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FINAL REPORT
FOR THE
POLAND OVER-THE-COUNTER SECURITIES MARKET PROJECT

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Final Report

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** All deliverables were provided to USAID with the project's monthly reports. Given their size, they are not included with this document.

I Introduction

This report reviews the OTC market project in terms of its

- Project Background and Tasks
- Project Implementation
- Key Strengths and Weakness of the Project
- Conclusions and Recommendations

II Project Background

The OTC Market Project was created to establish an Over-The-Counter Securities market in Poland, with the following key objectives

- **Support Privatization**--by providing a market where smaller and medium sized Mass Privatization Program companies could have their shares traded. The market would provide a trading and divestment vehicle for public shareholders, provide a corporate valuation, and enhance the companies' ability to raise new funds. It was assumed that these SME companies, which were held in the portfolio of Poland's National Investment Funds, could not meet the listing requirements of the Warsaw Stock Exchange and so needed another public market in which to trade their securities.
- **Develop the local Capital Market**--by creating a market which was owned and operated by the local brokerage community, in contrast to the government-owned WSE.

The main activities of the project as originally designed were largely to build central market infrastructure, primarily an OTC operating entity with selected SRO functions, market rules and regulation, and a trading system. Two key assumptions underlie the project:

- Once the infrastructure was ready, the Mass Privatization Program (MPP) immediately would provide a sizable number of issuers to the OTC market, generating market revenues and advertising the market to a broader group of NIF companies and potentially to other companies as well.
- The WSE would not have a second and third floor that these companies could list on and thus would not be a competitor to the OTC market. Instead the two markets would be completely complementary.

Towards those ends, the project had the following key tasks (see Table 1 for a list of these tasks and their deliverables)

Table 1
Key Activities and Deliverables
Under the Poland OTC Market Project

<i>TASK</i>	<i>DELIVERABLES</i>
1 Develop an SRO	1 CeTO Membership, Trading, and Listing Rules 2 Surveillance System, Surveillance Manual, Training Materials for CeTO staff on surveillance operations 3 Compliance Manual, Training for brokers on compliance
2 Develop an OTC Operating Entity	1 Financial projections 2 Organizational structure and staffing 3 Documents for addressing capital problems 4 Programmed system linkages to accounting package, billing and invoicing mechanisms, bulletin of information on market activities
3 Develop an OTC Trading System	1 Decentralized, screen-based dealer trading system 2 Complete system and operations documentation 3 Modules for market surveillance, linkages for clearing and settlement, local telecommunication capabilities (leased lines, Telbank, Polpak), public data feed (Telegazeta) 4 Evaluations for CBO dedicated telecommunications network 5 Guarantee fund designed by KDPW for OTC market trades
a Trading b Clearing and Settlement c Telecommunications Linkages d Market Oversight and Surveillance e Guarantee Fund f Investor Protection Fund	
4 Legal and Other External Issues	1 Suggestions and information on disclosure, private placement approach, and short selling 2 Comments on the draft Securities Law
4 Public Relations and Marketing	1 Presentation materials for NIF managers companies, and associations, voivods, venture capital firms, municipalities, private sector small and medium enterprises, bank investment departments
5 Training Programs	1 Training materials on general aspects of OTC market activity 2 Market maker training materials
6 Financing Information Memorandum	1 Application form, including criteria and program description 2 Evaluation reports of 37 companies and documentation for selecting 13 3 10 companies brought to the market
7 Mobilizing Brokers	1 Documents on how to form a Market Development Committee and relevant publicity

- 1 Develop an SRO
- 2 Develop the OTC Operating Entity (CeTO)
- 3 Develop an OTC Trading System
 - a) Trading System
 - b) Clearing and Settlement
 - c) Telecommunication System and Linkages
 - d) Market Oversight and Surveillance System (MOSS)
 - e) Guarantee Fund
 - f) Investor Protection Fund
- 4 Advise on targeted and related legal matters

However, it became clear one year into the project that the key assumptions underlying the project were not going to hold

- *NIF companies were not ready to list* The main reasons were (a) the World Bank program that would fund preparation of documents for listing on the OTC market was considerably behind schedule and funds could not be drawn down, (b) NIF managers were focused on preparing documents to list the NIF's shares on the WSE, and (c) NIF managers and companies were not convinced that an OTC listing would benefit the NIF company
- *The WSE had introduced a second and third floor that competed with the OTC market* NIF companies began to wonder whether to list on the more expensive but well established and prestigious WSE instead of going to the untested, small OTC market

Thus, the project needed to shift gears and become more externally focused, to encourage firms to list on the OTC market. Consequently, the following new tasks were added to the project

- 4 **Public Relations and Marketing**--To educate issuers, brokers, and to a lesser extent investors about the market and its capabilities
- 5 **Training Programs**--To provide training to brokers on market making and its benefits, so brokers would make markets, provide liquidity, and thereby encourage more issuers and investors into the primary and secondary markets

To further create issuers, revenues, and positive publicity, two additional tasks were added during the project's last segment

- 6 **Financing Information Memorandum**--USAID would refund up to \$10,000 of the costs of preparing Information Memorandum for up to 15 companies who sought an OTC market listing. Barents, working with USAID and CeTO,

Table 2 Main Time Line Events in OTC Market Project

Year	Month	Activity
1995	September - November	Strategic Group designs OTC market rules, regulations, and operating entity with Barents' assistance
1996	end-November	Strategic Group disbands
	mid-January	CeTO S A is formed
	February	USAID states that prototype system must be operational by June
	February to early April	Brokers want to significantly expand the system as they do not like the prototype system Barents, CeTO, and brokers determine how to expand the prototype system to make it more sophisticated technologically
	April through June	Barents significantly revises and expands the Phase I trading system to incorporate features desired by brokers and CeTO
	June	A significantly upgraded version of the Phase I trading system is operational The market's opening is delayed because CeTO shareholders reject the proposed fee structure (and later adopt it without revision) There are no issuers to list
	June through December	Work continues on the system Bond elements, surveillance modules, market statistics bulletin, accounting package, etc are finalized Essentially Phase 1 8 is created and from scratch
	July/August	Given the absence of issuers, Barents works to determine new clientele and to restructure the project to do more marketing
	August through December	Numerous conferences, seminars, and meetings are held with potential issuers to encourage listing Marketing packages are created and distributed widely
	December	The market opens with the listing of a company on December 6 and another on December 13 The trading system operates flawlessly despite very high levels of trading
1997	January through July	Extensive conferences, seminars, and meetings continue to encourage issuers
	March	Efforts begin to get brokers more engaged in actively developing and marketing the OTC market Individual meetings with 16 brokers are held in late March/early April The USAID Information Memorandum Financing Program (IMFP) is introduced
	April through July	Meetings continue with brokers Four tranches are held for the IMFP 27 companies apply, numerous others express interest, 13 are selected

was to establish criteria for awarding funds, hold a competition, review applications, and select companies to receive funding

7 Mobilizing Brokers to Market the OTC Market--To get brokers more involved in marketing the OTC market, in a structured way

Overall, we believe the project made important contributions to the Polish economy--by introducing a market that focuses on and services predominantly smaller and medium sized companies, and to the capital markets--by encouraging brokers to own and operate a local capital market and to learn important new business skills such as market making, underwriting and marketing. These activities will help Poland's capital markets become more sophisticated and competitive

The project had a few problem areas. Most important was the emphasis placed on the infrastructure of the project with little consideration given to the need to cultivate the external environment. Again, due to assumptions identified above which failed to materialize as expected. The need to shift focus rapidly in mid-stream and to target companies that were not prepared to go to the OTC market, who had expressed interest but needed considerable urging and education, meant that much of the project's work was done before the market was active and under CeTO's financial duress. A second and somewhat related problem concerned the structure of the relationship between Barents and its client, CeTO.

Below we discuss what was done in each of these areas

II Project Implementation and Tasks

A Original Activities Building Market Infrastructure

1 Developing an SRO

The original task called for creating an SRO entity that would implement rules and regulations for the market (trading, membership, listing) and ethical standards of conduct. Barents original client on the OTC market project was the Strategic Group, a group of brokers organized under the auspices of the Brokerage House Association (BHA) to work with USAID advisors on developing the OTC market. During October and November 1995, Barents advised the Strategic Group on

- Determining the OTC operating entity's SRO functions
- Drafting rules and regulations for trading, clearing and settlement, membership, and listing
- Preparing documents on the SRO's function in market surveillance

Once CeTO was formed, Barents advised CeTO on building its SRO capabilities--on drafting rules and regulations, developing a market surveillance system, and market surveillance training and capabilities

(a) Market Rules and Regulations

The objective was to create a market whose rules, particularly for listing, were less onerous than those of the WSE and thus more accessible to a broader group of issuers and more flexible in its trading operations

From February through June 1996, the Barents Securities Lawyer worked extensively with CeTO management in addition to a small team of CeTO-selected lawyers and brokers to prepare OTC market rules and regulations on trading, listing, and membership activities. Although the Strategic Group had prepared a set of draft rules for the OTC market, the new CeTO management sought to change those rules, and numerous meetings were held to review and revise each aspect. A first set of revised rules was distributed for comment to CeTO shareholders in early April 1996. Minimal comments were received. A revised version was distributed in June 1996. Thereafter, Barents periodically reviewed CeTO's regulations on several occasions as CeTO modified the rules. During late 1996 and through 1997, Barents brought in the former General Counsel of the NASD and a former lawyer who had worked at both NASDAQ and the SEC.

(CeTO management decided that it did not want to implement the Rules of Fair Practice, on the grounds that those rules applied to the capital markets overall, not just the OTC market. Various entities decided that the local Brokerage House Association would perform that role instead. The BHA prepared a draft set of those rules, which Barents commented on.)

Overall, the Barents lawyers throughout the project felt that the listing rules were fine, but the trading rules were overly cumbersome and did not take account of market realities. Over time, as the market opened and CeTO obtained first hand market experience, they too began to recognize the problems in the trading regulations and started reviewing and revising them.

(b) Market Surveillance

The surveillance work involved the following

- *Building a Market Surveillance System* Working with CeTO to develop specifications for a market surveillance system that allowed CeTO to oversee market transactions and identify irregular trading activities and then programming that system

- *Preparing Surveillance and Compliance Manuals* The Barents Securities Lawyer and SRO specialist prepared a Surveillance Manual for CeTO management that covered all aspects of surveillance and a Compliance Manual for brokers that educated brokers about the importance of compliance in general and how to comply with CeTO's rules (Many Polish brokers already understood the importance of compliance, due to their involvement on the Warsaw Stock Exchange) Each manual was revised in accordance with on-going changes in CeTO rules and was provided to CeTO in Polish and in English
- *Educating CeTO Management and Staff on Market Surveillance* Barents brought in a Surveillance and Compliance Expert who on several different occasions worked closely with CeTO management and staff, educating them on how to identify and resolve potential problems, deter violations, contact violating firms, and report to CeTO management
- *Improving the Operating Procedures of the CeTO Surveillance Unit* Barents also encouraged CeTO to establish a working relationship with the KPW for surveilling the market, retaining its independence as an SRO but having established procedures and an on-going dialogue for interacting with the KPW during periods of trouble Barents also encouraged CeTO to provide the KPW with a broker workstation that the KPW could use for surveillance purpose Relations between CeTO management and the KPW improved significantly over time Barents also met with KPW staff to review OTC surveillance issues with them and provided a copy of the Surveillance and Compliance Manuals

Unfortunately, delays in the market's opening, and the lack of real trading, made much of this hypothetical rather than "on-the-job" training Clearly, surveillance work is best learned using real life situations rather than classroom lectures and fabricated exercises--to teach surveillance staff how to identify and deal with real and potential problems The Barents advisors used whatever trading situations they could, such as national tests of the developing trading system software, constructed sample problems, and held meetings attended by brokers and CeTO management to discuss problem areas CeTO staff understood the processes and ideas In terms of the brokers, they had experience complying with SEC and WSE rules, but introduction of the OTC market brought several new elements for them, such as proprietary-account trading and market making These raised new rules about client accounting and set new obligations for market maker activities

2 Developing the OTC Operating Entity

The task was to develop an entity that would operate the trading system, and implement market rules and regulations Towards that end, the Barents team helped organize the brokerage community to develop the entity and then advised the newly created entity on its operations

(a) Developing the Entity

Developing the entity involved two main activities

- *Organizing Brokers to Support and Capitalize the Entity* In the fall of 1995, the Barents team traveled around Poland and visited thirty-two broker members of the BHA, to help educate the brokers about the OTC market, answer questions and concerns, and encourage the brokers to become CeTO shareholders. Forty-three brokerage houses became CeTO members, which was regarded as a significant accomplishment in Poland. Each broker invested a small amount of money (about \$12,000), some because they saw the market as a potentially key area for business, others to be involved in what might turn out to be an important Polish capital market.
- *Preparing Legal and Other Relevant Documents and Plans* At the same time, Barents advised the Strategic Group on a preliminary charter, set of by-laws, the legal infrastructure needed to incorporate the entity, financial projections, an organizational structure, and other operating elements required to establish the entity.

In November 1995 the Strategic Group was dissolved and in mid-January CeTO S A was formed. In between, there was no client with whom Barents could work, which stalled Barents' ability to move the project forward. It harmed the goal of having a market operational by mid-February 1996, which the Ministry of Privatization stated in November would be the beginning of trading share vouchers.

(b) Advising CeTO S A

After CeTO S A was established and its management selected (in late January/early February 1996), Barents advised CeTO management on numerous operational issues and on-going financial and organizational problems which CeTO faced. At the start, Barents advised CeTO mainly on financial projections for the OTC market and CeTO's organizational structure and staffing, working to find a staffing structure that fit the revenues of the company. Moreover, from its inception until the spring of 1997, the project financed CeTO's rent and several of CeTO's staff. Over the course of the project, Barents provided advice on such special topics as

Activity	Comment
<i>Assisted CeTO in reviewing and revising the Memorandum of Understanding with USAID</i>	CeTO spent considerable time trying to revise the MOU. The document was never signed.
<i>Advised on whether CeTO had to pay taxes on the value of the hardware/software provided by the project</i>	Because the hardware/software purchased by the project and given to CeTO was used to generate revenues, and because there was no tax treaty between

	Poland and the US on receipt of such gifts from a foreign government, Barents researched whether CeTO would have to pay taxes on the value of the gift
<i>Reviewed whether to retain the LIM Center</i>	CeTO management wanted to review whether the LIM Center was an appropriate data center Barents researched whether the LIM Center, which had been renovated at considerable cost by the project, should be retained or replaced CeTO decided to retain the LIM Center
<i>Informed CeTO on how to use project hardware/software in its daily operations</i>	Barents informed CeTO on how they might use the hardware and software provided by the project to perform their trading-related and daily operations
<i>Identified helped select and purchased an accounting system and linked it to the trading system</i>	Barents identified, helped select, and procured an accounting billing, and invoicing system for CeTO to use, and then programmed the server to link the trading system with the accounting system
<i>Procured equipment to be used in CeTO s offices</i>	Based on an agreed upon budget, Barents' procured for CeTO equipment CeTO wanted for its offices

The most important area on which Barents advised concerned CeTO's capital situation. Because NIF companies were not ready to list on the OTC market until 1997, CeTO had no revenue base. From the fall of 1996 until the Barents team left in July 1997, CeTO faced repeated threats of bankruptcy, mainly because of the lack of issuers and hence revenues. However, problems were also created because CeTO did not want to scale down its operations and expenditures in accordance with reduced revenue projections. In September 1996 and again in December 1996 and then in December 1997, CeTO received permission from its shareholders to try to raise new capital to avoid going bankrupt. In each case, CeTO was able to raise only minimal amounts of new money, as brokers had not yet seen the benefits (i.e. the profits) from participating in the OTC market. Some felt CeTO was spending too much money given its circumstances.

From September 1996 through to June 1997, CeTO management made minimal changes in its staffing and expenditures, thereby putting existing capital under pressure. Barents advised CeTO management to significantly trim expenses, as did USAID (CeTO certainly needed a core staff to run its operations if the market opened, however, Barents felt CeTO's staff exceeded the needed numbers and that the existing staff focused too much on internal, administrative and procedural matters.) Again, some changes were made but they were insufficient to avoid continued capital pressure.

Each need for new capital, and each capital raising effort, took considerable time and energy from both CeTO and Barents, took time away from the externally focused efforts (i.e. marketing) needed to create a revenue base, and created negative publicity about the fledgling market. It required CeTO staff to stay indoors preparing voluminous

analytical documents on the company's financial standing and Barents to spend time providing new organizational and financial scenarios to CeTO Barents still sought to meet with brokers and others to help sustain a positive attitude about the market and participation in it

3 Building a Trading System

As required by the task order, the project developed an electronic, screen and dealer-based trading system with the various features and the Hardware/Software Architecture noted in Table 3. A fairly extensive version of the system was ready for trading in June 1996--the date USAID targeted as the date for implementation. However, there were no issuers at that time and the market's opening was delayed when CeTO's shareholders rejected CeTO's proposed fee structure at the June shareholder's meeting. Between June 1996 and December 6, when the first issuer was ready, work continued on the system to fix bugs, add new features, and test the system. The system was completed in early 1997 when the municipal bond and bond index functions were finalized.

(a) Trading System

The project, as originally designed, envisioned that the trading system would be developed in two stages. Phase I would be a simple prototype system designed to provide basic trading functions and Phase II would be a more sophisticated, fully integrated system. The reason for this two phased approach was because the NIF companies were supposedly ready to list and trade in October 1995, all that was missing was a trading system for them to use. A quick Phase I system would be built from scratch and implemented by October 1995 to support NIF company trading. While it was being used, specifications for the Phase II system would be determined and then implemented. It was originally assumed that the Phase II system would be purchased and modified, analysis would be done to determine the best approach to creating Phase II.

A few problems arose with this approach, most importantly that the brokers and CeTO did not like the Phase I/Phase II approach. They felt the simple, prototype Phase I trading system did not reflect the highly sophisticated technology they were using or had access to, and they were prepared to stop supporting the project if certain changes were not made.

In response, in early March 1996, Barents met with representatives of the brokerage community to discuss their concerns and obtain their input on how the system should be improved. The brokers suggested that 13 elements be added--mainly concerning improved security and safety, linkages to local telecommunications networks (i.e. Telbank and Polpak), and linkages to their in-house LANs. These elements were reviewed closely by Barents, Barents, with CeTO, agreed to make most of the changes. USAID had earlier stated that it wanted the Phase I system operational by June, 1996. Thus, the goal was to get as many of the changes in place by that time.

Table 3 Key Features and Architecture of the Trading System

a Key Features

- *Trading* Dealer-based trading system where brokers, dealers, and market makers input offers, negotiate terms, then report and confirm trades
- *Instruments* Programmed to trade equity, bonds, and derivatives
- *Broker Accessibility* Decentralized and accessible directly by brokers around the country, using Pentium computers provided by the project and which can be linked to each brokers LAN
- *Telecommunication Linkages* Accessible through leased lines as well as Telbank and Polpak, two multi-use public networks
- *Clearing and Settlement Linkages* Links electronically to the KDPW (national clearing, settlement, and depository organization) for daily clearing and settlement, sending only trades that have been confirmed and matched by both parties
- *Data Feeds*
 - *Private* Has a coded feed that provides CeTO members with real time data on market transactions and activity that is not available to the public
 - *Public* Has a public feed that publicizes market data with a short delay
- *Surveillance* Has a market surveillance module for doing market surveillance
- *Accounting* Links to an internal accounting and billing system, so that transaction data can be used to calculate charges and invoices
- *Market Statistics Bulletin* Has a module for producing bulletins of market statistics from transaction data

b System Architecture

- *Hardware*
 - *Central System* Two production transaction servers (large Pcs running Windows NT), two communication servers (desktop Pcs running NT and Procomm), LAN based file sharing, modems, routers, and two test Pcs
 - *Client Workstations* A pentium PC with a color display capable of 800x600 resolution and communication via modem or router
- *Software* The application programs are in Visual FoxPro at the 3.0b level
 - Four sets of VFP projects (3 server projects, one client project)
 - Three server executable modules (for transactions admin surveillance)
 - One shared VFP code library for server code
 - Two VFP relational databases (one for the server complex and one for each client)
 - Data communications Procom scripts for dial-in security and file transfer
 - NT security functions for RAS, and NT TCP/IP networking over a LAN
 - Disk mirroring, CDROM and DAT data backup and recovery
 - VFP Professional 3.0b development environment

This work had several critical impacts on the project

- *The size of the initial system expanded significantly* The system available in June 1996 was far superior to, and significantly greater in size than, the prototype system that USAID wanted operational in June. Indeed, the system ultimately created as Phase I by mid to late 1996 was essentially Phase I 8
- *The cost of the initial system expanded significantly* The extensive increase in the system's size combined with the short time frame targeted for creating the larger system (from April through June 1996) meant that Barents had to have several expatriate programmers working at the same time--rather than one or two working over a period of many months. This meant more funds spent on labor and related expenses than was originally envisioned. It eliminated the need or ability to finance the originally envisioned Phase II system.

Numerous new versions of the system were created between April 1996, when the final evaluation of what could be done was communicated to the brokerage community at a CeTO shareholder meeting, and June 1996. Additional versions were created over the next six month period to incorporate added features such as bonds. Each new version was tested extensively to eliminate flaws (Tests were also used as a way to keep brokers involved in the process as there were no issuers for an extended period after the system was ready for trading.) Software was at first distributed to a select group of brokers to test and later to all brokers nationally to test. Barents also prepared Users Manuals for several of the versions--and short addenda for others to save time and money. Each manual was translated into Polish and was distributed throughout the country to all CeTO shareholders.

The market opened officially on December 6, 1996 with the listing of Rafamet. A second company, Polisa, was listed shortly thereafter. The trading system worked essentially flawlessly at the start of trading. There were no outages or interruptions to trading. Because of a tax break on Polisa trading in place only until the end of 1996, trading in Polisa shares was very high. During the second half of December, over 1.3 million shares were traded on a single day. The trading system handled the volume without any difficulties. Brokers were able to display their offers and report trades at any time during the trading day. The application and the communications servers handled the traffic without any interruption.

(b) Develop a Clearing and Settlement System

The project was to develop a mechanism for clearing and settling OTC market trades where the terms of the trade would be matched and confirmed by the system before the information was passed on to the National Depository for Securities (the KDPW). To achieve this end, the Barents team met frequently with the KDPW to discuss clearing and settlement issues, and what needed to be done to achieve that end. Key issues included

continuous versus batch processing of OTC trade data, message formats for transmitting data, and the necessary procedures for the OTC to obtain permission for a leased line connection to the KDPW for sending trade information at the end of each day for settlement at the KDPW. The final outcome was that the trading system matches the data on the trade before the information is transferred to the KDPW, and thus assures there are no problems with the information.

(c) Develop Telecommunications Systems and Linkages

This work involved two aspects: (1) a dedicated X 25 network for the OTC market, and (2) linkages to other market institutions, namely KDPW and Telegazeta (the entity which would publicly broadcast OTC market data).

(i) Dedicated Telecommunications Network

Barents had a separate USAID contract (called "Common Brokerage Operations" or CBO) to create a dedicated, telecommunications network for the OTC market. After considerable research and analysis in 1995, the Barents CBO team concluded that a dedicated network was required to ensure data security, speed, flexibility, reliability, and cost control--that use of telephones, leased lines, or existing multi-use public networks such as Telbank or Polpak was not sufficient to support the OTC market.

In late 1995, the Barents team prepared information for the Strategic Group on the technical details, cost projections, and other arguments concerning the benefits to developing a dedicated X 25 network. These were included in the Strategic Group's Concluding Report to the brokerage community and were presented at BHA seminars and meetings. Given the terms of the USAID contract, the network had to be procured by June 1996 or funds would be forfeited.

The start of CeTO in early 1996 and focus on getting the trading system up and running in June 1996 absorbed most of CeTO and Barents resources during the first half of 1996. However, in May/June, given the impending deadline for procuring the system, renewed efforts were made to determine whether it made sense to build the CBO network. Discussions and seminars were held with the brokerage community and CeTO. In October 1996, after reviewing and updating our analyses to reflect current conditions, Barents suggested that the network not be built for the following main reasons:

- *Insufficient support from the brokerage community*
- *Too high a cost* The volumes of OTC market transactions were far too low to warrant creating a separate network for them. Moreover, the WSE would not use the network and was preparing to implement a frame relay network that brokers would have to help finance, thus creating new telecommunication costs for brokers.

- *Lack of resources at CeTO* CeTO, which was to oversee the CBO network, did not have the financial and human resources to play that role
- *Potential for outdated technology* By the time the OTC market generated sufficient volume to warrant creation of the CBO network, the CBO network's technology would be significantly outdated. It would be preferable to wait and buy current technology later

Thus, it seemed better to wait and use telephone and leased lines and Telbank and Polpak until the market warranted a more expensive solution. Moreover, as part of the 13 points suggested by the brokers, the system had already been programmed to link with Telbank and Polpak.

(ii) Linkages to Other Institutions

The second set of telecommunications linkages concerned linking the trading system to brokers and to other market related institutions. As noted in the table above, the system has the following linkages:

- *To the KDPW* Trades that had been confirmed within the required period of time are electronically transferred to the KDPW for processing in their normal clearing and settlement procedures
- *To Telbank/Polpak* Brokers that have access to these public networks can communicate with the central server, transmitting offers, confirming trades, and sending and receiving other information
- *To CAIT* Brokers receive real time information on market transactions through a coded feed, so the information is not available to the general public
- *To Telegazeta* CeTO broadcasts to the general public, through the local TV network, market data on bids and offers, confirmed trades, messages about companies and other corporate data and market information. Information on the OTC market is available through local TV with a short delay

(d) Establish an OTC Market Oversight and Surveillance System (MOSS)

Market surveillance work operated on three levels: programming the system, providing legal and other documents on surveillance, and training CeTO staff to conduct surveillance. All of these are addressed above under SRO functions.

(e) Develop an OTC Guarantee Fund

Barents worked with the KDPW to determine what kind of guarantee fund to create for the OTC market trades. The issue was whether to have a separate fund, and

calculate contributions differently from the WSE, given the presumed higher volatility and hence risk of OTC market trades. Barents suggested modifications to the existing formula that might be applied at a later date to minimize the risks associated with a large participant's insolvency and assure that a credible amount is always deposited in the fund. After much consideration, the KDPW decided that the OTC market should have a separate fund, but that contributions would at first be calculated similarly to the WSE. Once market data was available, analysis would be done to determine whether, and if so how, a separate formula might be created.

(f) Develop an Investor Guarantee Fund

This task was eliminated because a fund was to be created under the new Securities Law and there was no need for a separate fund to be made for the OTC market.

(g) Prepare System Documentation

Barents prepared extensive documentation in Polish and English on the system, to ensure that CeTO staff could completely understand the system and how to revise it over time. (CeTO had wanted Barents to prepare system documentation early on in the project. Barents resisted because the system was in flux for a considerable amount of time, moreover, we did not have the resources to program and document at the same time.) The following documentation was prepared, a copy of which was provided to USAID at an earlier date.

- CTO Systems Specification--full version (844 pages)
- CTO Systems Specification Abbreviated Version (100 pages)
- CTO Server Users Guide
- CTO Operational Manual (for operating the system and LIM Center)
- Broker Workstation User's Manual (Polish Version)
- System Summary

A short version of the Abbreviated System Specifications document and the System Summary document are attached. By the time the documentation was completed, CeTO programmers were well versed in the system, as they had helped program the system and helped with some of the documentation.

(h) Procure System Hardware and Software

Barents procured approximately \$400,000 of hardware and software for the project for (1) the central trading system components, (2) broker workstations for each CeTO shareholder, and (3) CeTO's internal operations. The equipment was procured over a period of several months, in accordance with USAID procurement rules.

(i) Set Up Computer Center

Work on this area involved the following

- In late 1995, investigating and selecting a data center site. A site was selected in the LIM Center, at the base of the Marriott hotel, as it had special telecommunication lines that provided security that was not available in other buildings in Warsaw
- Substantially renovating the site as needed to make it usable for the intended operations
- Installing all hardware and software needed to run the site
- Preparing manuals on how to operate the equipment and how to operate the data center on a daily basis
- Training CeTO staff on using the equipment and operating the LIM Center so they could take over all operations from Barents

(j) Turning Over the System to CeTO

Barents needed to transfer responsibility for the trading system--for developing and operating the system and the LIM Center. As noted above, Barents prepared extensive documentation on the system, operating the system, and LIM Center procedures. Barents had wanted to turn the system over to CeTO starting in mid-1996 but CeTO management did not want to assume responsibility at that time (largely because CeTO management first wanted to confirm through active trading that the system worked flawlessly). In early 1997, CeTO started assuming responsibility and CeTO staff soon were able to manage all aspects of the system and LIM Center effectively.

4 Market and Infrastructure Related Training

The project as originally designed involved some training, largely to train brokers on how to use the trading system and on CeTO's rules and regulations, and to train CeTO staff on performing their SRO functions. These are standard types of training for infrastructure building projects. Towards those ends, Barents organized several training programs. The key programs, each of which was attended by representatives from the Polish brokerage community as well as from the KPW, KDPW, and BHA, were provided in June 1996 on market making, OTC operations and legal issues, and compliance (see Table 6). As noted later, considerably more extensive programs were provided by the project, as it became clear that more training was needed in these and other areas to create a successful market with skilled participants.

In addition to the training programs, the project involved extensive testing of the trading system between May and December 1996 when the market officially opened. During many of these exercises, trading scripts were distributed beforehand. As discussed below, the project ultimately spent significantly larger amounts of time and resources on the development of the trading system than originally envisioned.

5 Addressing Legal and Other External Issues

The original project design envisioned spending some resources identifying and addressing legal issues outside of CeTO per se--that is from the Polish Securities Commission This was especially geared to

- *The draft Securities Law on Public Trading in general*--To help ensure that the new Law supported and did not create obstacles to the OTC market
- *Public disclosure*--To ensure that a policy was implemented that would be workable for smaller and medium sized enterprises
- *Short selling*--To ensure that short selling was allowed as brokers cannot effectively make markets if they cannot sell short

A few tax issues were also reviewed During the first half of 1996, Barents had a team of Polish and foreign lawyers working full time, thereafter the project did not have the funds to provide full time assistance and work was done on an ad-hoc basis, teaming a prominent local capital markets lawyer with a prominent foreign capital markets lawyer

(a) General Comments on the Law

The Barents team commented on the draft Securities Law at various points throughout the project's duration Preliminary comments were made in the spring of 1996, when the draft was first issued and the project had a full time Securities Lawyer, and later in mid-1997 Overall, aside from disclosure and short selling related issues, the Barents advisors felt that the main issue of concern was the chapter on OTC markets Specifically, where the KPW was legislating certain detailed requirements for an OTC company (such as its capital levels) Barents felt that the Law should not legislate the details, it should instead require that the OTC market participants set those standards

(b) Comments on Public Disclosure

Having some form of reduced disclosure requirement was critical for the success of the OTC project, because many of the companies that were to list on the OTC market were smaller firms who found the cost of a Prospectus a deterrent towards entering the capital markets When the project started, the KPW was leaning towards allowing reduced prospectuses for smaller and medium sized companies By late 1996, the KPW was leaning against that idea for various reasons It proposed as an alternative for the OTC market that smaller companies issue securities through private placements and use the less onerous Information Memorandum as the disclosure document for listing those privately issued shares The Securities Commissioner discussed the private placement approach at a conference organized by Barents/CeTO, his Director of Corporate Finance did the same at another Barents/CeTO conference

While some form of reduced prospectus requirement was a cleaner approach to the disclosure question, Barents felt that, given all things considered, the “private placement approach” was acceptable for getting the OTC market started and should be actively promoted among potential OTC market issuers. As work progressed on developing the market, it became increasingly clear from discussions with brokers that there was considerable confusion over the private placement approach. In this connection, it was determined that brokers felt companies were reluctant to utilize this approach without more information. Absent any information in writing from the KPW, only added to the confusion and subsequently was another deterrent towards the market’s development.

To assist in resolving any outstanding questions, Barents proceeded with the following

- Collected information from a range of brokers on relevant questions about the private placement approach
- Discussed these questions with the KPW
- Organized a luncheon with the Securities Commissioner and representatives of a few brokerage houses to discuss these issues
- Prepared a questions and answers document that was circulated to every broker about the private placement approach. The document addressed such concerns as whether a company could get its Information Memorandum informally approved before the actual offering of securities, so as not to jeopardize the pricing

Over time, many of the concerns on how the Information Memorandum (“IM”) and private placements might be used for the benefit of the OTC market were clarified. Companies started using the private placement approach to issue new securities, which presented real-life examples, and hence confidence, for other issuers to follow.

(c) Short Selling

During the project, Poland did not allow firms to short sell securities. However, short selling was most important to introduce if brokers were to make markets in OTC securities and not take undue risks. Both the KPW and the KDPW, the two entities most involved with introducing short selling (the one for policy purposes and the other for operational ones), favored introducing short selling. To assist with this area, Barents performed the following

- With the KPW
 - Informed on why short selling was so important for the OTC market and suggested wording to be put in the law to assure that short selling was provided for
 - Held an open discussion with a group of over ten directors from the KPW on short selling, as a prelude to the KPW’s preparation of a short sale rule

- Provided the KPW with examples of some major laws and regulations on short selling in the U S
- With the KDPW
 - Discussed short selling with the President of the KDPW and her concern on how to create a securities lending and borrowing regime to support short selling
 - Commented on the KDPW's proposed plans for a securities lending and borrowing system

While the KDPW preferred to see securities borrowing and lending organized by market participants, it planned to do the operations itself because there were no large institutional investors in Poland with inventory to sell and only the KDPW was in a position to effectively pool securities accounts to create sufficient numbers of securities to lend

(d) Taxation on Securities

Barents also advised on important tax issues that disadvantaged the OTC market. The two most critical issues concerned eliminating

- The capital gains taxes for certain foreign investors in the OTC market
- The capital gains tax on shares sold into public trading which were not purchased in a public offering

The latter ruling meant that an investor who purchased shares in a private placement and then sold those shares at a profit when the issuer listed on the OTC market would have to pay tax on the profits--in contrast to an investor in a public offering who faced no capital gains taxes on profits from selling the shares into public trading. This tax policy would discourage issuers from using the "private placement/Information Memorandum/OTC listing" approach. (It would also hurt investors who had obtained NIF company shares from privatization transactions.)

Barents hired the most prominent Capital Markets Lawyer in Poland to work with a foreign capital markets expert to advise CeTO and the Ministry of Finance on these issues. One of our arguments was that this tax policy was created to encourage use of public trading, thus, it should not apply to private placement/OTC trading transactions, as they too were intended to encourage public trading and among a new class of market issuers.

B Broadening the Scope Building Market Participation

1 Background

By July 1996, most of the market infrastructure was in place. While additional changes would be made to improve the system and add new features, the system was ready for operation. The market's opening had been delayed because CeTO shareholders rejected CeTO's proposed fee structure. However, it was also clear that the NIF companies were not ready to list and that there were no immediate substitutes. The NIF companies were delayed for reasons that can be evidenced in many other countries, including

- *Lack of understanding* Many NIF companies did not understand the benefits to listing, saw many negatives (disclosure, receiving a poor market valuation of booked assets, etc), and so hesitated
- *Lack of funding* Most NIF companies wanted to wait until the World Bank program to provide funding for covering the costs of preparing the Information Memorandum to list on the OTC Market was in place. It had been substantially delayed
- *Other priorities* Many NIF managers were focused on preparing their own prospectuses to list on the WSE, rather than on getting NIF companies ready to list on the OTC market

This situation of having a market infrastructure but no market participation created a number of serious problems: poor press image, growing reluctance among potential market participants to be the first into the market, and lack of revenues and fears of bankruptcy for CeTO.

In reaction, Barents management, with USAID, set about investigating whether there remained sufficient interest in developing the market and whether there was a different and broader group of potential issuers to target. Although the NIF companies always were regarded as the market's first clientele, there had been a view that the market could serve a broader group of smaller companies over the longer term.

Several investigative meetings were held with various parties and it was determined that there was support for moving forward, and a base of private-sector small and medium enterprises among other entities from a variety of sources that could be viewed as the target audience. As a result, the project shifted gears, to focus on attracting issuers, creating "product", and sparking the market. Several new activities were designed and implemented between August 1996 through July 1997 to achieve those ends: (1) increased public relations and marketing, (2) increased training, (3) mobilizing brokers to do more coordinated and formal marketing, and (4) designing and implementing the USAID Information Memorandum Financing Program.

Again, at the project's inception, minimal work was included in public relations and marketing, as it was assumed that a large portion of the 500 plus NIF companies would list on the OTC market as soon as the market opened, although the companies were not required to do so by the Ministry of Privatization. The success of their listing in

terms of prices, publicity, etc would publicize the market's benefits to non-listed NIF companies and even private sector SMEs, and encourage them to list as well

2 Public Relations and Marketing

Starting in late July/early August 1996, Barents began doing the following to develop and implement a new public relations and marketing program that would educate targeted issuers, investors, as well as intermediaries and raise the overall profile of the market

- Identified potential groups to target, along with the NIF companies
- Prepared marketing plans to reach the target groups
- Organized seminars and conferences to educate target groups
- Met with and provided presentations and information to groups of potential issuers, interested smaller segments of those groups identified after the first round, and then to individual companies
- Prepared marketing materials on why and how to participate in the OTC market that were circulated throughout the brokerage community and to hundreds of companies throughout Poland

(a) Issuers

Our work focused on obtaining issuers, as we believed that getting product into the market would provide the necessary liquidity to attract issuers--and then investors and intermediaries alike. Some observers felt that going after issuers was the responsibility of brokerage houses and that Barents should rely upon the brokers to perform this function. Barents agreed that attracting issuers was the responsibility of the brokers, but based on numerous discussions with brokers, believed that many brokers were not prepared to take on that role (given its relative newness in Poland) and others were simply not willing. Barents learned that the brokers wanted to see new product in the market before they would enter themselves. Barents felt they could assist as a catalyst in this process--by providing education and customized "service" to selected individual companies with a view towards attracting new listings. Once completed, intermediaries could assist in identifying new issuers themselves.

Barents and CeTO identified the following as potential issuers in the market: NIF companies, private sector SMEs, municipalities, companies from voivods, companies being divested from a venture capital firm, companies in the restructuring portfolios of banks (see Table 4 for explanations of interest). Private sector small and medium sized enterprises were seen as the key long term clientele. They comprise an important part of the Polish economy in the number of firms and contribution to GNP, and are a rapidly growing segment of the economy. Municipalities were another key group, as many had issued privately placed securities and could use the Information Memorandum as the disclosure document for listing those securities. We were told by the team advising the

Table 4 Potential Issuer Groups on the OTC Market

Issuer	Potential Interest
Private Sector SMEs	Large and rapidly growing segment of the economy that can use funds to support its economic expansion
Municipalities	Many have or want to issue bonds Typically issue as private placements and can use the IM as the disclosure document Interested in OTC because of its less onerous disclosure requirements and lower fees
Banks with Equity Holdings	Looking for ways to divest from equity they received in exchange for non-performing loans (in a program organized by Poland's central bank)
NIF Companies	Many cannot meet WSE listing requirements and have the World Bank funding program to finance their IM
Venture Capital Firms	Are very interested in the OTC as a divestment vehicle for their equity holdings, particularly in companies that cannot meet WSE requirements, and to list their own shares
Holding Companies with Subsidiaries	May want to list their subsidiaries to obtain a better public valuation for their own shares, and to restructure their holdings
Voivodships	Have companies they want to privatize, many of whom cannot meet WSE requirements The Privatization Agency thought that voivod companies should be able to receive funding under the World Bank program

Municipal Development Agency and working with the municipalities on bond offerings that the municipalities were more interested in the OTC, rather than the WSE, because they could use the less onerous IM disclosure process

Starting in August 1996 and running for about 6 months, Barents ran a series of seminars, conferences, and meetings as detailed in Table 5. Presentations and marketing materials were distributed at each, many covering information such as why to enter public trading (many of the targeted firms had never thought about being publicly traded), why to be publicly traded in the OTC market (cost and time advantages, higher liquidity through market makers, etc.), and how to get listed on the OTC market. As noted, in many cases, we would start with a broad group, such as a group of NIF companies, then identify a few companies that were really interested and meet with them in smaller groups or individually. This broad-to-narrow approach helped create wide publicity for the market and at the same time allowed us to deal with individual potential issuers as well.

These seminars and conferences created positive press and helped improve the market's image. They were something to write about, they provided information and answered questions and concerns, and they helped generate interest among a growing number of companies. A growing number of companies expressed interest in listing on the OTC market, perhaps not immediately but at some time in the future.

(b) Intermediaries

Throughout the project, Barents met with selected brokers to discuss market developments and understand broker concerns. Work with the brokers intensified and formalized in late 1996. In December 1996, Barents and CeTO held a seminar on marketing to issuers and investors. In March 1997, Barents began a series of meetings around the country to discuss marketing efforts with the primary and secondary market departments of brokerage houses/banks. Sixteen brokerage houses were visited in four cities (Warsaw, Lodz, Lublin, and Krakow). These meetings provided an opportunity to discuss the market's status and development and answer the brokers' questions and concerns about the market. We also used them to encourage the firms' primary and secondary market operations to talk more to each other about the market. While most brokerage houses had an OTC market trader, that trader did not often speak with the primary market group about finding OTC market issuers. (At these meetings, preliminary discussions were held about forming a committee of brokers which would assist CeTO in marketing the OTC market to issuers and investors. See below.)

(c) Marketing Materials

Barents prepared a comprehensive package of marketing materials that was circulated widely around the country starting with the September 6 shareholders meeting and then at conferences, presentations, and in response to individual requests throughout

Table 5 Major Marketing Activities

MONTH	WHO	FORMAL CONFERENCES AND SEMINARS	MEETINGS/MATERIALS
July			Related USAID contractors
August			
September	Brokers Brokers NIFs Banks Munis All		Numerous domestic and foreign brokers Brokerage House Association Managers of four NIFs PBG Investment Fund Municipal Development Agency <i>Parkiet</i> management (to organize a special OTC issue of the magazine)
October	FB Banks	Presentation to 12 foreign investment houses (including CSFB and JP Morgan) Presentation to Company in PBG's Investment Fund	Executives from NIF #5 and NIF #6 Representatives from major brokerage houses Representatives of 2 venture capital funds (TISE, Wafra) Began organizing series of seminars to major market participants
November	NIFs NIFs NIFs Brokers Munis	Presentation to NIF Presidents and Management Board Members Presentation to Companies from NIF #6 Presentation to Potential issuer from NIF #10 Workshop with Brokerage Houses (on trading and procedures) Roundtable on Municipal Bonds	Prepared marketing materials for distribution to Munis and NIFs
December	NIFs NIFs NIFs Brokers SMEs Brokers	Presentation to Potential issuers from NIF # 1 Presentation to Potential issuers from NIF #11 Presentation to Head, Privatization Department of Min of Treasury (former Privatization Minister) Seminar for brokerage houses (on bringing companies to market) Presentation to Potential private sector issuers Market maker trip to US brokerage houses (through FSVC)	

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MONTH	WHO	FORMAL SEMINARS AND CONFERENCES	MEETINGS/MATERIALS
January	NIFs	Presentation to Association of NIFs	Letter to private sector SMEs about the market
February	Brokers Brokers Voivod Foreign Funds	Mock trading with brokers Trading seminar and mock trading for market makers Voivodships conference Presentation at Euroforum Conference (organized from London) Presentation to Korona Investment Fund	Leading brokerage houses in Warsaw and Katowice
March	Banks Consul Brokers	Seminar for Restructuring Departments of Banks Seminar for Consulting Companies Second market maker trip to US through FSVC	Portfolio managers from NIFs 15, 12, 1, 7 Primary and secondary market heads of brokerage houses in Krakow, Lublin Warsaw
April	NIFs Brokers	Presentations to NIF 7 companies Market maker training lecture and mock trading exercises	16 brokerage houses in Lublin, Warsaw, Lodz,
May	Brokers	Mock trading exercises	With local brokers in (to promote marketing) - Warsaw - Katowice
June	Brokers Brokers	Third market maker trip to US through FSVC Mock trading exercises	Minister of Economy With local brokers in (to promote marketing) - Lodz - Krakow - Poznan - Warsaw
July	Brokers	Mock trading exercises	With local brokers in (to promote marketing) - Krakow (twice) - Poznan - Warsaw

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the project and thereafter. The package covered the whys and hows of getting listed on the OTC market.

- Providing background information on why a company should want to be listed on the OTC market
- Providing information on CeTO and the KPW, their respective roles and rules and regulations in getting listed on the OTC market
- Walking a prospective issuer step-by-step through the process of getting listed, including all the steps on how to get an Information Memorandum Approved and then how to be approved for listing by CeTO
- Providing application forms for the KPW and the CeTO elements, fee structures, and estimated other costs involved

Overall, several hundred copies of these marketing/information packages were distributed throughout Poland over the course of the next few months. Brokers used the package in their discussions with Polish companies.

3 Market Maker Training Programs

In addition to marketing, the OTC market demanded that brokers learn how to be market makers. Otherwise, the liquidity needed for a successful dealer market that could support smaller capitalized offerings would not develop. Barents initiated a series of training seminars in market making that consisted of in-country and overseas training (see Table 6).

- In-country training was provided for free and thus was available to all parties interested. It included lectures and simulated trading exercises by Principle NASDAQ traders from the United States.
- Overseas visits were arranged to NASDAQ traders in the US. These visits were paid for by the participating brokers.

Overall, our view was that the in-country training is more cost effective and available to a broad range of participants, but the overseas training provides an opportunity for those who can afford it to see real-life OTC trading, creates a sense of camaraderie and professionalism among participating brokers, and is a chance to develop contacts in other major markets around the world.

(a) In-Country Training

Two main in-country training exercises were held for market making.

- *February 1997* A one day program led by Steven Shapiro, Principle NASDAQ trader, and Troster Singer (who was identified and participated under the auspices

Table 6
Formal Training Programs for Brokers and other Relevant Parties

Date	Brokers (with KPW, BHA, Privatization Agency etc)
June 15/16, 1996	Conference on trading practices and trading system for directors and traders of brokerage houses, KPW and BHA officials (80 attendees)
June 22, 1996	Conference on trading practices for traders Lecture then mock trading exercises with 17 workstations and 40 brokers trading at once 110 attendees
June 22, 1996	Session of above conference on compliance for compliance officers
December 1996	First FSVC-organized trip for CeTO market makers to visit US NASDAQ traders
January 1997	Organized and financed trip to London by the CeTO's President and Supervisory Board Chairman to observe trading practices in major markets and financial houses
February 21, 1997	Seminar for brokers on trading practices followed by simulated mock trading 54 brokers attended along with representatives of other entities Led by the Principle NASDAQ trader from Troster Singer in New Jersey
March 1997	Second FSVC-organized trip for CeTO market makers to visit US NASDAQ traders
April 16, 17, 18, 1997	Follow-up seminar for brokers on trading practices with two days of simulated mock trading Attended by representatives of 26 brokerage houses and others Led by Senior Principle NASDAQ Trader from Sherwood Securities in New Jersey
May 1997	Mock trading exercises
June 1997	Third FSVC-organized trip for CeTO market makers to visit US NASDAQ traders Informal mock trading exercises
July 1997	Informal mock trading exercises

* Representatives of the Polish Securities Commission (KPW), Brokerage House Association, Privatization Agency, Ministry of Treasury, National Securities Clearing and Depository KDPW), And other relevant parties participated in this training

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of the FSVC) The program involved four hours of lecture followed by two hours of mock training There were 54 attendees--brokers plus representatives of the KPW, KDPW, BHA, and Privatization Agency

- *Mid April 1997* A three day program led by Glenn Woo, Senior Principle NASDAQ trader from Sherwood Securities There were 65 attendees--brokers plus representatives from the KPW, BHA, KDPW, Privatization Agency, and a local investment fund The lecture explained the specifics of a market makers daily activities and answered detailed question on position taking, risk management, trading in illiquid securities, spreads, etc For two days thereafter, Mr Woo held eight two hour mock trading session for all Polish brokerage houses, government and BHA reps Traders were organized into five trading desks, with two to four people at each desk during each trading session, and assigned trading positions in three mock securities They were assigned positions in cash and for customer orders The objective was to test whether the market makers could fill their customer orders and cover their positions in an active trading environment Mr Woo worked at a sixth trading desk to provide the market dynamism The volume of trading was substantial

The brokers expressed interest in more mock trading exercises Consequently, following the seminar, Barents staff periodically ran mock trading exercises on Thursday afternoons for any broker that wished to attend Overall, these simulated exercises, run by current and former NASDAQ traders, gave brokers and CeTO staff an unusual opportunity to learn about market making in a simulated trading environment, and to improve their trading skills The Barents staff saw considerable improvement in the capabilities of the participating brokers and CeTO staff over time (Exercises were held in May, June, and July)

(b) Overseas Training

Three one-week overseas training programs were arranged for Polish brokers, with the assistance of the Financial Services Volunteer Corps (FSVC)--in December 1996, March 1997, and June 1997 Four to five brokers from four to five brokerage houses participated in each trip The FSVC arranged meetings in the US with NASDAQ (for an overview of OTC trading and the NASDAQ system) and NASDAQ market makers The US brokers gave an overview of their operations while the Polish brokers had the chance to sit on a trading floor with the US brokers Originally, Barents wanted the Polish brokers to meet with just one brokerage house for the entire week, to obtain depth of experience, but that was impossible because no one brokerage house could afford that amount of time Instead, FSVC arranged for the Polish brokers to meet with 2 to 3 brokerage houses during the week, but the work in each house was similar, which allowed the Polish brokers to gain depth of understanding over the week and see the different ways in which US houses approach the work

4 Mobilizing Brokers to Market the OTC Market

As the project progressed, it was clear that brokers needed to become more involved in the process of marketing the OTC market. A key element of the project was to increase the involvement of Polish brokers in the local capital markets, through self-regulation, ownership, and acting as traders and market makers in the OTC market. This was part of the project's empowerment aspect. But the brokers were not sufficiently engaged in marketing the OTC market. It seemed they were waiting for Barents and CeTO to create the market infrastructure and then start the market with a pool of issuers before they would actively step up and help expand that segment of the market.

Barents felt that part of the problem with the brokers was that they were not sufficiently incorporated into the market development process throughout a large part of 1996. Barents and CeTO actually had different opinions about the role of brokers in the market's development. CeTO management felt the brokers should not be highly involved in developing the infrastructure, rather, they believed that they should build it with Barents and then draw the brokers in. CeTO also believed that the brokers should be marketing the market on their own, for a long time CeTO did not want to do any marketing.

Barents felt the brokers should be involved in all parts of the development process, through formal or informal committees or at least regular meetings and discussions with brokers, to build consensus, buy-in, and enthusiasm. At the same time, Barents felt that the brokers' inability or unwillingness to market the OTC market may have partly stemmed from their lack of involvement in the broader development process.

These issues were ironed out over time, and CeTO came to support Barents in holding meetings with CeTO shareholders to help promote the market, however, outside of appearing at formal conferences and seminars, its work with the Supervisory Board and its work with individual brokers to address specific issues, CeTO management had limited involvement with brokers. CeTO had limited marketing staff and preferred to spend its resources on more internally focused issues and legal matters. Barents did not agree with this approach and felt that the marketing effort was harmed by the limited role played by CeTO management.

Throughout 1996 and increasingly in 1997, Barents held individual meetings with brokers to discuss OTC market issues and to conduct marketing (see Table 7). By mid-1997 it was clear that the brokers needed to become more involved in the process. This was particularly important because Barents would be leaving that summer. CeTO could not assume the entire marketing effort, and by that time the brokers should have been assisting anyway.

To engage the brokers more in the marketing efforts, Barents performed the following

Table 7
Formal Meetings with Brokers to Encourage Marketing Activities

A series of one-on-one investigative meetings were held with brokers from mid-March through April. Thereafter, a series of more formal, group meetings were held with brokers to discuss more formal marketing approaches in the following cities:

City	Date	Date	Attendees
Katowice	May 26	???	All 3 local brokers (Bank Slaski, Elimar,), Fundo Grunoslaski (local investment fund) and local voivode office
Lodz	June 17		All local brokers (PBG, HSBC Guziejewski & Albrecht, Patner, and BOS), PBG Investment Fund
Krakow	June 18	July 1 July 11	BPH, Penetrator, RDM Polonia, Magnus
Poznan	June 23	July 9	All three local brokers (WBK, Bank Staropolski, and BMT)
Warsaw	June 26	July 10	PKO SA, PKO BP, BRE, Bank Handlowy PBK, Amerbrokers, and Creditanstalt, Pioneer

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- *March/April 1997* Barents went around the country, met with 16 brokerage houses in four cities and tested the idea of developing some form of marketing committee. Most brokers were interested, thought it was a very good idea, but were somewhat tentative about the structure. They were concerned about how it would fit into CeTO's legal structure since CeTO's statutes did not provide for a committee as such.

Given these interests and concerns and that the project was drawing to a close, Barents concluded that we should move forward to put an idea and structure on the table, even though it might ultimately be rejected. There was hope that it would create momentum for greater broker involvement, marketing, and on-going cooperation and interaction among local brokers in different cities with respect to the OTC market. Accordingly, the following actions were taken:

- *May 21* Held a meeting in Warsaw with 9 major brokerage houses from around the country to discuss the idea of forming some kind of Market Development Committee in order to put forth a proposed structure and activities for discussion. Our original plan was to create regional councils in the six key cities of Poland (Warsaw, Lodz, Krakow, Katowice, Poznan, and Wroclaw) on the grounds that Poland had regional economies in many respects and the local brokers would best know the local potential issuers and how to approach them.
- *May through July* Met with brokers in five of the six cities to discuss marketing efforts and to try to create a formal structure or at least greater interaction among local brokers. Most of the work we wanted the brokers to do was standard networking, publicizing their involvement in and support for the OTC market, showing consolidated support for the market, and spreading the word.

Although the brokers decided against having regional councils around Poland and felt that such an approach was not appropriate for Poland, the work had several positive outcomes:

- It increased attention on the activity of marketing
- It got local brokers talking to each other more about the market
- CeTO formed two committees--one for trading and one for IT
- CeTO changed its statutes to allow for a marketing committee
- CeTO formed a marketing council which advises it on marketing though it is structured differently from the Market Development Committee

5 Program for Financing Information Memorandum

Our ongoing discussions with brokers in early to mid 1997 made it clear that getting 10 to 15 decent issuers into the market could be the spark, the "demonstration effect", needed to help jump start the market, create more positive publicity and get it

through the slow start up period. That critical mass could help overcome the “chicken-egg” problem of no issuers, no liquidity, little interest expressed by brokers and issuers. Moreover, Barents and USAID believed that for the market to be sustainable and generate revenues, it needed to attract a group of issuers by mid to late 1997. The slow speed of NIF company listings raised serious concerns about CeTO’s viability and created significant negative publicity regarding a sophisticated market infrastructure with little or no activity.

As a result, USAID decided to dedicate \$150,000 to finance preparation of Information Memoranda for 10 to 15 issuers in the OTC market, such as municipalities issuing bonds and companies from outside the NIF program. (The program was complementary to the World Bank program, under which the Polish government received a loan to fund the preparation of IM.) The first \$3,000 would be refunded after the IM was approved by the KPW. The remaining \$7,000 would be refunded after CeTO’s Supervisory Board approved the company for listing on the market.

To get the program going, Barents, with CeTO and USAID, performed the following:

- *Set criteria for winning an award*. The three main criteria were (i) how quickly a company could list (i.e. whether its statutes were appropriate, whether it had good entities to prepare the documentation, etc.), (ii) how much liquidity it would have (i.e., how many shares to list and trade, etc.), and (iii) how attractive it was to trade (i.e., how strong was the company economically, managerially, etc.)
- *Prepared an application form* including evaluation criteria, competition procedures, and contractual issues.
- *Publicized the program*. A meeting was held to publicize and discuss the program with brokers and get their input on the projected structure and timeframe before finalizing the program details. The program was publicized in newspapers, and a letter was sent to all 45 CeTO shareholders, voivodships, banks’ restructuring departments, consulting firms, and a range of individual companies that we identified and ones which subsequently expressed interest in the program.

Two committees were formed to handle the applications: a Screening Committee (comprised of three Barents staff, one CeTO management Board member, and one CeTO employee) which reviewed the applications and made recommendations to the Evaluation Committee (comprised of the USAID project manager, the Barents Chief of Party, a CeTO management board member, and a representative from an outside financial institution).

Overall, 27 firms applied to the program over a 3-½ month period.

Table 8 Key Dates and Statistics

Tranche	Closing Date	# of Applicants	# Selected
1	April 2	10	6
2	April 30	11	3
3	May 30	2	1
4	July	4	3
Total		27	13

Thirteen firms were selected (see Table 9), including a range of expanding industries such as computers and automotives, and two municipal agencies (a water treatment plant and a heating plant) These municipal agencies were seen as attractive OTC listees and a potentially interesting clientele, with their stable profit bases

The firms had to complete all documents and be listed on the OTC market by December 31, 1997 to receive the funding However, towards the end of 1997, it became clear that three firms would not be able to list at all due to financial and other problems, and that a few of the thirteen that were serious about listing could not meet the December 31st deadline Two of those firms wanted to raise capital to list on the OTC market, had strong 1997 financial results, and wanted to use those 1997 results in the offering They needed extra time to have their 1997 results audited Consequently, after discussion with USAID and CeTO, the program deadline was extended to June 1998 As of February 1998, all but 2 of the 13 awardee firms were listed on the OTC market One firm, Szeptel, had traded up to 40,000 shares in one day

This USAID IMFP had several key outcomes It (1) generated interest and considerable publicity Each tranche, tranche selection, expressions of interest among potential issuers, and information on selected issuers were given positive press, (2) generated interest among private sector SMEs Many of these firms had not previously thought about going to the market The capital markets were new to them, (3) brought 13 firms to the market

C Relationship with Other Projects

The OTC market project overlapped with several other USAID projects, which were used wherever possible These are described in Table 10

IV Project Impacts and Concerns

A Project Impacts

Table 9
Companies Approved
under the USAID Information Memorandum Financing Program

Name	Industry	Location
Aqua	Municipal Water Treatment Plant	Bielsko-Biala
IZNS Ilawa	Automotives Repair	Ilawa
OZC	Municipality Heating Plant	Ostrow Wielkopolski
Macrosoft	Computer Software	Warsaw
Wodkan	Municipality Water Supply and Sewage Treatment	Ostwo Wielkopolski
Szeptel	Telecommunications	Szepietowo
Ema Blachownia	Domestic Appliance Manufacturing	Blachownia
Izolacja-Jarocin	Construction	Jarocin
Anica	Computers	Lublin
Simple	Computers	Warsaw
MIFAM	Dental and Surgical Tools Manufacturing	Milanowek
Murawski Holdings	Water Supply and Sewage Pipes	Sniadaniowo
Errata	Publishing	Walbrzych

Table 10 Relationships with Other USAID Projects

- **Municipal Development**--The RTI project advised on municipal finance, and discussed with Barents about listing and trading muni-bonds on the OTC market. A major output of the RTI/Padco project was a model Information Memorandum for one municipality (Ostrow Wielkopolski). This IM was approved by the Polish Securities Commission and Ostrow Wielkopolski listed its securities on the OTC market with considerable publicity. Barents/CeTO did a presentation on the OTC market for RTI's Municipal Finance conference.
 - **Credit Rating Agency**--Barents had some interaction with the First Washington Project that was advising on development of a local credit rating agency, CERA, mainly in terms of debt products. CERA is actively trying to promote debt issuance in Poland, and the OTC market will be a good place to trade those debt products. At the end of the project, CERA and OTC management were meeting to discuss overlaps and how to work and market their activities together.
 - **Investment Banking**--Barents worked with the Crimson Capital project which advised Polish banks on developing investment banking skills and participating in capital markets, and worked with the Capital Investment Departments of banks in restructuring their equity holdings received in exchange for non-performing loans--particularly in terms of finding banks that might want to divest their holdings via the OTC market. Among other activities, Crimson Capital arranged an important meeting between Barents/CeTO and PBG's Investment Fund in Lodz.
 - **Financial Services Volunteer Corp**--As noted above, the project worked considerably with FSVC for overseas and in-country training.
 - **Small and Medium Enterprise Development**--Barents met with the Increasingly felt that this was the group to view as the long term recipients of this market. So met with USAID programs that were advising on SMEs to discuss etc.
-

The project made several important contributions which can be summarized as supporting and strengthening

- *Privatization*
- *Private Sector Economic Development* by providing a market for SMEs that in many respects is more responsive to the needs of this group of issuers than other capital markets in Poland
- *Private sector Capital Market Development* by strengthening private sector power and influence in the local capital markets, strengthening broker capabilities, and providing competition to the WSE

1 Supporting Privatization

The project provided a market where smaller sized NIF companies could list their shares. Although the WSE became accessible to many of these companies over the project's lifetime, there were still several companies that could not meet WSE requirements, even for the third floor (i.e. not enough shareholders was often a problem), while others could benefit from having a market maker.

2 Promoted Broader Based Capital Markets Use

The project raised consciousness among an entirely new class of entities in Poland about using the capital markets and gave some companies a chance to raise new capital. The project's marketing activities reached a wide range of entities, particularly SMEs and municipal, as did the numerous newspaper articles about the market and its goals.

(a) Smaller and Medium Sized Companies

As noted above, the project helped SMEs in several ways,

- *Provided a place where all SMEs could list and gain liquidity for their securities, including NIFs.* Increasingly, SMEs were discussing their interest in going to the market and the market was gaining credibility as the market for SMEs. Although the WSE became more accessible to SMEs during the project's life, the WSE did not target these entities as much as the OTC market.
- *Raised awareness about the capital markets among SMEs.* Indeed, one reason why it was so difficult to get the market going was because the project targeted companies that had never had access to the capital markets, and rarely if ever had been courted by the capital markets.
- *Pushed further focus of WSE on SMEs.* It appeared that the OTC market indirectly pushed the WSE to open its third floor (in June 1996, just when the OTC market was scheduled to open) and to target SMEs more aggressively than

the WSE had in the past or might otherwise have done if the OTC market had not been developing. The WSE typically focused on the highest quality, larger, often privatized companies.

(b) Municipalities and Municipal Agencies

The OTC market brought the first municipality and the first two municipal agencies to the capital markets and the prospect of others to follow. Municipal, as noted above, had issued securities in private placements and could list those securities on the OTC using an IM. One municipality listed on the market, Ostrow Wielkopolski, and it was an ardent supporter. Ostrow's listing advertised the municipality, and advertised the OTC market to other municipalities. Two municipal agencies and one company from the Ostrow Wielkopolski municipality competed for, and were granted, funding for preparing Information Memorandum under the USAID financing program. Thus, there were several positive outcomes of Ostrow's listing, for the municipality and the OTC market.

3 Expanding the Capital Markets

In addition to pushing the capital markets to provide services to a broader clientele, the OTC market project also helped expand the capital markets by expanding the role of brokers, creating competition for the WSE, and through these and other means adding a more private sector flair to the local capital markets.

(a) Expanding the Role of Brokers

The OTC market asked brokers to assume a more active role in the market place--in marketing to issuers and investors and as market makers, active owners, and operators of the OTC market.

- *Marketing* Most brokers in Poland were not used to actively courting and soliciting issuers and investors. Instead, these participants often came to them. With the OTC market, brokers would have to go after the companies to get them listed, as most were small and needed encouragement, advice, and assistance.
- *Market Making* Brokers were asked to act as market makers, a new skill for them. In the past, they mainly took orders from customers and entered them into the system which then automatically matched the orders. They did not have to manage positions actively.
- *Owners and Operators* Brokers with the OTC were asked to own and participate in operating the OTC market, as shareholders who would provide capital as well as demands on how the market should serve them and the general public. The CeTO shareholders elected CeTO's Supervisory Board, which in turn elected the Management Board of CeTO. They reviewed CeTO's rules and regulations,

capitalized the entity, and could use their capitalization to influence what CeTO could do to some extent. They held frequent shareholder meetings (between April 1996 and September 1997, 6 meetings were held). They eventually put a new Supervisory Board in place, which exercised its power to change CeTO's Management Board in June 1997.

Overall, the OTC market was somewhat of a catalyst for getting the Polish brokerage community, which has a considerable amount of talent, to assume new activities and develop skills in areas that are common in, and often important for, brokers to have in developed, internationally competitive markets.

(b) Providing Competition to the WSE

The OTC market provided an alternative capital market for Poland. Its introduction seemed to have an impact on WSE policies. For instance, the WSE introduced its third floor in June 1996 when the OTC market was scheduled to open. In mid-1997 it decided to introduce something similar to a market maker (called "market animator") for a certain segment of its securities, and it put greater emphasis on marketing to smaller sized companies than it likely would have if the OTC market had not been present. All of these actions contributed to a more open, dynamic capital market.

B Project Issues and Problem Areas

At the same time, there were some problems in the design and structure of the project that reduced the project's effectiveness and efficiency. These can be divided into two key areas: project design and the supporting environment.

1 Project Design

The project had three main design problems: (1) the infrastructure focus, (2) the emphasis on privatization, and (3) the Phase I/Phase II approach to building the trading system.

(a) Infrastructure Focus

The infrastructure focus was the key problem. This project was designed as a technical infrastructure project, with assumptions made concerning minimal resources that would be needed to cultivate the external environment. For instance, it was assumed that the NIF companies would provide the issuers, revenues, and publicity for the market. However, these assumptions did not hold up. The project was supposed to develop key market infrastructure (OTC trading system, OTC market rules and regulations, OTC market entity, etc.), and to train people to operate and use that infrastructure with some minimal, pointed coverage of related legal issues like disclosure and short selling.

As so much unanticipated external work was required, other aspects of the project suffered from lack of funding. The project team had to work overtime to accomplish its goals, but it was important to help get momentum going in order to push the market forward.

(b) Privatization Emphasis

When the intention is to support privatization, but privatization doesn't support the market, you have a problem. Here the timing was off. Delays created competition and a lack of understanding as people in jobs changed, circumstances changed, etc. In order to create this type of market, the design should have been expanded to include more than just privatization, and a secondary market at that. Hundreds of NIF companies were expected to list, but to list for the primary market as well as a secondary market. Not enough attention was given to this factor in the initial design stage of the project. Again, this reflects incomplete and inaccurate initial assumptions.

(c) Phase I and II Trading System Approach

The division into a Phase I and Phase II approach to building the trading system caused a number of problems in later implementation. This was compounded by the nature of the relationship between CeTO, the Polish counterpart, and Barents, which is discussed separately below.

There was insufficient funding to adequately manage and control the external environment and to do it quickly and effectively. This caused repercussions on the legal side as well, in working with external entities like the KPW. There were two sets of problems. First, there were not enough resources to provide ongoing and good advice. Barents advised on an *ad hoc* basis when necessary as we could not always get the right person in at the right time. This jeopardized the quality and the timeliness of the project's contribution to these efforts. The project team accomplished a great deal, but it may not have been enough to be truly successful. Second, our Polish counterpart wanted to handle elements of this legal work himself. We waited a considerable length of time for him to do this, but then had to go in ourselves when we saw his efforts were not succeeding. However, continuing to try to work together at those times when our counterpart was taking the wrong approach put Barents in a difficult position. By the time we could go in, it was very late in the process and our chances of success were limited.

2 Supporting Environment

The second set of problems stemmed from the fact that the environment was not ready for the market, resulting in a number of difficulties. As the budget was designed to support an infrastructure project, the project as designed did not have sufficient funding to address the surrounding environment.

(a) Surrounding Environment

The Mass Privatization Program was not ready to support the market. This was difficult to anticipate as even the Ministry of Privatization thought the NIF companies would be ready once the market infrastructure was ready. While this is not an unusual situation, it created considerable difficulties, as noted previously, and raised the question of whether the entire project was a failure because the market had no issuers.

The WSE unexpectedly introduced a second and third floor and thereby was formidable competition for the secondary market. This hurt the market's early development, as it led many potential OTC market issuers to question why they should not use the more prestigious WSE rather than the unknown and untested OTC market. CeTO and Barents always had to argue hypotheticals against reality--for example, that the OTC market would be more liquid than the WSE because it would have market makers, once enough issuers and active market makers existed. It heightened the pressure to sell the OTC market and to do so rapidly. Moreover, the WSE had considerably more political power than the OTC market. The voucher privatization program is a good case in point. The WSE did not want the OTC market to trade vouchers, as the WSE argued that it would fragment the voucher market's liquidity. The government backed the WSE on this position, the vouchers could have helped CeTO get off to a much more fortuitous start and compensated for lost revenues from the NIF companies that did not list. Many observers felt that fragmentation was not a real concern and wondered why the OTC market could not trade vouchers while Kantors in Poland and even some offshore entities could.

(b) Not Enough Time to Get the Environment Conducive to the Market's Success

The project introduced several new elements to the Polish capital markets, elements that take time to develop properly. The lack of active trading made it more difficult to introduce these elements, as the training ground and incentive mechanism--the market--was not available. Indeed, the dynamic between the two slowed the development of both. These new elements can be summarized as follows. They match the major contributions of the project, because they are the ways in which the project introduced change. They concern companies, brokers' role, WSE, etc.

(i) Companies

Getting a new group of companies, first, to think about using the capital markets and then to actually use it was a challenge. Capital markets are new to smaller companies in Poland. It was even a new concept for those companies included in the NIF, despite the fact that the concept had been given a period of time to germinate, therefore, it was even more foreign to private SMEs. Barents needed to prepare the basic concepts for them, which was a major task, even with the NIFs. Due to structural problems and attitude problems, the NIFs were still not ready to enter the market several months later,

as they simply did not see enough benefits in it for them. Although we tried to educate them, they remained unconvinced. If the brokers had been well educated to market the ideas to the companies, it would have been considerably easier, but that was not possible.

(ii) Brokers

This project demanded considerable changes among the brokerage community--as marketers, market makers, owners, operators of the SRO CeTO, to participate and voice their views on the market and to think about arguing with the KPW. These were relatively new roles in Poland. The BHA was not a strong organization, therefore it could not be used to stand up for the OTC market either. Intermediaries can often play a key role, but in Poland they are passive entities that are not prone to working together easily. We did not work with them enough, partly because CeTO did not want to at first, but also because the project ran out of time. The project expected these attitude changes to occur very quickly, however, that did not happen, which ultimately hurt the final results. In addition, it was difficult to get the Market Development Committee focussed on the proper course of action.

Another problem concerned encouraging the brokers to act as shareholders, as they were not sure how to play that role. As a result, they soon showed signs of being dominated by the big banks. Due to lack of time, this was another problem that could not be adequately addressed by the project.

An additional area that was problematic concerned the democratic ownership structure of CeTO. CeTO was encouraged to adopt certain democratic policies and procedures, which eventually caused long-range problems, particularly in the ownership structure of the company and in its ability to mobilize brokers. These efforts should have been initiated earlier, however, that was impossible due to CeTO's reluctance to participate.

(iii) WSE

It was necessary to set out clear lines of separation and to get the WSEs to accept these to some extent. It soon became evident that success would be impossible without their participation, however, USAID and the project team should have been more aware of the WSE views as they planned for the OTC market. The WSE President felt that his views on a second and third floor were not being taken into consideration and that no one was really listening to what he had to say.

(c) Problems with Polish Counterpart

The relationships between Barents and its Polish counterpart were set up differently than other entities and became problematic, due to CeTO's structure as an independent company. Normally an entity such as this is grown from the consulting firm rather than set up as a separate company. This structure caused an additional

level of difficulty because we had as a counterpart someone who came from a different style, did not like the idea of working with the brokers, and wanted to build from the top down—an approach that was not endorsed by USAID or Barents. The resulting problem appeared on two levels: on the project work and focus and on CeTO as an operating entity.

(i) Project work and focus

The fact that CeTO did not work with and get buy-in from the brokers was detrimental, however, CeTO did not want to work with the brokers or conduct a marketing effort. When they agreed to include this, they let Barents take an active role in these areas, but they did not do enough themselves. The effectiveness of the project was weakened because Barents needed CeTO's resources and active participation. Instead, CeTO wanted to focus on legal issues, which eventually caused disagreements and put Barents in a negative light. Barents was forced to go outside on its own so people could see what they were doing and how they were spending USAID dollars—and to prove that they were not wasting millions of dollars, which was a risk.

(ii) CeTO as an operating entity

Barents and CeTO had a contentious relationship, a triangular one where Barents felt responsible for using USAID money well, but in a way that was openly opposed by our clients. CeTO's management had very strong views on goals, methods and focus, which differed from those of Barents. Often the president did not want to listen to our advice and was antagonistic to some of our advisors. This antagonism covered a variety of areas, including staff organization, the expenditure of funds, rules and regulations, resource commitment and use, types of advisors (they often just wanted to use Polish advisors). One of the primary disagreements concerned the use of funds. CeTO wanted to focus on a prospectus and spent extensive resources of its own on this effort, when Barents felt those resources would be more valuable in a marketing effort. Ultimately USAID arranged with KPW to have Barents advise KPW directly, as an independent third party rather than as CeTO's advisor. Eventually, USAID thought it best for Barents to be an advisor on developing the OTC market rather than a direct advisor to CeTO, as this would help alleviate differences of opinion on how to use project resources and help assure that Barents used the scarce resources most effectively, given our professional judgment.

IV Lessons and Conclusions

A Lessons

Several important lessons were learned from this project. For instance, the necessity to focus less on building infrastructure and more on building markets. Often

there is an implicit view that "if you build it, they will come" However, that does not often happen Instead, important elements of the market, such as privatization programs, are often delayed, which was the case in Poland Even if there is compulsory listing of privatized companies and all elements are on time, it is still probable that intermediaries will not be prepared to perform their various functions and will need time to get educated and comfortable with the range of new roles being introduced by these markets In addition, even if companies do list and trade on the market, it still may be difficult to get them to use the market for raising capital--an activity that is important if the market is to contribute to generating economic development

Thus, it is necessary to put time and effort into cultivating the external environment--not just in training on how to use infrastructure, but also on why it should be in the market, how to research companies, market the market, and underwrite to encourage primary markets and then how to trade positions to create more secondary market activity Poland was farther along in its development than many other emerging markets as some basic infrastructure was in place--such as an SEC, KDPW, brokerage houses, etc However, this effort can be more difficult in a developed market as a developed market can also mean that the institution has to work more aggressively to get the market into the picture and must educate people more about why it is needed

In order to convince others of the need for the market, the market must be able to convince others that they can make money from the activity and must have the resources to attack the problems that might reduce that ability--or at least have the ability to wait until market opportunities push change from below Those problems may stem from several sources If entities cannot make money, they will not participate But often their inability to make money stems from laws and regulations, brokerage incentive systems, or other areas Resources need to be available on the project to go after these activities to create a viable environment

The securities industry must be active and profitable These types of markets need active securities firms who can help push the market forward, and take positions and bring participants to the market The markets are a catalyst for change, pushing these things to happen However, the timing and interaction must be synchronized or the market will never take off Thus, the project teams need to spend time developing the securities industry to make sure it has the voice to make necessary change, to get entities into the market The intermediaries are at the center of the activity--drawing in issuers and investors, helping to bridge transaction gaps, owning and operating the market

B Conclusions

This was a difficult project because of the reasons cited above (structure, counterpart, timing, etc) and stressful because one never knew if it would work Despite the difficulties, it produced many ideas on how to structure (and how not to), the importance of marketing and public relations, the importance of the right counterpart Also, it was rewarding because the project team was empowered by introducing new

elements and in educating SMEs about the market. It brought the capital markets to a whole new group of entities.

After the project ended, there were signs that the over-the-counter market was taking off. By the end of February 1998, there were a number of companies listed on the market, many private sector SMEs talking about their intention to list, a steady increase in trading, increased level of involvement on the part of the WSE, etc.

In sum, Barents worked exhaustively to make this more than an infrastructure project. If their efforts had been given more time for development, the final results would have been better. Setting up the infrastructure was difficult because we could not control the process, given our client's determination to dominate and unwillingness to benefit more from our experience. But there was extensive external work that was needed to make this an active market. In Poland developments generally tend to take a long time, because individuals are hesitant to step in and take leadership roles. Instead, they prefer to wait until someone else leads. They then feel comfortable in following along. Both USAID and Barents should have been aware of this tendency and should have set up the project accordingly.

It should have been established from the beginning that the client could not control the purse strings. Because it did, CeTO kept going bankrupt, which took enormous amounts of time of the President and of Barents in trying to repair the damage to avoid a major catastrophe. If Barents had held more control, or if USAID had stepped in and taken a stronger stand against the client early on and kept them in line, the project would have been more successful. A crisis was created by setting the immediate goal of completing the trading system, which was a course of action caused by USAID's overreaction in some respects to the demands of the brokerage community, so that other major issues took second stage to the trading system--namely getting issuers and making sure that finances were monitored. The contractor must be given professional responsibility--must want to work with the counterpart because that is an integral part of the work--but must be able to maintain control without major debates.