment manufacturing. Production will fulfill a quality control function by accepting or not accepting tanned leather from the tanneries. The areas of responsibilities of new organizational units have been clearly defined
- Current sales staff employed at the company began spending more time on the road going out with truck-loads of merchandise and trying to actively sell it. Unfortunately, the effectiveness of this measure could not be fully appreciated, as in January-February the season is almost over
- Several advertisements were placed in various local newspapers offering a prospective job of a sales agent for a young person. The company has attracted one new agent and is negotiating with several others. By the beginning of the new season, Belka hopes to have resident sales agents in several major Russian areas
- The company determined the largest cities in Russia as potential target areas
- The company has looked through its old records of customers that have been inactive, and began contacting these accounts by sending faxes and letters. There have already been some replies
- Belka issued a merchandising catalogue with a description of selected products for men, women and children. It needs some additional work and the new Marketing Director is going to be in charge of it. In addition, attractive plastic bags now accompany Belka's products

- Belka's design lab has made efforts in creating new models of garments for the new season to suit the targeted consumer segments
- Among the public relations measures have been: making a 15 minute documentary about Belka, which was shown on central TV, several local presentations of Belka's products and their coverage in media
- A list of fairs and shows to be visited in Russia and abroad has been developed for the year
- Parts of a new managerial accounting system have been implemented. The accounting office now reports variable costs for each product as well as full costs, which include all direct and indirect costs of the company such as social asset costs, fines and penalties and inflation. These calculations prove the conclusion of the consultants that the 'real' profitability of the company is close to zero, and not 28% as asserted by official financial statements. The General Director regularly requires this information and on this basis, some business decisions have been made (in particular, the termination of manufacturing of some of the products). The General Director admitted that management needed to substantiate more of its business decisions with hard figures and rely less on intuitive judgments
- With the recent removal of excise taxes, Belka did not fully reduce its prices, and thus increased its gross margin.
- For the minimization of data distortion, workshop accountants are now reporting to the accounting office directly and their salaries no longer depend on the performance of their workshops. In perspective, they are going to be rotated on their jobs from one workshop to another.
- The computer department is actively working on setting a computer network, which will allow to facilitate data processing and automate regulatory and managerial accounting systems.
- The completion of the unified coding system is planned upon the construction of a new warehouse. The old warehouse (former church building) is very crowded and congested, and the warehouse manager has his own coding system, which suits his needs better at the moment. However, due to the efforts of the computer department, it is now much easier to track sales made and availability of finished products at the warehouse.
- The economic and finance departments are in the process of preparing a business plan directed at external investors. Consultants have provided management with some guidelines.
- The Department of Labor and Wages is actively trying to introduce a new bonus plan. It is a huge task and will require some time (more than 6 months and up to 1.5 years) to accomplish. Initial elements of rewarding people for quality, quantity and ideas have been introduced into production. Staff are starting to believe that bonuses are not automatically a part of wages, as they have been until recently, but have to be earned.

4.4 Change Management Process Established

The change process established at Belka was primarily a "top-down" method. The consulting team provided much of its assistance through high-level meetings with the general director, and other key managers. The implementation process itself was then spearheaded by management.

The key element in establishing the change process at Belka has been the close working relationship between the consulting team and the General Director. The General Director and the rest of Belka's top management have been the leaders of implementation work. With their enthusiasm for the project, and their recognition of the urgent need for change, the Belka leadership will continue to act as the engine of change in the future.

4.5 Prospects For The Future

The success of Belka will depend on a number of external and internal factors, but the latter are expected to play the greater determining role in its success. The company is yet very inexperienced in marketing its products and needs to learn a great deal. The changes have started to take place. At the beginning of 1996, several major orders were canceled and the company found its stocks piling up with no distribution infrastructure to relieve its position. Marketing appears to be the vital area to be addressed by the company, and Belka now has the necessary assets to face these challenges: an energetic and knowledgeable General Director, an enthusiastic and intelligent Marketing Director, a well-connected and experienced Commercial Director, highly qualified designers and workers, and 100 years of experience as one of the leading fur garment manufacturers in Russia. Among the objectives of the company for the immediate future are:

- Become the leading fur garment manufacturer by emphasizing its striving for high quality and consumer satisfaction
- Develop brand names that will become widely recognized among targeted groups of consumers
- Establish an external sales force to achieve the above objectives
- Improve internal efficiency by completing the steps undertaken in the areas of remuneration, reporting, production rationalization, etc.

Transforming the company into a profitable, long-term viable enterprise will be a challenging task. It is encouraging that the company's management has dramatically changed their mentality and now understand how to best leverage their resources and knowledge. As the General Director said, "I am a very different man from what I was last August".

5. ENTERPRISE SUMMARY - URALREDMET

5.1 Description Of The Enterprise

Location

Uralredmet (URM) is located in Verkhniya Pyshma, Sverdlovsk Oblast (10 km from Ekaterinburg).

Lines of business

URM traditionally had three main lines of business: alloying materials (master alloys); rare earth and refractory metals and oxides, and derivative products produced using the factory's rare-earths as a base. These products include samarium-cobalt magnets and ferrite garnets.

Major products

During the Soviet period, the enterprise produced and sold over 300 products, the majority to the defense industry. Current major products include:

- alloying materials (master alloys) of vanadium-aluminum, used in the production of titanium alloys for civil and military aerospace industries
- electrolytic vanadium and niobium
- phosphors K78-P, used in television cathode ray tubes
- phosphors L-43, used in lamps
- erbium oxide, used in decorative crystal ware, lenses of sun glasses, amplifiers for fiber optic data transmission, host glass, laser glass or crystal for medical applications, and neutron generators
- gadolinium oxide, used in additives to nuclear fuels, phosphor for tricolor fluorescent lamps, and green X-ray intensifying screens.

Employment at beginning of assignment

The equivalent of 1,250 full time employees worked at the enterprise at the beginning of the assignment.

History Of The Enterprise

Originally called Giredmet under the Soviet system, the plant was basically experimental with a strong R&D department, and thus was well-positioned in the Soviet market. The plant enjoyed 25% profit margins on sales to military enterprises, which resulted in high reinvestment and growth rates. Demand for ferrite garnets, magnets, and yttrium oxides was especially strong at the time and constituted 60-70% of sales (RU 25-35 million per month). Other products were also reasonably profitable, largely due to the plant's access to cheap raw materials. Yttrium oxide, for example, was sold to defense enterprises at RU 635 per kg, while the raw materials to produce one kg of yttrium oxide cost the plant RU 35 and processing costs per kg amounted to approximately RU 100

The plant was leased to management and employees at the time of privatization. In the course of privatization, employees purchased 76.6% of the shares, and 22.5% were sold in voucher and cash auctions. The principle investors at the auctions were Uralelectromed -Europe's biggest copper producer - and Iset Fund. Since that time, these investors have divested their holdings, and employees have sold some of their shares (see "Ownership Structure" below).

The first years of operation under the market economy were fairly successful, due to a lingering perception by customers of Uralredmet's products as semi-precious metals. Nearly all of URM's output was purchased in 1992. The plant first experienced major problems in 1993, as sales to defense enterprises dropped severely and the plant lost its major sources of supply in the non-Russian CIS republics. The enterprise quickly began to accumulate tax debt. As the surrounding economic conditions worsened, URM resorted heavily to barter as the only strategy to overcome the growing non-payment crisis. The enterprise also initiated attempts to export its products, with some success: exports during the first 8 months of 1995 had grown to $976,000 from a total in 1993 of $76,000.

The current general director, a relatively young and energetic manager, was elected in April 1994 for a two year term. The necessity for restructuring and shift toward a market orientation was the main driver in his victory. After the general director's election URM's situation continued to deteriorate until reaching crisis levels. In Summer 1994 the main production lines were almost closed down. In 1995, URM continued to walk the line between death and survival, as the firm's compounding problems led to a constant state of crisis.

Asset value

As of April 1996, Uralredmet's fixed assets were RU 315 billion (RU 159 billion after depreciation), and current assets were RU 26.4 billion.

Profit & Loss

In 1995 Uralredmet's sales were RU 33.1 billion. Net Income, according to Russian accounting standards, was RU 1.1 billion. Taking into account social costs and other expenses that would be deducted to approximate net income under international accounting standards, Uralredmet had a net loss of approximately RU 1.4 billion in 1995.

Ownership structure

As of October 13, 1995, the enterprise had charter capital of RU 118.7 million, with 950,344 shares outstanding, at a nominal value of RU 125. The enterprise's major shareholders as of that date were:

Shareholder	Percentage Ownership
TPF Gornozavodchik	10.0
AOZT Optel - EKO	9.5
VTS	5.3
"URAL" Investment Fund	3.8%
AOZT "Ufinski Depotitari"	2.4%
Sberbank	1.2%
EASK-Invest	1.0%
Other	<1% each

Approximately 35% of shares were held by 17 legal entities, and 65% by 1,630 individuals, mainly current and former employees and management.

No major changes in shareholder structure have taken place since

5.2 Description Of Assistance Provided

Dates of assistance

The PIES project team worked at Uralredmet from September 4, 1995 to March 31, 1996.

Staffing

Diagnostic phase
Jean-Marie Roche - team leader
Vladimir Kim - marketing analysis
Alexia Tonnell - marketing analysis
Karl Wiley - organizational analysis
Vitaly Kozubenko - financial analysis
Andrei Gusev - financial analysis
Douglas Flett - industry expert

Implementation phase
Mary Frances Owens - team leader
Brian Armstrong - financial systems consulting
Alexia Tonnell - marketing strategy and systems consulting
Andrei Gusev - financial systems consulting
Olga Vidienskaya - financial systems consulting

Initial Assessment

The PIES team conducted a two week initial assessment at Uralredmet, during which the relationships with top management that would be key to the success of the project were forged. The management provided the team with guidance as to the issues they believed to be the top priorities for the project.

At this stage, the team made some initial important findings and conclusions:

- The company's product line was understood to a considerably higher degree than before, and it became clear that alloying elements for titanium alloys (master alloys) were currently the plant's leading product, despite a history of a much broader product range
- The constant shortage of working capital was identified as a clear indicator of the financial situation at the company
- It was noted that URM had recently made improvements in its export business, and that was targeted as an area in which the PIES consultants could be of significant assistance
- It was agreed that the team would evaluate three existing business plans, regarding master alloys, rare earths, and fruit juice
- The technological processes were discovered to be extremely complex, and it was decided that the team would need to focus considerable resources to mapping the process in detail

Diagnostic Review

URM's management knew the company was in trouble, and from the beginning was supportive of the team's efforts. The diagnostic review of Uralredmet revealed a number of important discoveries about the enterprise's condition and problems

First, URM was in the midst of a severe liquidity crisis:

- URM had amassed a RU 2 billion deficit of working capital over two years
- Outstanding tax debt had grown to RU 8 billion, and was continuing to grow by RU 1 billion each month
- A commercial bank credit of RU 1.4 billion was coming due in three months
- There was a severe shortage of current assets as compared to current liabilities
- Many large accounts receivable were aging significantly, due to a lack of an effective tracking and collections system
- 90% of URM's operations relied on barter.

Second, we discovered that even if URM were able to pull out of its current liquidity crisis, it faced some serious structural problems which would have to be addressed to achieve even medium-run viability.

- The team built a financial model of URM's costs and revenues, which showed that even if URM were able to sell all of its current output at world prices (a highly optimistic scenario), only 58% of fixed costs would be covered. In other words, URM could not operate as a profitable company given its current cost structure and product mix.
- Only one product - master alloys - was making a significant positive contribution toward coverage of fixed costs. A number of rare earth products were not even covering their variable costs.
- Furthermore, the profitability of master alloys was dependent upon the maintenance of a source of raw material (vanadium pentoxide) supply at or below around $11/kg. At the time of the diagnostic review, the current Russian supplier of raw material had just announced that they were raising the price of their vanadium pentoxide from $6/kg to $15/kg.

Management lacked a strategic vision that would address these serious problems. However, the identification of a viable strategy would be made more difficult due to some realities of URM's markets and competitiveness.

- Master alloys were only sold to one customer - Salda. The relationship with Salda was strong, but URM had little or no room to raise prices to compensate for increasing raw materials costs.
- With the shrinking of the Russian aerospace industry, which had been driven by massive defense spending previously, URM needed to look abroad for potential markets for its rare earth metal products. Unfortunately, a number of difficult barriers to entry were discovered:
    - URM produces only medium and heavy rare earth metals, while the largest world rare earth markets are for light rare earth metals. The production processes for the different classes of metals are completely different, and it would take massive capital investment to give URM the capability to produce light rare earths.
    - Even within the markets for medium and heavy rare earths, those products with the best market prospects were those that URM could not produce profitably. Those

products which did have positive margins had sluggish markets, or markets dominated by lower-cost providers such as the Chinese
- Export potential was further hampered by the lack of any technological competitive advantages. Purity is an important purchasing criterion in the international rare earth markets, and major investment would be required for URM to achieve international certification

The diagnostic review also identified a number of problem areas that were contributing to URM's high costs and inefficient operations
- URM was saddled with a heavy load of social assets, many of which were underutilized and extremely costly to maintain
- The company's organizational structure was confusing and many key business processes were not clearly defined, particularly the finance function
- The top company directors were highly involved in detailed operational decision-making, and there was no mechanism for strategic planning
- Management was very keen on purchasing a fruit juice production line, to be installed in some of the factory's unused space. The team prepared an initial assessment of the financial projections for the project, and it looked financially attractive, but strategically questionable

Major problems addressed

Uralredmet needed immediate turnaround management. The team recommended a program for short-term stabilization and medium/long-term revitalization, based on the following changes:
- The product mix must be simplified, and all unprofitable products eliminated. Using the financial model created during the diagnostic review, the team was able to identify a mix of four main products that would allow URM to operate profitably and begin to generate positive cash flow
- In order to reduce costs, URM must mothball all equipment and production lines that are not absolutely essential to the production of profitable products. Furthermore, a significant reduction in headcount would be necessary
- Given the importance of master alloys to URM's survival, immediate action must be taken to solidify the relationship with Salda, and, if possible secure a higher volume of sales to them
- Low-cost measures should be explored to increase URM's production capacity in master alloys
- A new supplier for vanadium pentoxide must be identified immediately
- The entire finance function must be restructured in order to improve collections, control and budgeting. This must be done immediately to address the need for effective financial management through the liquidity crisis
- The restructuring plan should be used to attract cash to address the working capital deficit, and to reschedule the commercial obligation
- In general, the management must demonstrate their ability to run their core business profitably before considering approaching lenders with the fruit juice idea
- URM must also begin to focus on medium and long term objectives, such as: extending the range of profitable product, establishing a broader customer base (including exports),

systematizing the marketing function, adopting improved human resources policies, and securing sources of longer-term financing for capital investment.

Types of analysis conducted

Production

Uralredmet's production processes were compared to those of Rare Earth Products Ltd of the UK. The following analyses were conducted: process flow assessment; capacity assessment; equipment/technology assessment; environmental assessment; quality control assessment; and assessment of technological implications to strategic options outlined by the project team.

Finance

As noted above, a key element of the diagnostic review was a thorough analysis of the company's cost structure and the profitability of individual products. The team also performed a complete analysis of URM's finance function. Specific financial analyses conducted by the team include: analysis of costs and revenues by product; development of a net working capital model; development of a cash flow model (with projections for the future); financial evaluation of URM's business plans (NPV, IRR, etc.); a barter profitability analysis; and mapping & review of financial processes

Strategy/Marketing

The team performed research on URM's domestic and international competitors and customers for master alloys, rare earth metals, refractory metals, and a number of other products. The research focused on customer purchasing criteria, market growth and price trends, and competitor strengths and weaknesses. Other marketing-related analyses conducted by the team include: strategic evaluation of URM's business plans; and build-up and quantitative evaluation of the enterprise's strategic options, with emphasis on its product mix.

Organization

Organizational analyses conducted by the team include: mapping and assessment of key business processes; a thorough inventory of non-core assets and recommendations for their use; development of a staff data base; and recommendations for overall organizational restructuring and the creation of new finance, marketing and planning functions.

Types of implementation work conducted

Cost reduction

Cost reduction was primarily the responsibility of enterprise management, using the approach recommended by the project team, and specific assistance where needed. This assistance included:

- Recommendations for a new organizational structure, including detailed suggestions on the size and structure of the headcount reduction
- Provision of information on services available to employees that have been retrenched. Specifically, the team talked with the representative of a TACIS project working with the

Urals branch of the Federal Employment Center, the deputy director of the Ekaterinburg Employment Center, the director of the Orjohnikidzersky District Employment Center, and the American Entrepreneurship Center - a USAID-funded project
- Providing standard rules and guidelines for spinning off separate business units
- Providing a general approach to analyzing costs
- Assisting with the conversion/divestiture of social assets.

Finance and financial systems

The team played two major roles in this area: assisting with identifying new sources of financing, and designing a new finance function. In the area of attracting finance, specific types of assistance included:
- Contracting an agent in Moscow to meet with banks
- Identifying a money manager to manage the company's incoming cash (primarily in investment in government securities)
- Providing a list of potential equity investors in Russia with contact and other information

In the area of restructuring the finance function, the team provided the following specific assistance:
- Designing financial information process flows (revenue cycle, expenditure cycle, petty cash, barter transactions)
- Adapting the process flows to the specific needs of the enterprise, and assisting with their implementation
- Providing descriptions of department personnel and responsibilities
- Providing a demonstration copy of "Turbo Buchalter" accounting software and instructions on how to purchase the software if desired
- Developing templates for financial reports for management decision making.

Marketing, marketing strategy and systems

The project team provided assistance with both marketing of products and sourcing of raw materials:
- Contacted potential new export customers for rare earth metals, for master alloys, and for vanadium metal to determine their requirements
- Sent a mailing to potential buyers of inventory in stock
- Identified potential sources of materials (vanadium pentoxide, tantalum feeds, scrap ferrite, and quaternary amines)
- Secured a reliable source of cheap vanadium pentoxide (US company Stratcor).

The team also assisted with the systemization of the marketing function:
- Developed a standard template for marketing plans
- Assisted with the writing of marketing and business plans for master alloys, erbium oxide, gadolinium oxide, phosphors K-78 and L-43, and samarium metal
- Created a data base of potential customers
- Provided published market research on vanadium and on rare earth metals in the CIS (Roskill)
- Provided templates for a contact/sales tracking system
- Provided information on the fruit juice industry in Russia and on juice distribution in the Urals

General

The team also provided specific implementation assistance in a number of other areas:

- Assisted with the collection of accounts receivable from two equipment suppliers (Tonlor in the Netherlands, General Vacuum Equipment in the UK)
- Presented diagnostic findings, the plan for revitalization and restructuring, and implementation results at Technical Council Meetings (200 middle managers), the board of directors, the oblast administration, and to shareholders at their annual general meeting (AGM)
- Described the company's current situation and needs to the International Executive Service Corps (IESC)
- Forwarded to management a copy of the new presidential decree on the possible delay of tax payments and instructions for changes to be made to the company's charter to adhere to the new law on joint stock companies
- Contacted officials on the local and federal level to elicit support for the restructuring program.

Reports, plans, and seminars delivered

The following reports, plans, and seminars were delivered over the course of the project:

Project team

- Diagnostic seminar
- Summary comparison of URM with western producers
- Report on environmental matters
- Revitalization and Restructuring Plan (medium and long term plans) Presentation
- Seminar on business plan writing
- Seminar on master budgeting and management accounting
- Financial department manual (including information process flows, all by major financial activity, descriptions of departments and segregation of responsibilities, duties and authority, and a standard monthly management information packet)
- Memos on:
    - quality control
    - activity diagrams for main process lines
    - technology review
    - preliminary recommendations
    - assistance available to redundant employees from employment centers, commercial search firms and business centers
    - fruit juice distribution in the region
    - financial institutions contact information (banks, investment companies, etc.).

Company management, with the assistance of the project team

- New organization plan (including positions, job descriptions, subordination, and in most cases, specific personnel)
- Plan for staff reduction

- Plant for direct cost reduction
- Marketing plans for: master alloys, erbium oxide, gadolinium oxide, phosphors L-43 and K-78, and samarium metal
- Business plan for master alloys
- Business plan for fruit juice

5.3 Accomplishments Of The Enterprise

By the end of the project, Uralredmet had achieved the following.

Cost reduction

- The company gave notice to 430 employees
- Buildings were closed, several production lines were mothballed, and employees relocated to provide 10% cost savings per month
- Housing blocks (as well as all employees, utilities, and connections associated with them) were transferred to the municipality of Verkhniya Pyshma. Cost savings to the plant should equal approximately RU 1 billion in 1996 and RU 2 billion in 1997
- The greenhouse and the rest home (profilactoria) were spun off from the enterprise as separate entrepreneurial business units.

Production

- During the process of investigating possible means of increasing efficiency at the plant, technical specialists identified a new technological process for production of master alloys which will double capacity to 50 tons per month, without major capital investment.

Finance

- Management rescheduled its RU 1.4 billion bank debt to be paid back over several months
- The company secured a credit of RU 0.5 billion for 6 months at 140% from Uralpromstroybank
- The company secured a credit of $100,000 from the Urals branch of Mosbusinessbank. If the company is successful in repaying this credit, it is likely to receive a credit of up to $800,000 from the bank in Moscow
- The enterprise received a freeze on regional tax debt of RU 2 billion
- Talks were underway with Stolichny Bank and their local representative, Gold Platinum Bank, for a loan of RU 2 billion at 100%
- The European Bank for Reconstruction and Development (EBRD) was considering credits to the company through its local partner, Uralpromstroybank
- Talks were underway with a consortium of banks lending to the agriculture sector. The credits would total RU 14-15 billion
- Concrete proposals were being discussed with 5 potential lenders, which together total $12.5 million
- The company engineered a plan for payment of its current taxes to the federal government. The Urals Military District will make the company's payments in return for capital construction. The company will pay contractors with consumer goods and construction

materials received in previous barter transactions. The plan was to pay approximately RU 500 million in federal tax payments by this method

- A new financial department and managerial accounting group were created on the basis of the project team's recommendations. The new department will implement the financial process flows, adopt and produce the sale/purchase contract approval system and apply the management decision making information designed over the implementation phase of the project

Marketing and Materials Sourcing

- A contract worth $9-10 million was signed with Salda for the sale of 532 tons of master alloys, over a 500% increase in volume terms over sales in 1995
- The company successfully completed negotiations with a government organization and signed a sales contract for niobium for state reserves worth RU 11 billion
- The company sold existing inventory for a total of $598,750, which is approximately $150,000 more than projected by the diagnostic team. Negotiations were underway with two additional potential buyers; contract values would total approximately $320,000
- The enterprise purchased 36 tons of vanadium pentoxide for $217,000 from a Chinese company
- Talks were underway with Stratcor (US), Blinko (Switzerland), and a Chinese firm for sourcing of vanadium pentoxide. Prices for vanadium pentoxide average $9 per kg
- Negotiations were started with German company Atek for acquisition of a fruit juice production line. Both parties were investigating leasing possibilities.

General

- The enterprise's annual general meeting of shareholders (AGM) took place on March 27, 1996. The general director was re-elected by an overwhelming majority (more than 85%), demonstrating the support of shareholders for ongoing restructuring of the enterprise.

When considering the future health and success of Uralredmet, several less quantifiable changes stand out as perhaps more important than all of the concrete accomplishments listed above. Uralredmet has become a market-oriented enterprise, as opposed to the research and production-driven enterprise it was at the beginning of the project. This has not been without some resistance by top engineering and R&D staff. Nevertheless, all of management now understands and accepts that the market will drive the company's future production and investment.

Another change that met with internal resistance was the plan to spin off some activities as separate entrepreneurial business units. The fact that this decision was finally taken is evidence of a growing understanding of the need to empower employees at lower levels of the organization to take ownership of company activities and to motivate them accordingly. The fact that individual employees have enthusiastically taken responsibility for these units are evidence that they are ready for this change and willing to put their careers on the line if they are able to benefit from the success of their own work.

The establishment of a new financial department and new financial information flows is a major change from the way the enterprise has operated in the past. More important than the actual information to be generated for management decision making purposes is the new sharing of information within the company (as opposed to the old system where information was guarded by individuals and departments as a source of power). The new system requires departments to work together more closely and partially eliminates a "that's not my job" mentality.

Employees and shareholders together have now demonstrated an active commitment to restructuring. An "it won't work" knee-jerk reaction among some members of management encountered by the project team at the beginning of the assignment has been replaced by a "buckle down and see how we can make it work" attitude. A great deal of credit for this goes to the General Director. Most members of management now demonstrate a very positive attitude towards change.

While management says that finding a foreign partner has always been an objective of the enterprise, they believe that, partly because of the project, they are now able to actively seek potential investors and have a concrete strategy to present to them. Management is now thinking seriously about the types of partners that might find the enterprise attractive, what they would like to get out of such a partnership, what percentage share of the company they would be willing to sell, and what sort of value could be put on the enterprise.

Since the end of the project in March 1996, the following have also taken place:

- Members of management traveled to Moscow to talk with representatives of United Technologies about a future partnership
- The enterprise participated in a defense conversion conference held in May, which introduced them to potential U.S. partners. Representatives of Teledyne visited the enterprise during the conference
- The General Director traveled to the U.S. to initiate talks with several potential customers and potential suppliers.

5.4 Change Management Process Established

The key to initiating the change process at Uralredmet was the team's solid working relationship with top management. From the beginning of the assignment, management had specific requests of issues to be investigated by the project team. Their enthusiasm for the project was demonstrated by active participation in weekly meetings during the diagnostic phase. Weekly "steering committee" meetings continued during the implementation phase, although in practice, the project team met with most members of top management several times each week.

Middle management was formally engaged in the restructuring process as soon as the revitalization and restructuring plan had been developed. The plan was distributed at a special Technical Council meeting, and middle managers were given more than a week to offer comments and make recommendations about the plan. They were again asked for input when financial information process flows were being designed. They are being informed on an ongoing basis (at Technical Council meetings held every two months) of the progress achieved in the restructuring process.

Most of the implementation work was performed by four working groups that were established at the end of the diagnostic phase. The composition of these groups and their activities are listed below.

Composition of implementation working groups

Working group 1: Communication and negotiation with local authorities

Zelyansky - General Director
Pushkarev - Director of Social Issues
Tkatchenko - Economics Director
Khalikov - Head of Financial and Shipping Department
Naidenov - Chief Accountant
Tikanova - Legal Consultant
Slovesnov - Deputy Director of Marketing

Working group 2: Organizational restructuring and cost reduction

Paznikov - Chief Engineer
Semakova - Department of Labor and Payroll
Rilov - Deputy Chief Engineer, Director of Marketing
Antonov - Head of Central Laboratory
Kopytov - future Financial Director
Personnel Department representative

Working group 3: Raising finance

Tkatchenko - Economics Director
Naidenov - Chief Accountant
Khalikov - Head of Financial and Shipping Department
Dubrovski - Deputy Chief of Production and Technical Department
Kopytov - future Financial Director
Tomilov - Consultant for Operational Issues
Rilov - Deputy Chief Engineer, Director of Marketing
Kim - Head of Department of Material and Technical Supply

Working group 4: Increasing sales and securing revenues

Zelyansky - General Director
Rilov - Deputy Chief Engineer, Director of Marketing
Burkhanov - Marketing
Schtenke - Marketing
Slovesnov - Deputy Director of Marketing
Dubrovski - Deputy Chief of Production and Technical Department
Simagina - Marketing

Functioning of working groups

Each group prepared a work plan with specific actions to be taken and documents to be developed; and each item was assigned to one or more individuals who agreed upon a completion date. Each working group met at least once per week and consultants from the project team were present at the majority of these meetings. The working groups were responsible for the following activities during the implementation phase:

Working group 1: Communication and negotiation with local authorities

- Inform authorities regarding restructuring plan
- Obtain regional credits/credit guarantees (RU 12 billion of which RU 3.5 billion for working capital and RU 8.6 billion for capital expenditure)
- Obtain relief from tax payments (local, regional, federal, pension fund)
- Hand over of social assets to municipality
- Obtain support from federal government regarding restructuring (RU 12 billion)
- Liquidation of debts

Working group 2: Organizational restructuring and cost reduction

- Analyze variable costs
- Staff reduction program
- Formulate new organizational plan
- Fixed costs reduction program

Working group 3: Raising finance

- Obtain credits for master alloy production ($800,000)
- Obtain financing from investment companies for working capital and capital investment ($2 million for master alloys, $700,000 for fruit juice)
- Prepare information for negotiations with local and regional governments
- Develop business plan for URM (5 basic products)
- Develop programs for financial revitalization 1996-2000
- Revise business plans (master alloys, fruit juice)
- Prepare barter contracts for sale $2.5 million in sales
- Study issue of selling pig farm
- Calculate financial information for spin off of enterprises
- Investigate possible sales in payment of Russian foreign debt

Working group 4: Increasing sales and securing revenues

- Conclude contract with major customer VSMPO (Salda)
- Secure feed material (vanadium pentoxide) for master alloy production
- Sell existing inventory
- Market research for major product groups
- Marketing plans for major product groups
- Market research and business plan for fruit juice production

Accomplishments of working groups

All the tasks listed above were completed by the working groups. Their accomplishments are described in section III. The work of group 3, which includes establishment of the new financial department, implementing financial information process flows, and securing future financing for the enterprise, as well as the work of group 4, which includes systematizing the marketing function, has continued beyond the end of the project.

Future change management

As discussed earlier, management, employees, and shareholders have all demonstrated an active commitment to restructuring of the enterprise. The project team believes that the process will be an ongoing one, driven by the General Director, and dictated by market forces. The new Marketing Department will be better able to determine the needs of the enterprise, and the new financial function will produce the information necessary for management decision making.

5.5 Prospects For The Future

Uralredmet still has two immediate problems to overcome. The enterprise has not yet been granted relief from its federal tax debt, the tax inspectorate visits frequently. This burden takes much of management's time. Although the enterprise has a firm contract for sale of master alloys to Salda, it still does not have working capital sufficient to purchase raw materials. Although great headway was made towards addressing these problems during the period of the project, no one expected that they could be resolved in a short period of time. Management is still working hard to overcome these problems; talks continue with regional and federal administrations regarding tax debt, and negotiations continue with banks, both in Ekaterinburg and in Moscow.

Under the most negative scenario, Uralredmet is likely to continue operations despite its crisis situation, given its reasonable plan for revitalization and restructuring and its support from the regional administration. It is difficult to say how quickly the company can "normalize" its activities, and if this can be achieved before employees and shareholders lose much of the enthusiasm generated during the project period. Our sense is that management will persevere and will eventually pull the enterprise out of its crisis - it is only a matter of time.

Once the enterprise overcomes its current difficulties, its prospects look reasonably good. Salda is negotiating new sales contracts with western aircraft producers, including Boeing. This indicates an ongoing need for URM's master alloys. In addition, the project team has identified 8 potential export customers for this product. Once the enterprise is earning reasonable profits from its sales to Salda, it can begin more actively seeking customers for its next two most profitable products, lamp and television phosphors.

At the same time, work continues at the enterprise on the new financial function. Uralredmet has contracted Deloitte & Touche for further assistance in this area. Financial information generated from the new system will allow management to continuously monitor the profitability of its different products and to react quickly to changes in the market. It will allow the company to manage its cash flow position and to plan for financing when it will be needed.

Based on the company's market research, the plan to produce fruit juice seems to be viable. It is questionable as to whether the company will be able to secure financing for both investment in equipment and for working capital for a completely new line of business. Management understands that working capital and management attention should not be taken away from its main business.

The next important step for Uralredmet will be to secure long term financing for capital investment to expand the company's product range to include other types of master alloys (aluminum vanadium, niobium-based, and molybdenum). According to the project team's analysis, this is the company's most viable medium term strategy. In the medium term at least, the company's chief competitive advantage relative to international competition will be in its price competitiveness. This may change as funds once again become available for research and development.

6. ENTERPRISE SUMMARY - FAYANS

6.1 Description Of The Enterprise

Location

Fayans is located in Konakovo, Tver oblast, 120 kilometers northwest of Moscow.

Lines of Business

Fayans is primarily a producer of ceramic dishware. It also manufactures uralite grinding stones and frit for making glass, which are both utilized in the manufacturing process and which are sold to other ceramic and porcelain manufacturers. A majolica line has been discontinued.

Major products

Fayans produces ceramic dinner places, cups, saucers and soup bowls. Several types of dishware are produced, including angob, printed, decalc, and handpainted. A separate "Unique Department" produces custom-made handpainted dishware and souvenirs.

Employment

Approximately 2700 people were employed by Fayans at the beginning of the assignment.

History of the Enterprise

Fayans was founded 185 years ago as a ceramic dishware factory by the merchant Kuznetsov, who owned many ceramic and porcelain factories in the region. It is the largest producer of ceramic dishware in Russia, though it competes with a large number of domestic porcelain manufacturers as well as imports from Ukraine, China, and Western and Eastern Europe.

Although the production capacity of the factory is around 110 million units, actual utilization has fallen to about 44 million units, and inventory has grown.

A young new General Director was appointed in late 1995 at the suggestion of Fayans' largest shareholder, the voucher fund Veteran Invest. He has taken steps to shift management away from the production orientation of the Soviet period and is generally supportive of efforts to increase the market orientation of the enterprise.

Nevertheless, at the time that the project team arrived, Fayans was on the verge of financial collapse. The company's bank account was frozen, and the only reason that the factory was avoiding bankruptcy was the failure of government officials and creditors to take action against it.

Asset value

Current assets as of December 1995 were RU 22.3 billion, while fixed assets were RU 60.3 billion.

Profit and Loss

Fayans' sales in 1995 were approximately RU 42 billion. The enterprise has been operating in the red over the last year, with monthly return on sales generally in the range of -10 to -40%.

Ownership Structure

Veteran Invest is the major outside shareholder, with a large portion of shares belonging to employees. At the time that the enterprise was selected for participation in the PIES project in mid-1995, the distribution of ownership was as follows.

Shareholder	Percentage Ownership
Workers	45.57%
Management	0.95%
State	20%
Veteran Invest	16.56%
Derzhava	7.57%
Afganets	1.76%
CS First Boston	2.52%
AO Roslegprom	1.88%
Individuals	1.68%

6.2 Description Of Assistance Provided

Dates of assistance

The diagnostic phase took place between October 1995 and February 1996. Action planning and implementation followed, between February and June 1996.

Staffing

<u>Diagnostic Phase</u>
Colin Maclean - project manager
German Ainbinder - financial analysis
Alin Giurgiu - industry expert
Ian Hendy - production and marketing analysis
Jeff Lehrer - marketing analysis
Monica Maclean - design expert
Yuri Malyshev - financial analysis

<u>Implementation Phase</u>
Colin Maclean - project manager
Alin Giurgiu - industry expert

Initial Assessment

The initial site assessment provided insight into the enterprise's key problems:

- Unappealing designs
- Lack of an active sales force or effective distribution system

- Lack of market research capability
- High energy costs
- Liquidity crisis
- Excessively centralized decision-making and lack of communication between departments
- High degree of theft

Diagnostic Analysis

During the diagnostic stage, the team bolstered the initial impressions with systematic analyses in the sphere of finance, production, and marketing.

Finance

- Analysis of liquidity ratios indicated that Fayans has been technically bankrupt for over a year, and cash position is worsening
- Adjusted net working capital is negative
- Further analysis of cash flows identified the major factors that are compounding Fayans's liquidity problems: overproduction, delays in receiving payments, and inflexible planning
- Social sphere costs have become an increasing burden on the enterprise, primarily due to spiraling heating costs for enterprise-owned housing

Production

- Many items are overproduced
- There is a mismatch between the market demand and volume of production of different quality grades of dishware High quality production was not oriented toward consumers who demanded it, primarily export and handpainted/custom-made products
- The structure of costs is such that Fayans operates most efficiently at full capacity, and poorly at current levels of output
- The quality of production is worsened by refractories that are poorly designed and that utilize materials which have been recycled too many times
- Other short-term technical fixes could reduce the costs of decalcs, reduce wastage of materials, and improve the quality of the material

Marketing

- Fayans has moderate market share overall, with a particularly strong market position in everyday dishware, targeted at working class customers
- Fayans's strengths are its low prices, simple long-run designs, and ability to fulfill large orders. A survey conducted by the project team found that consumers are dissatisfied with its designs, overall quality, and packaging Retailers also criticized the company for the level of breakage
- Fayans lacks an extensive distribution network, and is missing opportunities in the institutional sector
- Fayans's product portfolio management, including new product development, is not reactive to the market. This results not only in unappealing designs, but in a failure to be active in key markets, such as tea sets

- European market research found market opportunities in the ceramic dishware market, but European purchasers are skeptical about the designs, quality, assortment, and reliability of Russian suppliers

Other

- The Unique Department's products and uralite cylinders have promising markets, which are different markets from the main lines of production

Recommendations

The overall strategic recommendation was to increase the cost-effectiveness of the mass production line in the short term, while steadily developing its ability to react to markets and reach customers, and facilitating the growth of profitable side businesses, such as the Unique Department and the uralite line.

The project team developed a number of short-term cost cutting measures for management. These included the following:

- Create an improved cash management system to identify trouble spots in advance, prepare stop-gap solutions, and improve planning throughout the factory. Collections of receivables could also be improved
- Develop a system of adaptive control throughout the factory to produce the amounts of quality grade of products desired by a given market, thereby reducing inventory levels
- Adjust the production schedule to maximize output given the factory's cost structure. Alternate high volume production with periodic shutdowns
- Price products relative to competitors, rather than in relation to production costs
- Divest expensive social assets as quickly as possible
- Make technical improvements, such as the use of glass decalcs which do not require high firing temperatures, introduction of efficiently designed refractories, development of higher quality refractories for the high quality production line, and introduction of magnetic separators to reduce iron oxides.

The project team also made medium-term recommendations, focused on increasing sales volumes and expanding profitable side businesses. The team recommended that Fayans:

- Develop an active sales force
- Develop market research capability
- Establish a hub-and-spoke distribution system focused on high population areas, where Fayans already has a customer base and where it faces less competition
- Improve control over existing distributors, the Moscow General Representative Office and Legimpex, the exporting agent
- Initiate merchandising and other promotional activity
- Restructure the new product introduction system to make it more responsive to the market. Develop more attractive designs, especially for export
- Establish the Unique Department as a separate profit center, with an independent sales force, and more efficient production
- Establish a separate profit center on the basis of the uralite line, and increase sales reach to take advantage of opportunities in Russia and Eastern Europe

Recommendations for the long run emphasized improvements in business processes:

- Improved production planning and scheduling
- Greater market orientation in new product introduction
- More timely and detailed information in a management information system
- Increased incentives for quality work via performance monitoring and improvement
- Enhanced business planning.

Implementation work conducted

At management's request, implementation was focused on production planning, personnel incentives, business planning, and development of the sales and marketing function.

Production planning implementation involved working with the Chief of Production, the head of various production workshops, and the technology departments in order to develop a system for adjusting production to fit with projected demand. In part this involved preparing an information system, and in part setting in place the means for separating different quality level lines of production.

The implementation team also worked with the labor department to develop a new employee incentive scheme. The goal of the scheme is to boost productivity while increasing the incentives to produce high quality products.

Fayans has entered negotiations with a major German investment bank to discuss a possible $10 million loan. The General Director consulted with the project team on the format and necessary financial and marketing information for a business plan.

Development of the marketing and sales function included assistance in the following areas:

- Assistance in negotiation with foreign purchasers
- Development of promotional materials
- Improved sales forecasting.

6.3 Accomplishments

Production

- The factory artists developed a wide range of attractive modern designs which were exhibited at the Frankfurt trade fair
- An interdepartmental group identified ways to create separate production lines for differentiated quality grade levels
- A software system was developed to identify optimal levels of production volume, quality, product mix, and costs, given sales forecasts. Personnel have been trained in how to operate the program. Measurable results should be available in August
- An optimum production level of approximately 4.5 million pieces per month has been identified as the volume required to maximize profitability based given the current three month sales forecast. This assumes that 3.5 million pieces are sold on domestic markets and 1.0 million pieces are distributed to export markets
- An employee incentive scheme has been installed in the production department to reward employees based on the quality and quantity of output of specific products

- The speed of the wagons in the kilns was optimized to improve quality and decrease energy usage, especially electricity and hot water
- The combined effect of these recommendations was that in April, production costs per item were reduced by 12 percent

Marketing and Sales

- A major sales agreement was concluded with a purchaser from Holland for 10,000 "pizza-size" plates per month (with the customer's own designs). The customer agreed to consider paying a premium for high quality products once the adaptive control system is implemented
- A major UK importer is negotiating to purchase one to three truckloads of 50,000 pieces each per month to distribute to major outlets in Britain. The dishware will be produced utilizing the customer's decalcs.
- A customer at the Frankfurt fair was attracted to the new designs and expressed interest in purchasing 2 million plates as a sample, to be followed by further orders. Since this involves a great deal of hand work which would demand a large increase in highly trained staff, the proposal is still being considered by the factory
- The chief of sales was trained in preparing sales forecasts, which take into account anticipated demand, as measured by the terms and levels of advance customer orders, as well as previous sales. A three month sales forecast was developed
- The enterprise developed professional sales brochures and price lists for distribution to potential clients and display at trade fairs.

Other

- Fayans is in the final stages of completing a Western-style business plan to back a major debt financing proposal

In addition to the improvements at Fayans, there may be some spill-over to other enterprises of the know-how associated with the adaptive control production planning system. Veteran Invest, the major shareholder at Fayans, is interested in applying the system to the other 15 enterprises in which it has a stake.

6.4 Change Management Process Established

Management worked closely with the project team from the outset, and occasionally requested work on specific issues for early implementation, such as the potential split-off of the Unique Department as a separate business. Work on implementation was focused on two working groups:

Production working group

Shirokova - Deputy Director for Economics	Motorin - Chief of Mass Preparing Dept.
Gursheva - Quality Control Department	Belova - Chief of Forming Dept.
Savenkova - Chief Technologist	Gerasimov - Chief of Firing Dept.
Raspopova - Chief of Planning Department	Smirnova - Chief of Overglaze Dept.

Marketing working group

Akopov - General Director

Podgorny - Deputy Director for General Questions
Anisimov - Head of Sales Department
Sereznova - Chief of Warehouse
Glaznev - Head of Legimpex

The production working group worked full time with the industry expert while he was at the factory. Their task was to develop mechanisms for implementing adaptive control, in order to optimize parameters of production to fit with the demand for various types and quality grades of products. The group developed the data necessary to design the computer program for production planning, and the Chief of the Planning Department will take primary responsibility for implementing it. The four core members met constantly, and were occasionally joined by the heads of specific production workshops. The group intends to continue to meet to implement adaptive control and other production planning questions in the future.

The marketing working group was more decentralized. Export questions and business planning were discussed primarily with the General Director and with the head of Legimpex, the export distributor. Sales forecasting was taken up primarily by the Head of Sales, who developed the three month projections. Other marketing issues were discussed jointly with the Deputy Director for General Questions (who has responsibility for sales, marketing, supply, distribution, and security), the Head of Sales, and the Head of the Warehouse.

6.5 Prospects For The Future

While it is possible for Fayans to improve its trading operations by implementing new methodologies and techniques in marketing and production, it will of course still be influenced by the macroeconomic situation of Russia in the coming months and by the resolve of the future Government to create an economic environment which promotes the development of a market economy. Unless social sphere debts are addressed at Government level and enterprises such as Fayans feel confident they can restructure their operations, specifically in terms of labor force retrenchment, it is highly unlikely that in the longer term they will be able to compete with, for example, Far East producers. Fayans's current price advantage cannot be sustained forever and the time will surely come when the only way to remain competitive and to attract foreign investment will be for the enterprise to take far more drastic action in the management of its businesses and to focus its attention on core or niche markets.

7. ENTERPRISE SUMMARY - URALELECTRO

7.1 Description Of The Enterprise

Location

The company is based in Mednogorsk, a city of 35,000 located 80 km from the city of Orsk. Mednogorsk is in the Orenburg region, close to Kazakhstan and Bashkiria. There are two key enterprises in the city, Uralelectro and a copper mining plant.

Lines of business

- Induction motors of 0.25 to 5.5 kilowatts
- Starters of 60-250 amperes
- Vacuum cleaners

Employment at the beginning of assignment

At the beginning of the project the employment level was 3,200 as compared to 6,500 at the time of privatization. In June 1996 the company employed a total of 2,800 staff.

History of the Enterprise

A Tula arms manufacturing plant was evacuated to Mednogorsk in 1941 and became the basis for Uralelectro. Production of civilian goods began in the early 1950s.

Induction motors are sold in Russia and exported to Italy, France, Morocco, Hong Kong, Australia, Benelux and others. Of the 12,000 motors produced per month 40% are sold in Russia and the rest are exported. New export markets in Kazakhstan and the Far East are being explored. In June 1996 the demand for exports was strong while domestic market was sluggish.

Starters are sold domestically and Uralelectro has a strong monopolistic position in its range of starters. Sales in the first half of the year were decreasing but are expected to pick up in the fourth quarter.

Vacuum cleaners are sold domestically and the enterprise is not competitive in this market. Sales have decreased significantly and the company is presently formulating an exit strategy.

Privatization took place in November of 1992. The enterprise was transformed into a closed joint stock company. The majority of shares are owned by Uralelectro's employees. In June 1996 the shareholders committee approved the transformation of the company into an open joint stock company.

Production facilities

Utilization of production facilities is at 20% of the pre-perestroika level. There are 25 workshops including foundries, assembly, plastics and tool-making, i.e. a very high level of vertical integration. Two former military production workshops stand idle. Although most of the equipment is in working order, it is old and in need of modernization. The company has a number of modern, fairly new, machining centers. These cannot be fully employed due to the lack of appropriate Computer Aided Manufacturing systems.

Asset value

Current assets at the end of the first quarter of 1996 were approximately RU 35 billion, while fixed assets were approximately RU 85 billion.

Profit and Loss

Over the last two years Uralelectro has operated profitably. In 1995:

- Revenue: RU 70 billion
- Profit (EBIT): RU 10 billion
- Net Income: RU 4.9 billion

The company is expected to make a small profit in 1996.

Ownership Structure

Although the shareholders have recently voted to transform Uralelectro into an open joint-stock company, that transformation has yet to take place and it remains a closed joint-stock company.

7.2 Description Of Assistance Provided

Dates of assistance

The PIES project team worked at Uralelectro from January 8, 1996 to June 30, 1996

Staffing

Ebby Adhami- team leader
Saulius Umbrasas - marketing analysis
Oleg Lutan - financial analysis
Maggie Taylor- co-team leader and strategy consultant
Mike Woods - industry expert
Alex Matveev - organizational analysis
Alexei Zemko - production analysis

Initial assessment

The aim of the preliminary visit was to conduct an assessment of the company's position and its readiness to commence the restructuring project. The specific objectives were to:

- Ascertain whether the company would be able to meet the requirements set by RPC and USAID
- Discuss the objectives of the project and the expectations of the management
- Establish the ability of the company to put forward senior staff to work with the team
- Discuss key problems of the enterprise.

During the initial visit the following problem areas were identified:

- The company lacked effective business processes
- High level of vertical integration had reduced cost competitiveness
- Lack of net working capital
- Ineffective inventory management and utilization of raw material, due to inadequate purchasing policies
- Inappropriate organization of accounting functions and ineffective management and cost accounting systems
- Lack of skills in sales management and in market research and analysis
- Inadequate information system infrastructure.

Diagnostic review

The aim of the diagnostic stage was to conduct a detailed review of the company's operations, products, customers, and suppliers in order to formulate a strategy.

The key findings of the diagnostic phase were as follows:
- Although Uralelectro is profitable, its financial position is worsening and it has liquidity problems;
- The present trend in working capital management, if continued, would lead to serious liquidity problems
- The product portfolio is having mixed success:
  - Starters are very profitable, sales are growing and dominate the market
  - Motors sales have declined, competition is intense and margins are low
  - Export sales of motors are unprofitable
  - Vacuum cleaners are very unprofitable and sales have plummeted
- A looming threat exists from Western competitors operating in Russia, and from cheaper imports from Eastern Europe and Far East
- Vertical integration combined with inappropriate production, procurement, material, and energy management significantly reduces cost competitiveness
- The company lacks meaningful controls for materials utilization, particularly given that direct material costs represent more than 50% of total manufacturing costs
- Limited skilled human resources are not being well managed and are not effectively focused
- Although the cost of social assets has been significantly reduced, there is potential for further cost reduction.

Recommendations

The team made the following recommendations in response to the diagnostic findings. First, in the short-term, Uralelectro should:
- Focus only on profitable and sustainable activities and minimize the cost burden of unprofitable activities.
- Focus on buying time in order to make Uralelectro a more attractive investment target by:
  - Making the profitability of the starter business visible
  - Developing a comprehensive plan for rationalizing production facilities
  - Implementing a program to reduce working capital requirements through faster collection of receivables, reduction of inventory levels and work in progress, and liquidation of obsolete stock

- Strengthening financial systems and practices in order to improve management and cost accounting

Furthermore, Uralelectro's medium and long-term survival depends on attracting finance and/or gaining access to know-how in order to:

- Modernize its manufacturing base
- Rationalize product range and design processes
- Retain and build domestic market share

In addition to these practical survival measures, the team also developed detailed strategic recommendations to enable the company to focus on its core competencies and reduce the burden of non-profitable operations. These recommendations included a corporate strategy and associated strategies for marketing, manufacturing, finance, and human resources. Key recommendations for the strategic direction included the following:

- Uralelectro must separate its business operations into four business units, each with an identifiable P&L statement, in order to focus on its core competencies and facilitate the divestment of non-strategic operations
- Uralelectro should retain full control and ownership of the starters business, share the control and ownership of the motor business with a western partner, find a buyer or a partner which will assume ownership and management of the consumer goods business, and rationalize the components (foundry, plastic parts, etc.) business by determining which elements of production are strategically important for supplying the core businesses of the company; more generally, make vs. buy policies should be designed and implemented.
- Uralelectro must clearly articulate and quantify its investment needs and concentrate on putting its own house in order before targeting investors and joint venture partners
- Uralelectro must develop and initiate a formal change management program to implement changes in its corporate structure, marketing strategy, financial management, human resources strategy, and assign a Change Director

The above recommendations were supported by specific recommendations for marketing, manufacturing, finance, and human resources strategies.

Types of implementation work conducted

Immediately after the diagnostic stage, an implementation plan was formulated. This plan was presented to the management of Uralelectro at a number of workshops in May 1996. The following specific assistance was provided during the implementation phase of the project:

Cost reduction

- Assisted with the establishment of cost centers and the development of the new accounting systems for allocating and managing costs
- Provided a method to determine the optimal structure for vertical integration to achieve cost reductions.

Production

- Provided detailed information on Western producers of induction motors
- Provided advice and assistance on methods for improving the effectiveness of materials utilization

- Conducted a half day seminar on steps necessary to implement a Total Quality Management system. The results of the quality and process control workshop in aluminum foundry were presented. It was agreed to conduct similar analysis in other production processes
- Introduced more effective production planning and scheduling method and develop information systems to support it.

Finance

- Introduced modern financial management practices and established an effective management and cost accounting system
- Organized a half day workshop to discuss financial issues relating to the new structure: allocation of overheads, accounting for business units, sharing of profits, and financial planning and budgeting
- Provided reference material on methods for budgeting and cash flow analysis.

Marketing and Sales

- Provided marketing research reports on "International Markets for Electric Motors and Generators".
- Organized a two day marketing seminar for staff who are either directly or indirectly involved in marketing and sales activity. The seminar was directed toward the specific business issues facing Uralelectro
- Further developed the dealership network and value adding services to increase sales volume.

Reorganization

- Suggested a revised organizational structure
- Ran a one day workshop to discuss structural issues and division of responsibilities between business units and central functions.

Other

- Identified joint venture partners to strengthen the Motors business and financial partners to invest in developing the Starters business
- Arranged a meeting between the General Director and senior management of AMETEK (a potential Italian partner in the motors business) to discuss the necessary steps towards forming a joint venture operation.

7.3 Accomplishments Of The Enterprise

Uralelectro's management worked closely and enthusiastically with the PIES team to move towards the company's reorganization. A number of the recommendations have already been implemented and others are progressing.

Cost reduction/Production

- In order to improve efficiency of energy usage, meters are being installed in all the workshop to enable costs to be directly attributed to cost centers. The investment in metering will be paid back in less than two months.
- During the diagnostic stage, a working group identified significant savings in materials and rework reduction in the aluminum casting foundry, which could be achieved through the application of more effective quality and process control systems. A group has been assigned to conduct similar analysis of other manufacturing processes as the first step towards the introduction of a Total Quality Management System
- Made changes to the purchasing function and implemented systems for management of raw material inventory and work in progress.

Finance

- Financial analysis conducted during the project has been replicated and instituted as management reports providing information on cashflow, inventory, product profitability, and receivables
- The finance function is being reorganized in order to make transparent the financial performance of the four business units and assign a management accountant and a chief accountant to each unit.

Marketing

- Uralelectro has initiated a program to strengthen its relationship with its dealership network and increase sales through dealers. A successful conference of dealers was organized by the Marketing Director to communicate the restructuring plans and discuss Uralelectro's policy for working in partnership with its dealership network
- The team worked closely with the purchasing managers to create an accurate inventory of obsolete material, establish its value, and identify potential buyers. Since the start of this exercise, RU 1 billion of obsolete material has been sold and plans are in place for further liquidation of stock.

Reorganization

- The management agreed to a new corporate structure, restructuring its operation into four business units: starters, motors, components, and consumer goods
- The company approved and implemented a revised organizational structure. A new board of directors has been appointed which includes managing directors of each business unit.
- Relationships with external organizations have significantly improved (Orenburg and Mednogorsk administrations, LPC, potential joint venture partners).

Joint venture

- Joint venture discussions have successfully been initiated with AMETEK and ABB SACE SPA and internal project teams have been set up to continue negotiations.

7.4 Change Management Process Established

A major accomplishment of the project was a real shift in the culture and behavior of the organization. The approach to introducing change that the team found successful at Uralelectro consisted of:

- Obtaining the full commitment and sponsorship of the General Director. This was achieved by maintaining regular contact with him, fully understanding his concerns, and providing tangible assistance early in the project
- Involving senior management in the day to day running of the project and in the decision making process
- Adding value early during the project by undertaking activities with quick pay off and demonstrating the feasibility of medium term objectives such as finding a joint venture partner
- Forming multi-disciplinary task groups to work on identifying solutions to specific business problems;
- Organizing a number of off-site meetings for the board of directors to stimulate teamwork and effective discussion
- Devising and agreeing on a reward mechanism for employees
- Finding opportunities to uncover barriers to change via informal communication
- Assigning a change director responsible for execution of the change management program.

Working Groups

It is important to mention that although the command economy had collapsed around the company, the mindsets of many employees remained those of the old system. This was identified early during the project as a main barrier to change. The team did not believe that it would be adequate to provide basic recommendations such as setting up a sales and marketing department, introducing financial management, reducing costs, etc., without a way to institutionalize the process of making these changes. Without an appropriate vehicle for the management to continue improvements, such recommendations would have only generated short term gains and would have been abandoned once the team left the company.

From the beginning of the project it was clear that management understood its problems but was unable to take positive action. Therefore the team saw its priority as coherently analyzing the implications of present practices on the financial performance of the business and devising a corporate and organizational structure that would create an environment which would encourage desired behaviors. The structural changes that were recommended and the methods used for their implementation were specifically designed to create internal competition. When new structures were created, it soon became apparent to managers that power and responsibility was shifting from old areas to new positions in the firm. Managers who shifted from centralized departments to lead business units began to lobby vigorously for decentralization, even if, as was sometimes the case, they had previously opposed such restructuring. By coopting some managers, stimulating competition between departments, and forcing fundamental structural questions to come to the surface, major issues were debated, some deeply held assumptions were abandoned, and new conclusions were reached to support the restructuring process.

The success of the project did not solely depend on the quality of the work conducted by the consultants but by the input and commitment to change on the part of management. In order to secure commitment to reform and managerial ownership of the restructuring process, a number of working groups were formed to investigate specific issues. These included:

Corporate and Organizational Structure

The team leader and the General Director had agreed to investigate a more appropriate structure for the business. A number of sessions were organized to define the attributes of an effective organization. Based on the outcome of these sessions the business was divided into four business units. At the end of the process the General Director fully supported the structural changes and requested that the team interview over 30 candidates for the board of directors.

Financial Department Restructuring

Another element of organizational restructuring was the merger of the Finance, Accounting, and Economic Planning departments. The groups were merged with the decision of the General Director, after discussions with the consulting team. Distributing new roles, however, required a wider circle of participation in discussion. The former head of the economic planning department agreed to become the new Finance Director. A group of accountants from the former Accounting Department met to discuss guidelines for accounts by the new business units, and how to formulate consolidated accounts. Production planning decisions were then devolved to the new business units.

Marketing Organization Restructuring

Reorganization of the enterprise also required restructuring of the Marketing Department. The Marketing Director agreed to become the head of the Starters division. Marketing functions were then devolved to the separate business units.

Obsolete Material

A group was set up with representation from purchasing, marketing, finance, and production work on obsolete raw material inventory. This group created a thorough list of obsolete raw materials and their estimated market value. The value of obsolete inventory was estimated at 2 billion Rubles instead of the book value of 700 million Rubles. For each item of obsolete inventory, the working group identified potential buyers and a list was presented to the Purchasing Director. The inventory included electromechanical steel and cast iron, which has now been sold for around 636 million Rubles. The exercise also highlighted the need for a more extensive analysis of all inventory in order to establish appropriate policies for stock levels in the future. At the end of the PIES project, it was agreed that a new group will be formed to conduct a thorough analysis of all inventory, how to improve the purchasing process in the future, and how to liquidate excess raw material inventory.

Energy

The head of the Energy Department and one member of his staff were tasked to identify initiatives that would reduce energy by 25%. The key recommendation of the group working on the energy usage was the installation of meters for each of the workshops. Presently it is difficult to accurately measure the energy consumed by each workshop. Energy costs are treated as overhead and are allocated to product costs in an arbitrary fashion. This does not allow Uralelectro to identify poor practices and to set appropriate targets for improvement The group presented a cost and benefits analysis for the installation of meters. It is estimated that the investment will be recouped within 1.5 months. The cost of metering is estimated at around 27 million Rubles and benefits are based on a reduction of 5% in total energy consumption. This is a conservative estimate and savings are likely to be around 30%. The tools production workshop, which was set up as a separate legal entity, has achieved over 35% reduction in its energy cost since introducing metering. As a result of this exercise, meters have been purchased and are being installed.

Value Engineering

This working group consists of three engineers engaged in the production of starters. The aim of the value engineering exercise was to conduct a detailed analysis of each step involved in the manufacturing process of marine starters and to analyze the value added by each step and the associated costs. The analysis of the marine starters demonstrated that there were significant potential for cost reduction. Its has been agreed to conduct a similar analysis of other products during the implementation stage. The managing directors of the Motors and Starters business units have agreed to set new working groups to conduct similar analysis for all the products in each of the units.

Quality management

The quality group, consisting of members from the Quality Control Department, concentrated on a detailed analysis of the operation of the aluminum casting workshop. The group estimated that over 250 million Rubles a year could be saved through the introduction of a more effective quality control process which would result in 25% reduction in rework levels. The working group will prepare a detailed plan for revising the quality control processes in the foundry. The responsibility for quality management has now been devolved to business units A seminar was run for the new quality managers in order to put forward an approach to be adopted by each of the business units.

Each of the above working groups were facilitated by one of PIES consultants. The formation of these working groups were instrumental in building relationship, demonstrating that the management was able to develop its own solutions, and transferring skills in team working and collaborative problem solving.

Although the recommendations of the project were fully accepted, slow progress was being made towards implementation. A meeting was called by the General Director to identify barriers to change. This meeting did not produce the desired results. The team suggested to the General Director to hold a two day workshop for the directors off-site. The workshop was organized into a number of sessions including games as well as more serious sessions. Although the management was initially unsure of the value of the workshop, by the end of the workshop significant number of issues had been discussed and resolved. This was the first time ever that such a forum was set up for discussion and all the attendees found it valuable. Based on the success of the first workshop, the team was requested to run further workshops.

During the last two weeks of the implementation phase, General Director requested that a group should be set up responsible for finalizing the preparation required for the implementation of the new Corporate Structure. This group consisted of:

- Managing directors of Motors, Starters and Components business units
- Technical and finance director

This group worked for two weeks to fully define the new operating procedures and rules. Different members of the senior and junior management were invited during those two weeks to discuss specific matters such as technical services and quality control. At the end of the two weeks specific proposals were presented for approval to the General Director. It was also agreed that project teams will be formed as a vehicle for addressing specific issues. The ones that have already been agreed include a "make or buy" analysis of castings, and market research to support the joint venture project with AMETEK.

In addition to the working groups and workshops, the team spent considerable amount of time with the senior management outside working hours. The time spent on informal communication and exchange of views was equally as important in understanding the fears of the management and their real attitude towards changes. This enabled the team to devise appropriate methods of dealing with barriers to change. Furthermore, the sessions introduced new working methods and problem solving methods that were not previously attempted.

Future change management

A Change Director will be assigned to take responsibility for the management and co-ordination of the reorganization program. The responsibilities of the Change Director and his team (task forces) were defined as follows:

- Develop and agree upon additional detailed action plans through discussion with the managing directors of the business units and other directors
- Ensure that central functions are established and structured appropriately to support the business units and define business relationships between them
- Identify potential barriers to implementation and devise methods to overcome them
- Facilitate management workshops and assist in devising an effective mechanism for internal communication
- Define key performance indicators, establish baseline data, and agree upon performance targets with the directors
- Identify joint venture partners and facilitate negotiation with potential partners

Several candidates have been identified for the position of Change Director and one is expected to be appointed in the near future.

7.5 Prospects For The Future

Although during the past six months significant progress has been made, much work remains to be done before Uralelectro can realize tangible benefits from its restructuring program. Effective implementation of this program is unlikely to be achieved in less than two years. The ability of Uralelectro to manage the scale of changes involved depends on the availability of skills in organizational change management and access to specialist skills. In the medium term Uralelectro will need internal and external assistance to address the following problem areas:

- Organizational aspects of the global change management program
- Support for the managing directors of the business units with formulating their business plans and producing budgets for the first year of operation

- Development and implementation of a management and cost accounting system to enable management to track the performance of the businesses reliably
- Design and introduction of a revised reward system encouraging behaviors that will lead to quality and performance improvements
- Reorganization of the sales and marketing department and introduction of new procedures and information systems needed to support and extend the dealership network
- Rationalization of the manufacturing processes in order to reduce costs significantly and prepare for the implementation of a Total Quality Management system
- Implementation of information systems for production planning, material planning, and the management of inventory and work in progress
- Facilitation of discussions with potential joint venture partners and assist the business units with quantifying and meeting their investment needs.

Uralelectro has started negotiations with the RPC for a technical assistance program as part of the new Enterprise Restructuring Fund, a program through which some of this assistance may be available.

8. ENTERPRISE SUMMARY - PLASTIK

8.1 Description Of The Enterprise

Location

Joint Stock Company "PLASTIK" (Plastik) is located in 7 km from Uzlovaya, a town in the Tula region.

Lines of business

Plastik comprises 5 key businesses:

- Chemicals (liquid monomer from oil derivative)
- Resins (various resins from monomer) - major business by turnover and profit
- Processed products (for automotive, industrial, construction and consumer markets)
- Wallpaper printing
- Wallpaper machinery refurbishment

Major products

Chemicals	• Stirol (production capacity: 40,000 tons/year)
Resins	• ABS (production capacity: 23,000 tons/year) • Polystyrene – Polystyrene emulsion (production capacity: 6,000 tons/year) – Polystyrene suspension (capacity: 4,000 tons/year) – High impact grade polystyrene (capacity: 1,800 tons/year)
Processed plastics	• Automotive parts – Ignition cases, tubes, window trims, electrical components, etc. • Industrial products – Helmets – Separators – Decorative PVC films • Consumer products – Plastic bags, plastic covers, shower curtains, toilet seats, buckets, picture frames, beach toys, etc.
Wallpaper	• Ordinary and washable wallpaper
Wallpaper machinery	• Regrinding printrollers

Employment at the beginning of assignment

Total employment level at the beginning of assignment was 3900 people. 1400 employees worked in main production workshops. There was a reduction of some 120 staff during the project.

History of the enterprise

Plastik was established in 1959 in place of a coal processing plant which made compressed coal briquettes. The vertical clamping hydraulic presses were converted to compression molding of phenolic resin and phenolic laminated safety helmets for the local mining community. By 1963 Plastik expanded compression molding operation to include large parts made from phenolic resin.

PVC extrusion started with membranes for large storage batteries and has been expanded to include several types of extruded PVC film.

Plastik began injection molding in 1963. Their selection of injection molding machines was dictated by the sizes of parts made at the beginning: small presses for automotive parts, and larger presses for helmets.

Polystirol facilities were constructed in 1967 to produce polystyrene suspension and polystyrene emulsion. In 1995 Plastik started production of high impact polystyrene.

The ABS production began with the construction of ABS polymerization facilities during 1969-1972, under license to Asahi Chemical (Japan). Originally Plastik purchased stirol (styrene monomer) for ABS production, but a synthesis plant for stirol was built in 1975.

The wallpaper operation, started in 1985, is a combination of printing on paper, with or without PVC coating, printing on PVC film and laminates.

Asset Value

Plastik has over 350 billion rubles in assets (as of January 1, 1996). 80% of these are fixed assets.

Profit and Loss

1995 turnover was 193 billion rubles. 1995 profit was 48 billion rubles (according to the balance sheet of 1 January 1996).

Ownership structure

Plastik was privatized in 1993. The ownership structure as of March 1996 was:

Employees	48%
State	20%
Other natural persons	14%
JSC AZOT	10%
Investment funds	8%

There has been significant activity in trading of the enterprise's shares during the course of PIES Project. Two Moscow investment companies have been actively buying stock from employees over the past 4 months. One company, Derzhava, offered employees a price of 7,000 rubles a share in March and April. They have accumulated approximately 4.5% of issued shares. The latest buying effort has come from OLMA, a Moscow-based financial group. They have accumulated nearly 10% of issued shares offering a price of 10,000 rubles per share. The General Director has met with the State Property Committee representatives in Tula to get their agreement not to sell the government's shares without an investment tender. A cash auction at the beginning of June was not successful because there was only one bidder, Derzhava, and the government considered the offered price inadequate. The intentions of Derzhava and OLMA are not fully known, although observations made by Plastik management at other companies where Derzhava is a majority shareholder, are not encouraging toward giving this investor further opportunities.

The enterprise began to buy its own shares in May and has continued to do so throughout June in an effort to maintain control of the enterprise. They have spent at least 500 million rubles in this effort, accumulating approximately 3% of issued shares.

8.2 Description Of Assistance Provided

Dates of assistance

The PIES project team worked at Plastik from February 5, 1996 until July 3, 1996.

Staffing

Diagnostic phase	(February 5, 1996 - April 17, 1996)
Robert Munns	Team Leader/ Industry Expert
Benjamyn Damazer	Co-Leader/ Business Strategy, Marketing
Jean Berg	Marketing Strategy
Eric Mottard	Marketing Strategy
Dmitry Danilovich	Organizational Structure and Processes, Marketing
Tom Thornhill	Finance
Arkady Gerasenko	Finance
Vladimir Tchernets	Social Assets, Finance

Implementation phase	(May 13, 1996 - July 3, 1996)
Benjamyn Damazer	Team Leader/ Business Strategy, Marketing
Jean Berg	Marketing Strategy
Dmitry Danilovich	Organizational Structure and Processes, Marketing
Tom Thornhill	Finance
Arkady Gerasenko	Finance

Initial Assessment

The PIES team conducted an initial assessment at Plastik during the week beginning February 5, 1996, which included intensive meetings with the General Director and other key managers. During the assessment, the PIES team made the following initial observations and conclusions:

- The organizational structure of the company was confused, with significant overlap in responsibility
- It was clear that, not surprisingly, Plastik's liquidity problem should be a key area of focus. The team's concerns were heightened when provided financial data that were identical for two different months.
- The production technology generally appeared satisfactory and appropriate to the business

- The marketing/sales function was inadequate or barely existent.

Diagnostic Review

During the full diagnostic review, the PIES team explored its initial findings in detail, and focused on developing a proper strategic plan for Plastik.

The team's initial impression - that Plastik suffered from many of the typical problems of Russian industrial enterprises - was verified. Plastik experienced: low production levels, overstaffing, significant reliance on barter transactions, large amount of overdue receivables, high credit costs, and excessively high costs for raw materials. However, while these factors had definitely affected the financial health of the company adversely, the enterprise was not in the worst of conditions.

Finance/liquidity

Plastik was normally able to maintain an acceptable level of liquidity as measured by its current ratio, but its acid-test (quick ratio) liquidity was clearly insufficient. This was due to a large portion of stocks of materials and finished goods which appeared unlikely to be used or sold in the short-term. Similarly, a large portion of receivables was long overdue and seemed unlikely to be paid in the near future. With working capital tied up in stocks and receivables the enterprise was in a cash crunch. They had nearly 4 billion rubles in short-term bank loans at interest rates between 140 and 170% outstanding in early 1996. Only partial salary payments were being made starting in December 1995.

Technology/production

Technical know-how was strong and finished products actually met world standards, especially in ABS and Polystirol. Nevertheless, asset utilization was low (about 40%), especially due to a "one machine for one product for one customer" strategy.

Marketing/sales

The company's marketing ability was very limited, with its Marketing Department included within the Production Department. In practice, this one-person Department's main activity was to look for outlets for consumer goods, which it did without much success. This poor support for sales led to many consequences:
- Little or no understanding of customer requirements, aspirations or development plans
- No demonstrable understanding of the purchasing process or criteria adopted or applied by customer base

Plastik's product strategy remained unclear, with many opportunities within its 5 businesses. This unfocused strategy hampered the company's ability to invest and concentrate where it should, remaining an "average" producer everywhere instead of striving to become a leader in selected lines.

Organizational/social assets

Plastik's organizational structure was very complex, with large and growing spans of control. A total of 16 departments/ deputy directors reported directly to the General Director.

Social sphere costs were very high, due to a wide range of services, including substantial housing provision, a profilactorium, heating and water filtration for the local municipalities, and farming and leisure facilities.

The enterprise is located within the Chernobyl state benefits area, entitling employees to extended leave period, early retirement and other benefits.

Recommendations

The team presented its recommendations in response to its findings during the diagnostic review. The central recommendations were:

Strategy/Marketing

The team's main recommendations in the area of strategy and marketing were:
- Concentrate and invest in ABS, industrial and automotive parts by developing new products, finding new uses, and selling in Russia and abroad
- Focus on selected market segments in Polystirol
- Divest Stirol, consumer goods and wallpaper production.

This strategy must be carried out with the help of an ambitious marketing department. To do this Plastik should:
- Set up a marketing department
- Define and implement marketing plans for each business line
- Change its sales techniques to include: continuous follow-up of sales and customers, development of follow-on sales to current customers, including creation of "large account managers" at major clients, and a search for new industries with potential profitable clients.

Production

Regarding production, the team recommended that Plastik:
- Improve the efficiency of the company by reorganizing the workshops
- Sell unneeded equipment using international brokers in Europe and the USA
- Switch from a "one machine for one product" philosophy to a "higher assets utilization" philosophy, in order to be more cost efficient and competitive for potential customers, mainly in injection-molded parts.

Finance

The major recommendations in the financial area included:
- Active and structured monitoring of cash flow
- Preparation of cash flow forecasts and constant use of a cash flow model
- More aggressive management of accounts receivable and payable in light of the current cash shortages
- Analysis of aging of payables and receivables
- Implementation of a management information system linking production, operational, commercial, and financial data

- Improving cash flow through discounted sales of goods received in barter
- Widening of the functions of the Financial Department to include profitability analysis, investment reviews, and regular reporting.

Organization/social assets

The team developed and recommended a new organizational structure that would enhance decision-making and opportunity identification. This proposed reorganization reduced the direct reports to the General Director in stages from 16 to 10, with departmental reorganizations in tandem to optimize effectiveness. Additional recommendations in this area included:

- Establishment of a marketing function to identify and capitalize on market opportunities and changes in customer (and potential customer) requirements
- Redesign of several key processes:
  - Sales order process
  - Goods dispatch process
  - Production planning process
  - Purchasing process
  - Warehousing process

Recommendations regarding the social sphere included:

- Transfer housing and kindergartens to city authorities
- Convert other social assets into profit centers
- Generally reduce costs wherever possible.

Types of analysis conducted

Strategy/Marketing

Marketing and strategy analyses included:

- Sales analysis and customer evaluation, including current and previous customers
- Market research on ABS, Stirol, Polystyrene, Phenolic Resin, Wallpaper, Automotive industry and consumer goods in Russia and Europe
- Domestic and international competitor evaluation including Bayer, Dow, Chi Mei and others
- Strategic option evaluation and recommendation for sectoral divestment and investment

Production

The quality of the products was compared to international standards with good results for Plastik. On the processes, the following analysis was conducted:

- Process flow and capacity assessment
- Equipment and technology assessment
- Determination of the equipment and people needed for each business line.

Finance

The team's financial analyses included:

- An evaluation of Plastik's current liquidity position

- A review of warehouse contents
- Status of outstanding payables and receivables
- Cash flow analysis for 1995 and a cash flow forecast for the first and second quarters of 1996

- Cost structure analysis for the enterprise's major products
- Analysis of the impact of social asset costs
- Review of major financial processes and information flows.

Organization/social assets

Organizational analysis centered around a review of the existing overall company structure and internal processes in the core functional areas: sales, production, purchasing, finance, economics & planning departments. Organizational processes were reviewed for effectiveness and cost efficiency.

The team also conducted a thorough analysis of Plastik's social assets:

- Analyzed actual social sphere costs to the enterprise
- Defined social sphere objectives and financing options
- Defined essential and desirable social sphere activities with cost reduction strategies.

Other

The team provided assistance to the enterprise related to ownership issues in light of increased interest from investment companies in Plastik's shares. The important issues were to make sure that the shares were not undervalued, to encourage the enterprise to talk with the parties interested in the enterprise's stock, to evaluate their intentions, and to understand fully the implications of a change in ownership structure.

Types of implementation work conducted

Cost reduction/production

The team conducted an investigation of used-equipment brokers in the US and Western Europe to locate potential buyers for Plastik's surplus machinery.

Finance and financial systems

Implementation work in the financial area focused on cash flow and developing a system of management information reporting. Seminars and workshops were held on the methodology and uses of cash flow statements and forecasts. Team members identified data sources for the cash flow statement (including barter operations) and guided the Deputy Director for Finance in creating a monthly report and a monthly cash flow forecast.

Extensive work was also conducted in organizing a management information system involving production, procurement, sales, and financial data and forecasts. This work involved a seminar for senior management about the need for such information and how it could be used. The team worked with various department chiefs to assess data requirements and determine optimal processing flows.

Discussions were held with the Deputy Director and Financial Department staff about the range of responsibilities for the Financial Department, including investment planning and the financial analysis of the factory's operations.

Marketing

Implementation work related to marketing involved two main areas:

- Setting up of the marketing department, through marketing seminars, marketing plans, and teaching of methods to develop sales to current customers. The specific objectives of this task were:
  - Define the first steps of the newly created department
  - Enable the members of the department to work independently in the future
  - Help them be the "heart" of the new market-driven company
- New customer and partner identification:
  - European partner identification
  - Successful search for trading and investment partners internationally
  - Identification of potential resins distributors, agents and buyers in France, Italy, Germany and elsewhere.

Reorganization

Proposed organizational changes were discussed with company senior management in great detail, and some recommendations have already been implemented. Consultants assisted with establishing a new marketing department, developed department structure and staffing plan, and conducted comprehensive training of staff hired into the department. Consultants also assisted in establishing a production planning department, and conducted training for department staff.

Reports, plans and seminars delivered

The following reports, plans and seminars were delivered over the course of the project:

- Diagnostic seminars on strategy, marketing, production, finance, organizational structure and processes, social assets
- Diagnostic report
- Implementation plan
- Marketing seminars
  - Marketing principles : targeting and marketing mix
  - How to write a marketing plan
  - How to get information (market research)
  - Pricing strategies
  - How to develop sales
  - Negotiations and terms of conditions
  - Role of the Marketing Department
- Seminar on basics of international trade (contracts, payment terms, delivery terms)
- Organizational restructuring seminar
- Production planning seminar
- Seminar on sales order process
- Financial seminars

- Liquidity and financial indicators
- Cash flow and cash flow forecasting
- Management Information Reporting
- Role of Financial Department.

8.3 Accomplishments Of The Enterprise

Marketing/Sales

- Identification of customers in France
- Identification of potential distribution partners in Europe
- Establishment of a marketing department with dedicated marketing managers
- Closer relationship with key customers in automotive sector, through "large account managers"
- Basis for research function with information sources
- Identification and focus on profitable product ranges
- Rationalization of product portfolio
- Appointment of key account executives.

Production

- Recognition of process limitations and strengths
- Sale of surplus molding machines
  - Ten machines sold to Russian company
  - Bids from brokers for other machines anticipated
- Stocks review
  - Plans being considered for tax efficient disposal of 15,000 helmets and extensive consumer goods stock to release working capital
- Revised factory layout
  - Warehouses being amalgamated to release production space and reduce operating costs.

Finance

- Began weekly preparation of cash flow report
- Began monthly cash flow forecasts
- Created a group within the Financial Department specifically for management of receivables and payables
- Created a program to age receivables and payables
- Began implementation of a system of management reporting

Organization/Social Assets

- Establishment of streamlined reporting structure
- Establishment of marketing and production directorate
- Establishment of production planning review
- Reorganization of finance department
- Negotiating transfer of housing and kindergartens to local authority

8.4 Change Management Process Established

- The General Director is actively involved in all process changes. Much of his time, however, is involved in fending off stock predators, collecting old receivables, working with local authorities, and searching for new investment possibilities.

- Working groups comprised of deputy directors and department heads have been established to work out a variety of issues related to finance, marketing, and organization. The finance group has involved the IT department in an effort to automate some aspects of financial analysis and reporting. The marketing group includes previous employees of the central laboratory, IT department, production areas and sales office who became marketing managers in a newly established marketing department.

- The team has attempted to instill within management the need to focus on what will work best, not on theoretically optimal solutions. The company is ambitious and must take care not to overextend itself at this stage.

- Consultants facilitated ongoing reviews of investment proposals in keeping with overall strategy and affordability criteria. The wallpaper machinery proposal was suspended, while the proposal for polystyrene production is being developed and awaiting finance review by the Ministry in Moscow for import permits and financing.

- Seminars were provided for small groups based on real issues facing the enterprise. Topics covered include marketing principles, case studies on Plastik's position, product definition, pricing, promotion, distribution, marketing plan construction, automotive marketing review, polystyrol case analysis, major sales development, marketing development and a full range of financial issues.

8.5 Prospects For The Future

Plastik is a fundamentally sound, technically strong company. The enterprise is involved in a very large number of businesses, however, and faces major decisions regarding shutdown or rationalization of unprofitable businesses. The team's diagnostic report contained a detailed analysis of the long-term viability of each of the enterprise's major activities with various recommendations. The General Director faces a re-election challenge in July 1996. Major decisions are likely to be withheld pending its outcome.

Short-term issues continue to occupy the minds of senior managers. Cash flow remains a key concern. High fixed costs (including social asset support), interest payments, low production volumes, and a large percentage of barter combine to squeeze Plastik's cash resources. The recent attempts by outsiders to buy the company's shares has put an additional claim on the enterprise's resources by inducing management to buy their own stock. If negotiations with the local authorities for the transfer of housing and kindergartens are successful, the pressure on the enterprise will be eased considerably. The major effect of the cash flow problems is a lack of resources for investment. The enterprise is actively looking to sell some surplus machines to raise cash. The increased attention being given to marketing should help to increase sales within selected businesses in the mid-term.

Improved information flows and reporting procedures should help to make management more aware of the condition of the enterprise and spur on additional process modifications. It is also expected that increased availability of information will raise the General Director's expectations of his deputies.

Profitable product lines have significant market potential which can be developed. Plastik needs to extend its product range to high impact ABS, high gloss products, and high added value polystyrene, and to establish a research and development function for new resins. The latter project is to be managed in close cooperation with the Marketing Department.

9. ENTERPRISE SUMMARY - URALOBUV

9.1 Description Of The Enterprise

Uralobuv JSC is a footwear manufacturer whose products range from specialized shoes for workers to ballet slippers for dancers and include regular footwear for men, women, and children.

Location

Uralobuv JSC is based in Ekaterinburg where it started operating in 1930.

Lines of business and major products

Uralobuv's sales are spread over a wide range of products, as is normal for a consumer goods producer, but they can be grouped into two major segments:
- "Business to business" products: all the specialized shoes for workers or police/military sold to other companies or state administrative bodies; this product line accounted for 40% of the sales volume in 1995
- "Regular footwear" products: all regular shoes for men, women and children sold directly to the final user

Although Uralobuv remains primarily a shoe manufacturer, it has diversified in order to bring in additional cash. For example:
- Uralobuv has been selected by the local authorities to certify shoes before they are put on the market
- Uralobuv is renting vehicles and space
- Uralobuv is selling adhesives
- Uralobuv performs a wide range of public services, such as building repair, energy supply, associated with its social sphere assets.

Employment, layout and machinery

Since 1991, main site employment decreased sharply and continuously from 6,000 employees to about 1300 in the beginning of 1996. The employment level did not change significantly during the four months of the project, although a large number of employees currently are not working regularly due to a partial shutdown.

The workforce breakdown indicates that:
- Administrative staff accounts for 15% of the total
- Indirect operatives[1] account for 25% of the total
- Direct operatives account for 60% of the total.

Uralobuv is currently operating on a 40, 000 m^2 layout comprising 9 different workshops.

Uralobuv benefits from a fairly good machinery base which includes some western equipment purchased in 1987-89 in Germany, Austria and Italy. Due to good maintenance, most of those

[1] indirect operatives = supervisor, maintenance, security, etc.

machines are still in good enough condition to be sold in case the enterprise faces an urgent need for cash

History of the enterprise

During the Soviet period, Uralobuv was the third largest footwear manufacturer in Russia, with an output of approximately 10 million pairs per year It considered itself to be a general shoe manufacturer, with the full range of men's, women's, children's, and specialized (worker and military) footwear.

Until 1991, Uralobuv retained six affiliates/subsidiaries located in various parts of the Urals region. Prior to becoming an open joint stock company in 1992, all except one were spun off and became financially and operationally independent.

Since 1991, Uralobuv's competitive environment has changed substantially. Russia witnessed a decline in footwear consumption both in regular and specialized segments as a consequence of the general macroeconomic downturn. This was exacerbated by the flood of imports into the regular adult footwear market in Russia. At the same time, Uralobuv failed to react to the collapse of its old state distribution system collapsed, and its sales became restricted exclusively to the Ekaterinburg region.

In the meantime, Uralobuv failed to adapt its organization to this new competitive market. Cost reduction efforts did not keep pace with the decline in revenues. The firm maintained its whole range of technologies, machinery and equipment, while general and administrative expenses and social sphere burden costs continued to rise.

Internal processes contributed to the decline in Uralobuv's position. In particular the costing process lacked sufficient precision for Uralobuv to measure accurately the costs and contribution to fixed costs for each product group and to adjust to changes over time. Moreover, prices were traditionally set only to cover full costs, rather than variable costs, with little consideration of the position of the company's products relative to its competitors'. As a result, Uralobuv's products were often priced too high.

Consequently, by the beginning of the project, Uralobuv was facing a severe liquidity crisis. Inventories were building up, and the factory lacked cash to buy materials and to maintain production levels.

In 1994 the company was privatized in accordance with the second model of privatization. All shares were distributed by the end of 1994.

Asset value

Uralobuv's asset value is approximately US $10 million, as follows: (August 1995 figures)

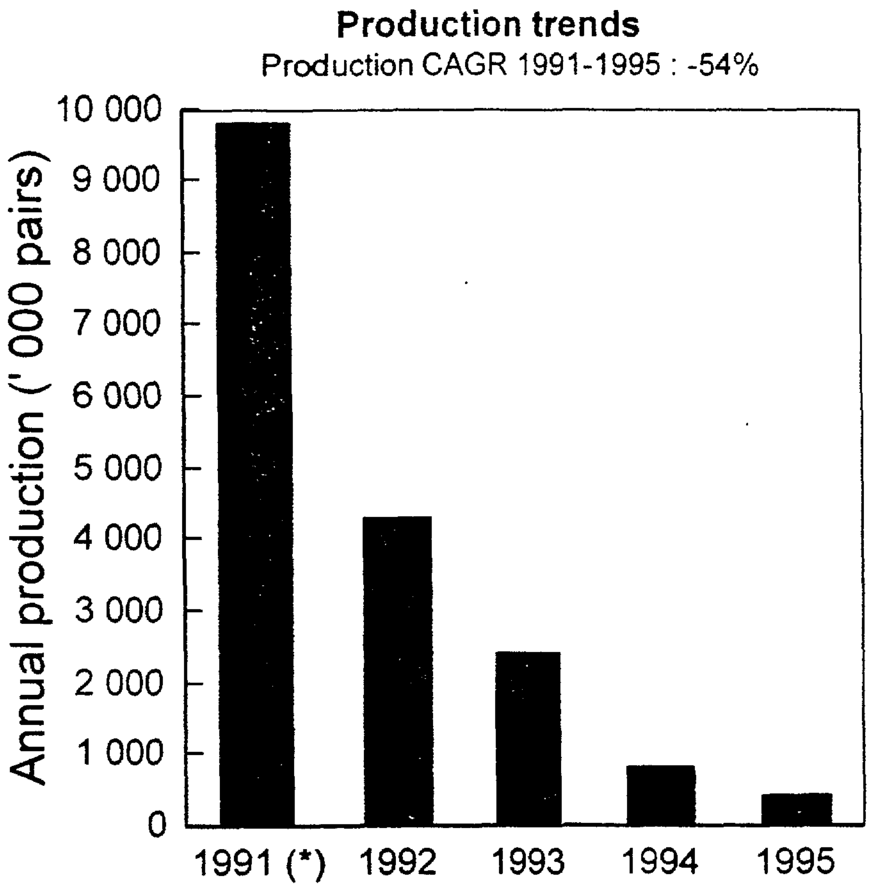
	Assets	Liabilities
Short term	17.8%	11.3%
Long term	82.2%	88.7%

Profit and Loss

Results for 1995 showed for the first time an overall loss of about $133,000 mainly due to a dismal fourth quarter: (all figures from 1995 in US dollars)

	1st quarter	2nd quarter	3rd quarter	4th quarter
Net Income	43,000	93,000	137,000	(39,000)
Net Earnings	(11,000)	21,000	30,000	(173,000)

Other trends



Source: Production and Accounting Department

As shown on the figure above, Uralobuv's activity has dropped off sharply over the past five years. In 1995 turnover was down to US $4.15 million.

Uralobuv's working capital also declined sharply, especially in the fourth quarter of 1995. Adjusted and deflated operating net working capital fell from RU 3.9 billion in the first quarter of 1995 to RU 2.1 billion in the fourth quarter. The following factors contributed to the decline in liquidity:

- Barter grew from 40% of sales in the first quarter to 60% of sales in the fourth quarter of 1995, while cash sales declined
- Despite the decline in sales, general and administrative expenses remained stable through most of 1995 and increased by about 30 percent in the fourth quarter
- Social sphere expenses continued to rise
- Uralobuv incurred tax penalties (connected with failure to keep up with payments to nonbudgetary funds) of about RU 380 million in the third quarter and RU 345 million in the fourth quarter of 1995

Ownership structure

The shareholder structure at the beginning of the assignment was as follows:

Shareholder	Percentage Ownership
Medsbitservice (Moscow)	21%
Asko-Capital	21%
Current employees	21%
Former employees	7%
General Director	7%
Other (less than 1% each)	23%

The Board of Directors consists of the General Director, the Financial Director, two representatives from Asko-Capital, and a fifth independent shareholder who is close to management. Two seats on the Board, to which the Moscow-based investment group is entitled, have been left vacant.

9.2 Description Of Assistance Provided

Dates of assistance

The enterprise was the last to take part in the PIES project, with work on site beginning in February, 1996. The program of assistance provided followed the basic approach of the previous PIES enterprises, beginning with an initial assessment, followed by an intensive diagnostic review, and then implementation assistance.

Staffing

Diagnostic phase

Jacques Berger - team leader
German Ainbinder - financial analysis
Evgeny Bobrov - financial analysis
Oleg Kozlovsky - financial analysis
Alexandre Kramer - market research
Marc Lamure - production analysis
Jeff Lehrer - marketing analysis
Reginald Pointer - industry expert
Laurence Vernon - marketing analysis

Initial assessment

The team made an initial presentation to the managers of Uralobuv's major departments. It then held extensive discussions with the General Director and the Financial Director. The team also met with the Deputy Director of the Mid-Urals Privatization Center to discuss collaboration and secure alignment of priorities with their expectations.

In addition, the team met with a member of the Board of Directors and two major shareholders who hold about 20% of the shares of Uralobuv. Their greatest concern was that the PIES project should facilitate the search for a potential foreign strategic investor.

In those initial interviews, we identified management's major concerns and expectations:

- Need to expand and train the sales forces and establish a marketing competence
- Need to bring working capital up to 'safe' levels
- Absence of a management information system
- Lack of liquidity (bank account was frozen)
- Need for a market-oriented organization
- Lack of initiative and creativity from staff
- Excessively high price/quality ratio given the reduced purchasing power of the current Russian consumers and industrial/state purchasers
- Overdependence on suppliers who dictate unfavorable terms of payment
- Need to rebuild distribution network
- Concern about the speed of divestment from the financial burden of social assets
- Ineffectiveness in collecting receivables, worsening the working capital situation.

Diagnostic analysis

The diagnostic analysis indicated a number of serious problems at Uralobuv:

Finance

- Sales in 1995 plummeted to one-tenth of 1992 levels
- Profitability, as measured by cost/revenue ratios and the levels of net income and net earnings, has also worsened over the past two years. Furthermore, Uralobuv posted major losses in the final quarter of 1995
- The enterprise is facing a liquidity crisis, as indicated by several measures of net working capital, and is already facing consequences, such as a frozen bank account, and an inability to purchase quality leather with steady on-time delivery; reliance on barter is also excessive
- Men's and specialized footwear, taking into account their volumes, assume more than 80% of global contribution
- Social sphere net costs are an important contributor to Uralobuv's losses.

Production

- Uralobuv is operating at about 10% of capacity, and productivity has declined
- Productivity is at least three times lower than a comparable Western company (Mansfield. a British footwear manufacturer, was used as a benchmark)
- Overheads have increased as a portion of revenues. and excessive overheads contribute to a cost structure that is more rigid and less competitive than a comparable Western company
- Uralobuv's production layout is inefficient
- Material costs are high compared with those of a Western manufacturer
- Uralobuv uses an excessive number of footwear constructions, and has not rationalized its activity despite the dramatic reduction in output
- The design process is not market oriented, and it fails to minimize costs.

Marketing and Sales

- Uralobuv's prices are high relative to its competitors. due to the lack of a coherent pricing strategy, a flawed costing process. and excessive costs
- Uralobuv is a market leader in the specialized footwear market: it meets all the success factors (e.g. state specifications, high quality and durability, etc.), has a strong competitive position in quality and price, and has an adequate distribution system. Terms of payment are generally favorable, although barter is used to an extent
- Other product lines also were rated along similar marketing criteria. Then the production competencies were measured in accordance with technical competency, quality and appropriateness of machinery, and availability of supplies. An overall assessment indicated that specialized footwear, men's boots and shoes, and women's boots were the product lines with greatest potential. given Uralobuv's financial constraints
- Uralobuv's Marketing and Sales Department does not pursue essential marketing functions (including product portfolio management, sales and production planning, market research, etc.). conduct active sales campaigns. or effectively meet customer needs for order fulfillment. Primarily this demands a shift of priorities, but additional personnel resources and additional training are also required
- Uralobuv lacks an extensive distribution network
- Uralobuv's products would not be competitive on Western European markets at present, but many Western European manufacturers are interested in subcontracting arrangements in Russia and Eastern Europe.

Despite Uralobuv's problems and the poor performance over the past 5 years, the diagnostic analysis uncovered a number of strengths that could be the basis for a successful turnaround strategy. These include high levels of industrial capabilities and competencies particularly in the areas necessary for manufacturing heavy boots and shoes, skilled personnel, committed management, and supportive shareholders.

Recommendations

At the completion of the diagnostic phase, the project team formulated key recommendations to support a turnaround strategy for Uralobuv's recovery and sustained development over the next three years:

In order to increase Uralobuv's sales:

- Pursue the following product portfolio strategies for three product groups:
    - Strategic focus on the first group (specialized footwear, men's boots and shoes, women's boots) with additional investment. This group should represent 80% (relative to 25% currently) of Uralobuv's sales within three years
    - Opportunistic development of the second group (women's casual, children's general and slippers). This group cannot support Uralobuv long term growth and should receive investment only after the first group is fully funded
    - Cease production of the third group (men's, women's and children's summer, textile and sport shoes and women's classic and hand-made shoes) in which, for market-driven or production-driven reasons, Uralobuv is basically not competitive and faces too much of an uphill battle to sustain.
- Build marketing and sales skills base and expand distribution network:
    - Transform the current Marketing & Sales Department into an effective one by redefining tasks and responsibilities (Marketing & Sales Director, product managers, sales representatives and order fulfillment agents),
    - Emphasize the essential role that this revitalized department should play in key factory processes (product portfolio management, production planning, price setting, budget finalization and order fulfillment) to slowly transform Uralobuv into a market-oriented firm
    - Reestablish a decent distribution capability as follows: the first priority is to become a "master at home" in the Sverdlovsk Oblast via a proactive salesforce; the second is to become a major player in the Urals through a tight-knit network of trade agents, and the third is to build business relationships in Western Russia with trade agents or wholesalers in three or four of the largest cities
- Define an aggressive pricing policy, as soon as Uralobuv's cost structure and competitive environment are capable of sustaining it, to raise volumes of activity and gain market shares
    - The first group of products should receive factory price discounts of 15 to 30%.

In order to reduce Uralobuv's costs:

- Reduce fixed costs:
    - All production facilities could be moved into the main building of 20,000 m^2; this would still allow a production capability of 3 million pairs/year
    - Total personnel could be reduced by 30% (65% of this effort being borne by indirect operatives); this would still maintain workforce of sufficient size to produce 2 million pairs/year.
- Reduce variable costs:
    - Uralobuv's labor productivity is 3 to 4 times lower than current comparable Western standards
    - Uralobuv's cost of materials could be reduced by improving engineering, improving purchasing negotiations, purchasing higher quality leather (leading to fewer rejects and rework) and improving cutting process control.

In order to improve Uralobuv's cash situation:

- Improve cash management:
  - A strategy to allow adequate cash and working capital for increasing sales and consolidating production should address cash budgeting and cash and working capital management
  - Implementation of cash and working capital management decision-making support tools is vital.
- Sell unnecessary assets:
  - Uralobuv could sell production machinery for more than $300,000 according to very conservative assumptions based on observed second-hand market prices.

Implementation work conducted

Implementation has been strongly supported by the participation of Uralobuv management in three specific working groups: Marketing, Finance and Production. The working groups were in charge of reviewing the recommendations for change, discussing objectives and launching corresponding action plans.

Because of time constraints, it was decided with Uralobuv top management to focus the attention of the working groups on a few priorities selected by the management among the recommendations. Each task was to be implemented through a series of workshops, that is, meetings between members of the consulting team and the working group:

For the Marketing working group:

- ***1st priority*** : define marketing activities, job descriptions, recruit and train people (5 workshops)
- ***2nd priority*** : define key indicators to monitor the sales and marketing department (4 workshops)
- ***3rd priority*** : define product portfolio and establish marketing strategy (6 workshops)
- ***4th priority*** : expand distribution network (5 workshops).

Building marketing and sales skills involved extensive training, and planning for enhancing the role of the department. Training involved providing the managers with an understanding of the uses of market research; the types of analyses developed to analyze the size, trends, segmentation, competition, positioning, and customer needs for specific markets and how to conduct these analyses; the sources of market research information; and the conclusions drawn from market research. Staff were also trained in how to develop sales forecasts and establish sales budgets.

Key short and long-term indicators were defined to provide regular reporting on sales performance and the breakdown of Uralobuv's customer base. Plans were developed for gathering and monitoring this management information.

Managers were trained in the basic tasks and distribution of departmental responsibilities in product portfolio management. Through workshops, the company defined distinct product lines, and prepared to conduct the necessary supporting market research with respect to anticipating product volumes, understanding the customer base, and identifying purchasing criteria for each product. Plans were also developed for obtaining customer feedback on footwear designs prior to production of the new season's collection.

Implementation of recommendations for rebuilding distribution networks focused on developing action plans. First, an overall distribution strategy was developed on the basis of recommendations from the diagnostic report. Then, action plans were developed for expanding the company's presence within Ekaterinburg, including entry into open markets, opening new stores, renting departments within existing stores, and expanding the network of retail purchasers. For the Sverdlovsk oblast, the enterprise developed action plans for conducting market research, increasing direct sales, establishing trade representative offices, and undertaking advertising and promotional activity. The enterprise also plans to expand distribution throughout the Urals and other regions, and to strengthen distribution of specialized footwear.

For the Production working group:

- ***1st priority*** : reduce cost of labor (3 workshops)
- ***2nd priority*** : reduce cost of materials (3 workshops)
- ***3rd priority*** : rationalize layout (2 workshops)
- ***4th priority*** : sell unnecessary assets (1 workshops).

Efforts to reduce the cost of labor focused on establishing targets for reducing indirect workers, broken down by department and identifying possible productivity improvements. To improve productivity, the Production working group developed and began implementing action plans for obtaining higher quality materials, developing a more commercial approach to footwear design (i.e. minimizing cost where there is no perceived value by the customer), improving the organization of production, setting up a bonus system to improve worker motivation, rationalizing and standardizing production, eliminating unnecessary production operations, improving ergonomics and work methods to simplify operational work, improving the layout of production, and identifying new equipment needs.

Reducing the cost of materials was a second area for implementation. Participants identified the necessary tasks and began implementation of the following: developing a commercial approach to design, raising quality standards and the cuttability of leather, reducing excess waste of materials, managing, training, and motivating purchasers to minimize costs, identifying new sources of materials, improving relations between purchasing, production, and marketing within the factory, and improving the negotiation of purchasing agreements.

The production working group began taking the necessary steps to rationalize layout. This included identifying possible production facilities which could be consolidated, developing options for a new factory layout, assessing the costs and benefits of moving, drawing up a schedule for moving, and establishing staff responsibilities.

In addition, the production working group began identifying machinery and equipment necessary for maintaining an adequate production capacity, listing the unnecessary assets which could be sold off, developing a catalogue of assets to be sold, locating potential purchasers, and drawing up a program for disposal of these excess assets. The consultants also provided suggestions for how to dispose of unnecessary raw materials in inventory.

For the Finance working group

- ***1st priority*** : establish a Strategic Business Plan for Uralobuv (4 workshops)
- ***2nd priority*** define next steps for finding potential partnerships (4 workshops)
- ***3rd priority*** : define cash management/finance MIS (4 workshops).

The Finance working group developed a Strategic Business Plan to be shown to potential investors and partners. The group revised a number of key financial indicators and projections developed in the diagnostic report, selected supporting materials, and established a format for presenting the enterprise's capabilities and projected financial performance.

In the pursuit of potential partnerships, the Finance working group devised a strategy for establishing partnerships. The group categorized potential partnerships into three types: subcontracting, licensing and joint ventures, and other partnerships. An action plan for pursuing partnerships was developed for each type. The working group also estimated the contribution margin for products that could be produced in various types of partnerships (e.g. in partnerships where the external partner provides raw materials vs. ones in which the factory purchases supplies, production under one shift vs. two shift production), breaking down fixed and variable costs to provide the costing information necessary for financial analysis of a partnership with Uralobuv.

The Financial working group received training in the areas of cash management and financial management information systems. Training related to such subjects as how to assess cash needs, how to conduct short-, medium- and long-term cash management, and an overview of corporate finance in general. Factory staff were also trained in how to operate a detailed computer cash model, that would enable Uralobuv to better manage cash and to project cash needs.

In addition to approximately 40 workshops held on site with Uralobuv personnel, three meetings with potential partners have taken place in Western Europe :
- Inova, a French manufacturer and distributor on June 5 in Paris
- PEP, a French manufacturer and wholesaler on June, 11 in Paris
- Jalatte, a French leader on the security shoes market in Europe on June 12, in Paris

Reports, plans, and seminars delivered

In addition to the workshops and action plans discussed above, the following reports were delivered:
- Diagnostic report
- Appendices to the diagnostic report
- Summary of implementation workshops and action plans
- Customer survey data and other market research materials
- Financial reports, costing information, and other company information about Mansfield Shoes
- Cash model.

9.3 Accomplishments of the Enterprise

As the implementation stage began only in May 1996, the ultimate impact of the recommendations and preparations for implementation cannot yet be properly assessed.

Nevertheless, some tangible results from the project were already observable during the diagnostic phase:

- The management of Uralobuv asked for practical advice on two specific issues:
  - The first related to the formulation of business plans in order to obtain financing. We reviewed the enterprise's initial plan, assisted the Financial Director in assuring that all relevant issues were addressed, and made specific suggestions to improve the clarity of the financial projections and financing requests.
  - Second, we responded to Uralobuv's request to improve their sourcing of components from abroad. The factory was currently negotiating with a trade agent in Germany to procure leather components. We conducted research to obtain comparative pricing on export guarantees. This information enabled the factory to more effectively conduct negotiations.

- Following severe steps taken by Uralobuv's bank, the Financial Director asked the project team to help him design a short-term plan to take Uralobuv out of its financial dire straits. Two consultants and the industrial expert spent one week to help the Financial Director build up this short-term plan while the rest of the team remained focused on the medium to long term strategy. In summary, this short-term plan was in line with the main findings that we had already validated with the top management at that time:
  - Focus on Uralobuv's most competitive products: specialized shoes
  - Stop spending money on uncompetitive products: regular footwear
  - Liquidate finished goods inventory by offering huge discounts (up to 50%) if necessary
  - Increase the pressure on debtors to collect receivables
  - Try to reduce pressure from creditors through barter of specialized shoes.

- At the beginning of the diagnostic phase, a workshop was run with the management of the Sales & Marketing Department on needs in term of sales force and organization within the department. As a result of this workshop and several additional meetings, a new staff - 3 persons in total - was hired and committed to the achievement of the short-term plan sales objectives. Following those steps, Uralobuv sold 2 billion rubles from inventory in April, about half of which was accomplished by the new staff. By the end of June almost all of the remaining footwear in inventory had been sold. This speedy sale of inventory was achieved by instituting sharp price reductions, improving terms of payment, and more actively seeking customers through direct sales efforts. In addition, the new sales team reduced unpaid receivables: of the 1.2 billion rubles in accounts receivable that were over 60 days old in mid-April, about 1 billion had been collected at the beginning of May.

As a result of meetings held with Western industry contacts during the diagnostic phase, Uralobuv was offered opportunities to price the uppers of some shoes that European manufacturers were interested in subcontracting. The initial prices have been discussed and negotiations are continuing.

In addition, the first steps were taken during the implementation phase in a number of areas. These include:

Production

- Management agreed to a timetable for consolidating production activities into the main production buildings
- Management agreed to a timetable and target levels for reducing indirect workers
- The decision was taken to phase out unneeded constructions
- New bonus plan introduced for cutters to increase productivity
- Initial steps taken on reducing material costs: identified possible sources of higher quality leather, initiated meetings to create more cost-effective designs, and began discussions on simplifying the engineering process
- Excess equipment has been priced for possible sale.

Finance

- Developed computerized cash model for projecting effects of product selection on liquidity and following key financial indicators
- Staff at Uralobuv trained in the operation of the computer cash model
- Business plan prepared for attracting debt financing and for potential foreign partnerships.

Marketing

- New sales department staff hired with more aggressive direct sales activity
- Individual appointed to pursue marketing activity
- New product portfolio selected for the fall/winter season based on marketing criteria and emphasizing the priority groups recommended in the diagnostic
- Product lines defined according to market-oriented criteria
- Initial market research completed on customer segmentation and purchasing criteria for each product line; additional retailer interviews and customer surveys planned
- Sales budget developed for 1996 and 1997
- Key performance indicators defined
- Initial steps taken for opening new factory outlets in Ekaterinburg and identifying a distributor for open markets
- Entered negotiations with possible distributor in Novosibirsk
- Plans developed for expanding distribution network in the Sverdlovsk oblast.

9.4 Change Management Process Established

With the diagnostic report as a starting point, implementation aimed to demonstrate practicality of converting recommendations into detailed action plans:

- All the recommendations made in the diagnosis were considered full fledged 'Projects' for Uralobuv Management provided that they had been agreed
- With practical input from Uralobuv Management, recommendations/projects were broken down into a detailed list of 'tasks'
- For most of these tasks, a very precise and detailed list of 'steps' was determined and compiled into 'action plans'.

Given the short period of time allocated to implementation, priorities had to be established

Instead of initiating all of the projects, Uralobuv management agreed to focus on a select number in order to establish as many detailed action plans as possible, the main decision criterion being the potential for know-how transfer to the enterprise.

The working group workshops focused on one particular task at a time and consisted of

- Agreeing on the terms of the tasks, and related quantified objectives
- Identifying steps to achieve the objectives
- Determining responsibilities, timetables and indicators of the degree of completion (if relevant) for each step.

Consultants facilitated the workshops, encouraged participation from all attendees but did not impose any final decision. All decisions were made by Uralobuv management, resulting in increased commitment to the projects.

Detailed action plans specifying responsibilities and timetables were formalized for each task. These plans will provide Uralobuv management with the necessary tools to support implementation in the long run.

The working groups were staffed from the enterprise as follows:

<u>Cost Reduction/Production</u>

Chief Engineer	Chief Mechanic
Chief Technologist	Chief of Energy Services
Chief Designer	Deputy Head of Supply
Head of Hand-made Footwear Workshop	Estate Manager
Head of Cutting Workshop	Head of Labor Department

<u>Finance</u>

Financial Director	Chief Accountant
Head of Planning Department	Senior Economist
Financial consultant	

<u>Marketing</u>

Head of Sales	Market researcher
Chief Designer	Chief Technologist

The working groups were formed with a directive from the General Director and met regularly with the project team from the beginning of implementation. At times the working groups would subdivide into smaller task forces to address specific issues. For example, a subgroup of the production working group met to establish and action plan for reducing material costs.

The working groups are expected to continue meeting in order to carry out the action plans.

9.5 Prospects For The Future

The greatest challenge that Uralobuv faces is to extricate itself from its current cash crisis. Uralobuv continues to experience difficulties in paying for supplies of high quality materials due to its liquidity constraints, which can disrupt production schedules. In fact, unless the company receives substantial new credits in July, its fall winter collection will have to be delayed past the start of the selling season. The short term program for increasing cash reserves has had only modest effect so far, although the company managed to sell off almost all of its excess inventory, some unneeded equipment, and has pursued debtors more aggressively. Still, the company must be able to resume regular operations in order to maximize the effect of other restructuring efforts.

The domestic footwear market has become highly competitive and Uralobuv must now compete with Western shoes on the upper range of the market and with Far Eastern shoes on the lower range of the market. Nevertheless, if Uralobuv sticks to its strengths in durable footwear, while improving its designs and cutting costs, the enterprise should be able to compete successfully in domestic markets. The business plan developed with Uralobuv's management anticipates that the company could be in the black within one to two years.

Exporting finished or semi-finished goods to Western Europe may prove rather difficult. Quality standards are high, the market is fairly mature, and there is a high level of price competition due to the excess of supply (in part due to the entry of other Russian and East European manufacturers which are interested in the same subcontracting arrangements as Uralobuv and which have similar capabilities). Despite these challenges, the first meetings run with potential French partners showed, in particular with Jalatte, that Uralobuv can attract interest due to its industrial capabilities, the quality of its work, and for the opportunity that a collaboration with the company offers for entry into the Russian market.

Establishing a working partnership with a Western manufacturer could be instrumental to Uralobuv's long term recovery. Such a partnership might involve not only additional capital investment, but also transfer of information, skills, know-how, and access to Western markets. For its part, Uralobuv could increase its attractiveness to Western investors interested in entering the Russian market by developing its own domestic distribution network.

Appendix A - Original Project Work Plan

Overall Project Logic Flow

Phase 1
Initial Assessment

1.1 **Initial Enterprise Assessment**
- Introductory presentation to Management
- Identify key issues
- Unstructured management interviews
- Synthesis
- Presentation

Phase 2
Detailed Diagnostic Review
a. Strategic Review

2.1.1 Product Review
- Existing range
- Delivery record

2.1.2 Technological Review
- Processes
- Skills - manufacturing
- Capital equipment
- Skills - design/engineering

2.1.3 Labour productivity assessment
- Direct labour
- Indirect labour
- Indirect office
- Benchmark vs reference competitors

2.1.4 Market opportunity assessment
- New vs existing products
- Domestic vs export outside of CIS
- Competitive situation by market
- Size/growth by market
- Customer needs by market

2.1.5 Strategic Synthesis of Opportunities
- Existing Products
  - Domestic
  - Export
- Existing capabilities
- New products using existing capabilities
  - Domestic
  - Export

2.2.7

2.3.2

Overall Project Logic Flow (continued)

Phase 1
Initial Assessment

Phase 2
Detailed Diagnostic Review
b. Organisational Review

1.1
Initial Enterprise Assessment
- Introductory presentation to Management
- Identify key issues
- Unstructured management interviews
- Synthesis
- Presentation

2.2.1
Marketing
- Existing capabilities
- "Best practice"
- Identify gaps

2.2.2
Design
- Existing skills, & technology
- "Best practice"
- Identify gaps

2.2.3
Manufacturing
- Labour allocation
- Task tracking/management
- Productivity measurement
- "Best practice"
- Identify gaps"

2.2.4
Finance
- Treasury
- Control/accounting
- MIS
- Project tracking
- "Best practice"
- Identify gaps

2.2.5
Overall Corporate Processes
- Board
- Executive committee
- Define best practice

2.2.6
Strategy Development and Planning Processes
- Define best practice
- Outline changes needed

2.1.5

2.2.7
Synthesis of Organisational need for change
- Marketing
- Design
- Manufacturing
- Finance
- Overall corporate
- Strategy development

2.3.2.

Overall Project Logic Flow (continued)

Phase 1
Initial Assessment

1.1

Initial Enterprise Assessment

- Introductory presentation to Management
- Identify key issues
- Unstructured management interviews
- Synthesis
- Presentation

Phase 2
Detailed Diagnostic Review
c. Financial Review

2.3.1

Analysis of Enterprise Financial Position
- Balance sheet
- Income statement
- Cash flow

2.3.2

Projection of Enterprise Financials

2.2.7

2.1.5

Overall Project Logic Flow (continued)

Phase 3
Development of Restructuring Concept and Plan

3.1 Urgent enterprise strategy development programme (Strategy / Organisation / Finance)
- Detailed laying-out of strategic direction

3.2 Short-term intervention programme (Strategy / Organisation / Finance)
- Short-term initiatives need to stabilise enterprise, eg
  - Costs
  - Financials
  - Sales

3.3 Medium-term build-up programme (Strategy / Organisation / Finance)
- Initiative to build core competencies in line with strategy, eg
  - Technology
  - Cost

3.4 Long-term repositioning programme (Strategy / Organisation / Finance)
- New product/markets
- Additional core competencies to build
- Long-term organisational changes

Phase 4a
Implementation (initial)

4.1.1 Monitor actions against plans

4.1.2 Review/revise plan in light of evolving circumstances

Phase 4b
Implementation (Subsequent)

4.2.1 Handover to Enterprise Management

4.2.2 Handover to IESC Manager

Appendix B - Summary of Accomplishments: Detailed Backup

Accomplishment	*Almaz*	*Belka*	*Uralredmet*	*Fayans*	*Uralelectro*	*Plastik*	*Uralobuv*
Restructured corporate organization	Restructured finance and purchasing depts.	Created mktg. dept. Using new overall org strucure	Implemented new org structure and Finance dept.		Created new business unit structure	Set up mktg. and production planning depts.	Mktg. Dept. reorganized
Closed non-profitable lines	4 target mkts. identified, others delayed		Shut down unprofitable rare earth lines		Vacuum cleaner business phasing out	Stirol line to be divested	GD agreed to stop producing everyday footwear
New technology employed	Quality assurance system in place	Uniform coding system in place. Shops reorganized	Developed new technology for Master Alloy production	Adaptive Control technology being used	New energy meters in shops	Shopfloors reorganized	Shopfloors reorganized
Developed marketing networks	Attended new exhibitions, conferences and trade shows	Sales agents to be in place for next season	Identified new suppliers. Sold inventory to new European customers	New designs shown at major Frankfurt trade fair	Developed dealership network through conference	Indentified new resin distributors	Opening new factory outlets and identifying a new distributor
Finished deals with investors							
Received bank credit		Bank credit received	Credit received from Mosbusiness-bank	Bank credit received			
Management committed to change	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Set up or began to set up JV	In negotiations with Dutch shipbuilder		Holding talks with United Technologies		Negotiating with AMETEK		Meeting with three French companies
Received new orders	Sold metal kiosks to bring in cash	New Defense Ministry orders received	Major order from Salda for Master Alloy received	Major orders from Holland, UK		Orders to new customers in France	All footwear inventory sold
Profitability increased	Must wait for financial results						
New accounting or management system in place	ABC costing work done	New Mgt. Accounting system in place	New Mgt. Reporting system in place	New production monitoring system	New acctg. system to manage business units	MIS system developed and installed	Computer liquidity monitoring model in place