

About **Privatization** through ESOPs[^]
and
About the Promoter of **Employee Ownership**
the Share-Participation Foundation

SHARE-PARTICIPATION FOUNDATION

Budapest, Hungary
June 1994

BEST AVAILABLE

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The articles come from **PRIVINFO**, a Hungarian bi-weekly Privatization Magazine

AN INTERVIEW WITH JANOS LUKACS, EXECUTIVE DIRECTOR OF THE RESZ-VETEL (TAKE-PART) FOUNDATION, MEMBER OF THE BOARD OF DIRECTORS OF THE SPA

Experience with ESOP, with Special Regard to the Articles of Association

The preconditions for launching an ESOP at company level are that a) proprietors agree with the program, b) at least 50 per cent of the employees assume responsibility for it, and c) a financial institution grants a loan for the purchase of shares

The credit would be a refinancing loan granted by the National Bank of Hungary to a commercial bank. The loan will carry a rate of interest equivalent to 75 percent of the current central bank base rate. Financial institutions will not be allowed to raise this by more than five percent. The loans will be granted with a maximum maturity of 10 years. Employees have to pay 25 percent of the value of the shares in cash. Employees are granted a personal income tax allowance on such investments.

ESOP (Employee Share Ownership Program) is a financing and organizational technique enabling employees to come forward as joint buyers, in such a way that the purchase is guaranteed not by their personal property but by that of the enterprise concerned. This enables the collective to become owners with the provision – ensured by the law – that this jointly acquired property could be divided among individuals in the process of repayment. Therefore the property will be divisible among individuals, according to the extent and schedule of repayment. An individual will become an owner if he or she is able to repay both principal and interest. If he or she is not able to fulfill this obligation, then the property is transferred either to the bank or back to the seller.

THE ORGANIZING COMMITTEE

PRIVINFO Let's look at a typical ESOP buy out. How does it start?

LUKACS The Act on ESOP prescribes the obligation to form an organizing committee. It is a three-member committee representing the employees' collective desire to make a joint buy-out against the seller, the bank and all official or unofficial organizations.

P In your experience, who become members of this organizing committee, and what is the incentive?

J L They hear about the ESOP from somewhere – from this article, for example – and it becomes attractive to them. They figure why not? The management often says:

Well, we have brought this company to its present standard. It is promising and marketable. It is worth owning, so why should we not try to obtain it not only for ourselves – within the framework of a management buy out, let



us say – but for all who have taken part in it, or will take part in the future?"

P It is probably the management that has to deal with all kinds of legal regulations day in, day out, so the ESOP probably attracts their attention first.

J L It also occurs that the ESOP is initiated by unions or an opposition consisting of a lower-level management – for example, if the higher management has made a commitment to an external investor or itself.

P Has that occurred?

J L Yes, it has. However, the best thing is when they row in the same boat, because it is easier to do together. If they take steps against each other, it not only implies conflicts but the possibility of failure, too. An ESOP is good if collaboration can be established among as many employees of the company as possible. However, if it implies an increase in conflict, if interests can be validated against each other, that is the death of not only the ESOP but the company itself.

P Let us assume that employees have managed to come to an agreement on the composition of the organizing committee.

J L Then the organizing committee has to inform potential participants that is the employees. Maybe people have already heard of an ESOP, but they may not know what it stands for. If they hear from it for the third or fourth time, then they already have a rough idea what these initials stand for and what mechanisms lie behind it, so I repeat that people need to be informed! On what an ESOP means at all, whether the company concerned has a future, whether it is possible to put together such a business plan and such a business strategy which indicate that it will work and be a profitable venture, so that it will be worth owning. After that, they will have to start establishing the ESOP organization. That already requires a certain kind of acceptability – and a 25 percent support is necessary for the establishment of an organizing committee itself.

P Therefore, if three people come together with the idea of forming an organizing committee, they have to conduct a public opinion survey on whether the collective will authorize them?

J L That is right, on whether people are interested in an ESOP at all and whether they will accept these three or want someone else. If this is achieved, then comes the second stage of acceptability. Namely, draft articles of association are required for the establishment of an organizing committee, as well as the support of at least 40 percent of the whole staff for this project.

GENERAL ASSEMBLY AND ARTICLES OF ASSOCIATION

P Generally, how is it done? With questionnaires, or is all the staff called together to an auditorium?

J L That will have to be decided at the

INTERVIEW

foundation meeting or at partial meetings and the main thing is that at least 40 percent of the whole staff has to attend and vote for the approval of the articles of association under such conditions

P Still that contains the potential for conflict later on, because it may occur that employees face for the first time the result of the work done by the organizing committee. I think they have to get acquainted with a great deal of data and statutory rules, and somehow accept it at first hearing. The articles of association regulate matters essential for the future, and that will be approved by people who may, just then, be hearing in detail about an ESOP itself for the first time in their lives. How will they know whether what the organizing committee has put together and envisaged is acceptable for them? Isn't there a danger that the organizing committee may favor one group of people within the company, but do it so deftly that the others do not realize it upon hearing the articles of association for the first time?

J L. That danger is undoubtedly present. An ESOP is a rather complicated legal and economic scheme precisely because the purchase is not made individually. If I buy something on my own, if I have the money, I buy something and I enter a legal relationship. However, here we are talking about an acquisition of property in which the proportion of my ownership will turn out only later on. That is decided by the articles of association and by the rules of division. That is – together with a lot of other things about it, of course – what makes the articles of association so important. They are actually the constitution of the whole thing. It is the duty of the organizing committee to furnish plenty of information on these articles of association while things are going on. Surely the great majority of people will see clearly only much later as the articles involve a lot of complicated legal terms.

EXAMPLES FROM THE U.S.

P Let's see then, what does a good example of ESOP articles look like?

J L. In both the United States and the United Kingdom the basic principle is that the extent of acquisition of property should be proportionate to contribution to the performance and profit of the company.

P That is a rather subjective category. How can that be accepted by someone, and how can it be measured?

J L. Indeed a measure is applied – for example they say that the division of property can involve predominantly or maybe exclusively two basic principles: salary received from the company and years of service. Namely they start from the fact that a salary reflects how valuable an employee is for his company according to the principle that

if a company pays more to its staff than they deserve it will go bankrupt anyway.

P This applies mainly to market economies, and not to former state-owned enterprises.

J L. It should apply not to former ones but to present-day enterprises. Companies cannot pay more than market conditions and performance allow.

P Therefore the salary has to be included in the calculation or formula, on the basis of which the future property shares of individual employees are calculated. Does the act prescribe this?

J L. Unfortunately the act does not even mention it. According to the feasible American practice it should be included somewhere – and it is in the United States. The U.S. law says that on one hand all the employees must be embraced by the ESOP so nobody can be left out of it. The other basic principle is that an equal measure must be applied for everyone and the only difference possible in that equal measure can be on the basis of salary and years of service. If another method is applied then there are no tax – or other – allowances. The other thing is that they say well gentlemen here in the acquisition of property by individuals in the division of the property to be repaid a greater difference in proportions than that among salaries cannot be made from one person to the other. Let us say if the difference between the highest and the lowest salary is only 15-fold then – assuming an annual work performance – the difference between the biggest and the smallest property share may not exceed 15-fold either.

P Is it included in the Hungarian law?

J L. It is not. In Hungary it may occur that, right from the start or gradually the ESOP is limited to a small circle of people. It is also possible that there are built-in restrictions for those who join the ESOP later on the basis of which the number of participants of the ESOP is always decreasing. According to the law all that is possible now. In my opinion additional rules and fair restrictions should be provided, just like in the United States.

P You mean amending the act?

J L. Either amending the act or it could be added to the taxation rules concerning the ESOP that a tax allowance is due only if the Foundation is determined to make the act work better to be more usable to avoid contradictions – by small steps or bigger ones.

ARTICLES OF ASSOCIATION – WHAT TO ATTEND TO?

P How can different interests be built in and validated, prior to the approval of the articles of association?

J L. Originally we had in mind making a sample of articles of association. As it would

have numerous advantages and disadvantages too eventually the government rejected the proposal. So it is not possible to say. Here is a sample please follow it. There will be a lot of different articles of association.

P Are there simple criteria which if checked, would tell a person whether the articles are any good for him?

J L. I can list four such areas briefly. The first is the rules for new participants to join. Which are the conditions for someone to join this organization as a new employee and a new participant? The second one is the rules of the division of the acquired and repaid property. What kind of basic principles and which factors are considered how much are they weighed and on the basis of which formula and which algorithm? The third one is the possibility of exercising voting rights both at the meeting of the organization and at the shareholders' meeting or at the meeting of the limited liability company. The fourth one is the marketability of shares later on that is they must not be just a piece of paper which can not be sold but actually negotiable securities which can be cashed.

The articles of association must ensure these four things in addition to compliance with three acts: the Act on ESOP, the Financial Code and the Act on Economic Associations. Articles of association are rather large in volume usually a hard-core legal document of 15–20 pages and in my opinion considering the future operation of the joint stock company relationships among individuals participating should be regulated so as not to be destructive but to improve and increase performance and to contribute to the more successful operation of a company in a market economy.

CHANGES ARE FEASIBLE!

P If some groups within the enterprise only realize later on that the approved articles of association are disadvantageous to them, then, in your opinion, is it worth initiating their change?

J L. By all means. I propose to make changes if they think that there are errors in the articles which may lead to conflicts or if some issues are not regulated at all. An ESOP organization has an executive management which may propose changes to the meeting for modifications of the articles for example. It is the duty of the executive management to review the articles – either itself or with consultants – on the basis of experience accumulated in the meantime – and to say that it is in the interest of both ourselves and the company to change them. Whenever I attended a foundation meeting I always used to say that a few hundred people at a foundation meeting neither can nor should compose articles of asso-

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ciation. That is a legal document and it must be previously coordinated.

P First there are consultations, then they come together, coordinate, and later on vote for and sign the articles of association.

J L That is right.

P As I see it this also means that if someone has not yet seen the articles, or has not received a proper explanation of what

they contain, then he should at least be skeptical at the meeting, instead of raising his hand automatically.

J L It is the duty of the organizing committee to make the articles accessible beforehand to the people who should indicate both orally and in writing if they have a problem. If necessary, an amendment proposal should be made and the articles should be modified

but prior to the voting. Three hundred people are too many to compose articles; only chaos would come of it. However, the executive management can be made to review opinions in the year following the foundation and – if necessary – to make proposals for other meetings concerning the modification of the articles.

Tibor Hollauer

The Resz-Vetel Foundation was established at the end of 1989 by a handful of lawyers, economists and sociologists. Their purpose was to initiate the preparation of an Act on ESOP and to take part in the elaboration of methods enabling the population – primarily employees – to take part in privatization. At the beginning the foundation had a property of HUF 10 million; currently it has an equity capital of HUF 5 million and a HUF 10 million property. By the end of 1992 about 60 companies and private individuals had joined the foundation.

During the past two and a half years the staff of the foundation took part in the discussions of the draft law on ESOP. In October 1990 the Ministry of Labor commissioned the foundation to draw up the regulation concept in principle and the text of the Act on ESOP. The staff of the foundation has given more than 100 lectures to company managers, employees and trade unions. By the end of 1991 they had provided consulting for the transformation of 15 companies in order to support such transformations where in some form (on the basis of Property Policy Guidelines E-Credit or out of ESOP resources) a substantial employee ownership can be ensured.

Since the Act on ESOP was passed the foundation has sought to ensure that professionally fair and honest ESOPs be established by any means possible. For the new Hungarian Act on ESOP – as opposed to its U.S. and British counterparts – does not exclude the establishment of so-called false ESOPs.

The real purpose is the establishment of ESOPs which promote the interests of both the employees and the company.

The Resz-Vetel Foundation has also established an international set of contacts; it can rely upon the assistance of the British Know-How Fund and the American USAID. With their participation, for example, Hungarian civil servants and professionals have been able to study how ESOP companies work in Britain and in the U.S. A managerial course has also been proposed to be held in Hungary, probably this year, with the participation of one of the most successful British ESOP firms, Baxi Partnership.

A Foundation for Facilitating the Acquisition of Property by Employees

The Resz-Vetel ("Take-Part") Support Foundation for the Acquisition of Property and Participation by Employees has so far helped the transformation of about 15 companies, and it currently provides consulting for more than 100 companies. PRIVINFO asked Janos Lukacs, executive director of the foundation, about the foundation and about U.S. and Hungarian experience with the ESOP so far.

The assistance of the foundation is also necessary because the ESOP is not a common privatization technique in Hungary yet. Precise figures are not available, but the number of companies transferred to the ownership of employees, either wholly or partially, is estimated at less than 100, and well-founded ESOP offers have been submitted in about 50 cases. Beyond these there are also other initiatives, but their number is less than 100. Efforts are made for the development of ESOPs in a number of Eastern European countries, but application has come farthest in Hungary, Slovenia, Bulgaria, Romania, Ukraine, and Russia regard the Hungarian act as a model.

The American Example

In other parts of the world the ESOP is not mainly a privatization technique but a means of improving company performance. Apart from Hungary, only the United Kingdom and the United States have regulated it by a legal Act. The American ESOP Act was passed in 1974, although employee share ownership had occurred in practice before that. The purpose of the Act was to ensure the possibility of acquisition of ownership by employees and to increase the marketability of the company, and eventually a couple of paragraphs were included with the aim of

preventing the abuse of the allowances by other strata. Namely, ESOP organizations and those involved in the scheme are entitled to substantial tax allowances; among others, an ESOP company can use its entire pre-tax income for loan repayment; employees can deduct from their tax base the sum paid; and crediting banks do not have to pay taxes on 50 percent of their income coming from ESOP interest.

At the moment 12–13,000 medium-size and larger companies are owned by employees, wholly or partially – nine percent of the companies of that size. Employees have acquired an average of 22 percent ownership share in companies; at 1,800 companies the share of employee property exceeds 50 percent, and about 200 companies are wholly owned by employees.

The tax allowances were not a bad deal for the U.S. budget; additional tax income (from excess income, for example) counteracted the shortfall of taxes, and this does not even include the benefits which appear later on. Namely, if modern participative management methods are applied in ESOP organizations, then the company performance is 20 to 30, or in some cases 50 percent better than in ESOP organizations of similar size and profile, not applying management methods.

Intentions of the SHARE PARTICIPATION FOUNDATION
Promoting Employee Share-Ownership
in the Creation of a Market Economy in Hungary

For nearly three decades the conception of reform of the state socialist economies of East Central Europe was dominated by the search for the correct mix of plan and market within the state sector. By the mid 1980's a new conception of reform emerged in Hungary focussing on the private sector as economists debated the correct mix of public and private ownership across sectors of the economy. Developments during the past year indicate a fundamental break with the earlier conceptions of reform rather than simply stimulating the expansion of the traditional, small-scale private sector, policy makers are designing a variety of measures for the privatization of the public sector itself. Whereas previous debates addressed questions of how to reform the economic mechanism of state socialism, current efforts seek to transform the fundamental institutions and property relations of the Hungarian economy.

The current wave of privatization in Hungary takes numerous forms: the creation of limited liability corporations, joint stock companies, share-holding firms, joint ventures, and the sale of state sector enterprises in parts or whole to domestic and/or foreign owners. Among these multiple routes of creating a market economy policy makers are including provisions for the establishment of Employee Stock Ownership Plans in which employees - workers and managers alike - will be shareholders in their own companies. The State Commissioner of Privatization will soon submit draft legislation to Parliament to establish and regulate these new arrangements under a unified Program of Employee Share-Ownership.

The purpose of our Foundation is to promote employee ownership as one aspect of property reform in the creation of a market economy in Hungary. Working with employees, employers, and their organizations, it disseminates information, publishes documents, conducts research, and provides direct expert advice to enable employees to become share owners in their companies within the framework of the Share Ownership Program of Employees (in Hungarian: Munkavállalók Résztulajdonosi Programja -- MRP).

During this period of political and economic transformation in Hungary, the goals of our Foundation are

a / to support democratization of property and widen opportunities to obtain property

Programs widening the circle of private owners and democratizing access to credit have already been operating in the United States, Western Europe, and some developing countries. Through various types of Employee Stock Ownership Plans /ESOPs/ employees gain property rights by securing a part or the totality of shares in their companies. Typically, employees acquire these shares not on the basis of their own savings but in a framework of advantageous credit repayment schedules based on the dividends of their shares. As shareholders, employees have an interest not only in retaining their workplaces but also in the profitability and long term market position of the companies as well as in fruitful cooperation with each other.

The primary aim of the Foundation is to offer expertise to promote the elaboration of the Share Ownership Program of Employees (MRP) and to further its development and operation along lines similar in theory and practice to the Employee Stock Ownership Plans. It undertakes dissemination of the idea of employee share ownership to the widest possible circle of employers, employees, and their organizations. It further supports such activities by providing technical assistance in investigating the feasibility of a Share Ownership Program of Employees and in creating institutions at the company level to facilitate successful functioning of the employees' share ownership.

b / support creation and extension of the participation possibilities of employees

- by assisting employees, in accordance with their ownership rights as shareholders, to prepare for strategic decisions of the company and for elections of the most important management organs of the company,
- and by assisting firms to create possibilities for all employees within the framework of an overall company participation system to contribute directly to increasing profits in their own fields of activity

c / support design and construction of an intensive communication system within the company

to enable the employees, as shareholders, to understand the situation of their company, to identify its existing problems, and to resolve these problems by overcoming obstacles to cooperation and developing the kinds of activities needed to increase the profits and competitiveness of the firm

The Foundation was founded by scholars and experts in economics, law, sociology, and psychology who regard economic democracy and political democracy as equally important (and mutually supportive) features of the Hungarian society of the future. One of the founding members -- Janos Lukacs, an industrial sociologist who is now executive director of the Foundation -- has conducted numerous field investigations over the past decade in a variety of organizational settings. During a ten month visit in 1988-89 at the Industrial Relations Institute at the University of California-Berkeley, he studied ESOPs in the United States and conducted several months of field research on management-employee relations at the 100% employee owned Weirton Steel Corporation in West-Virginia.

In the past year our organization has

- participated intensively in drafting a new legislation for an Employee Share Ownership program,
- presented over a hundred lectures in enterprises and a variety of public forums to employees, managers, and public officials
- published articles in daily newspapers and weekly periodicals for the general public,
- provided technical assistance to managers and employees of enterprises where ESOPs are being adopted,
- consulted with numerous representatives of employee organizations and management (including foreign and Hungarian companies considering buyouts of state owned firms) in cases where ESOPs are being examined as one aspect of property transformation

In the coming months we plan to

- prepared handbooks on Employee Share Ownership that explain the legal and financial formulations of the new law on Employee Share Ownership in lay terms as well as outline the practical steps necessary to establish such programs in Hungarian enterprises,
- distributed the handbook and other brief explanatory materials to a wide circle of managers and labor representatives using mailing lists from the Ministry of Industry, the National Management Training Center, the Bureau of Workers' Councils, and branch unions,
- gave free consultations to provide technical assistance according to the draft concept of the new legislation on Employee Share Ownership programs,
- having received grants from the Know-How Fund of the British Government we were able to help representatives of companies interested in employee

- ownership to attend a conference in Oxford on employee ownership and participation and to visit partially employee owned companies in GB,
- sent Hungarian experts to the United States and Western Europe to visit enterprises with ESOPs and learn first-hand from their experiences,
- organized conferences and workshops on the legal, financial, and organizational aspects of Employee Share Ownership

To carry out these projects

we have received support in the form of small grants from twenty two companies already intensively considering Employee Share Ownership programs Several other firms have promised additional (although again, small) grants The British Embassy in Budapest helped us financially to purchase equipment (for communication, spreadsheet analysis, word processing, printing, and copying), to assemble a specialized library of materials on employee ownership, and to cover travel costs and consultancy fees of British experts

But to go on with our efforts we need further funding from Hungarian and foreign sources We need grants also in convertible currencies from foreign foundations and other organizations interested in supporting employee ownership and participation during this period of political and economic transformation in Hungary

Budapest, February 22, 1991

FOUNDATION

founded by

Ács Eva, Diczhazi Bertalan, Dr Kotz Laszlo, Lukacs Janos,

Dr Szalai Erzsebet, Dr Szantai Janos

with the following conditions

1 Data of the Foundation

- Name **Share Participation Foundation**, Supporting Employee Stock Ownership and Participation
- Office H-1089 Budapest, Villám utca 15

2. The aim of the Foundation is to promote employee ownership as one aspect of property reform in the creation of a market economy in Hungary Working with employees, employers, and their organizations, it disseminates information, publishes documents, conducts research, and provides direct expert advice to enable employees to become share owners in their companies within the framework of the Share Ownership Program of Employees (in Hungarian Munkavállalók Resztulajdonosi Programja -- MRP)

In detail The Foundation intends to

a) support democratization of property and widen opportunities to obtain property: Programs widening the circle of private owners and democratizing access to credit have already been operating in medium and highly developed countries representing different kinds of Employee Stock Ownership Plans /ESOPs/ Their basic aim is to support employees in gaining property rights through securing a part or the totality of shares in their companies Typically, employees acquire these shares not on the basis of their own savings but in a framework of advantageous credit repayment schedules based on the dividends of their shares As shareholders employees have an interest not only in retaining their workplaces but also in the profitability and long range market position of the companies as well as in fruitful cooperation with each other

The primary aim of the Foundation is to offer expertise to promote the elaboration of the Share Ownership Program of Employees (MRP) and to further its development and operation along lines similar in theory and practice to the Employee Stock Ownership Plans It undertakes dissemination of the idea of employee share ownership to the widest possible circle of employers, employees, and their organizations It further supports such activities by applying expertise in organizational analysis to conduct investigations of Hungarian experiences in this field and to publish widely the results of this research

Persons and organizations requesting support receive assistance from the Foundation in investigating the feasibility of a Share Ownership Program of Employees and in creating institutions at the company level to facilitate successful functioning of the employees' share ownership

b) support creation and extension of the participation possibilities of employees in two senses

- to enable employees, in accordance with their ownership rights as shareholders, to prepare for strategic decisions of the company and for elections of the most important management organs of the company,
- and to assist in creating the possibility for all employees within the framework of an overall company participation system to contribute directly to increasing profits in their own fields of activity

c) support design and construction of an intensive communication system within the company to enable the employees, as shareholders, to understand the situation of their company, to identify its existing problems, and to resolve these problems by overcoming obstacles to cooperation and developing the kinds of activities needed to increase the profits and competitiveness of the firm

- 3 In order to start the execution of the foundation's tasks the founders will hand over to the Foundation - within 30 days following approval of the Foundation - the amount of altogether 10 000 - Ft
- 4 The Foundation is open, accepting also the participation and donation of others
The original aims of the Foundation cannot be limited or impaired by the new participation Extension and acceptance of further participations and donations for the foundation will be decided by the advisory board having a competence described below
- 5 For the administration of the Foundation, the founders create the organization of the Foundation described below

The organization of the Foundation consists of the Advisory Board, the Executive Committee, the Board of Supervision, and the Work-organization

a) The Advisory Board is the governing body of the Foundation responsible for the proper management of the Foundation's resources through safeguarding the value of its property and overseeing the utilization of such property and the income from it

In order to achieve the goals of the Foundation

- the Advisory Board administers the Foundation's property and the individual property objects included in it. The Advisory Board has the right -- in the absence of opposing stipulations of the donation contract -- to alienate, mortgage the individual property objects, or to execute any operation serving use, utilization, safeguarding and extension of the property. It has also the right to invest the resources at its disposal within its own competence with the aim of extending its property.
- By means of an additional extension of the Foundation property or by donations made by newly joined individuals or organizations, the founders can stipulate that also the capital of the donated property be utilizable for the fulfilment of the Foundation targets and they have the right to stipulate it in the relative contract of donation. In such cases, administration of the Foundation property can deviate from the general rules stipulated in the Foundation document.
- The Advisory Board decides about acceptance of extension of the foundation property by the founder, especially in cases when the conditions of property extension deviate from the general conditions.
- The Advisory Board also has the right to decide about the acceptance of any offer to join the Foundation. If the conditions of the offer to join will result in the extension of the Foundation aims or widening the circle of beneficiaries, the board is entitled to make such a decision only on condition that it not infringe on the original aims or on the circle of the original beneficiaries. Acceptance of an offer to join that modifies the original conditions requires the approval of the competent state authority.
- Reinterpretation of the Foundation's aims and the prescriptions relating to the circle of the beneficiaries is within the competence of the Advisory Board. Such reinterpretation must be formulated in a resolution and attached to the Foundation document. The competent state authority must be informed about this decision.
- The advisory board determines the annual plan of the Foundation, as well as its budget, and decides about the acceptance of the annual financial accounts prepared by the Board of Supervision.
- The Advisory Board elects the chairman of its own body. It is further responsible for appointing the members of the Executive Committee as well as the members of the Board of Supervision.

b) At the time of its founding the members of the Advisory Board consist of the founders themselves or their representatives, and one representative of the su-

pervisory state organ Afterwards, the Advisory Board will also include one representative of each of the institutions, companies, and private persons joining the Foundation until the number of members of the Advisory Board reaches 21 persons The mode of delegation of representatives is determined by the internal regulations of the state supervisory organ, as well as those of the joining institutions and companies, always with a validity for themselves

- Members of the advisory board serve 5 year renewable terms Membership does not lose its validity with any change in a member's employment status In the case of resignation of a member, acceptance of the resignation and release of the member in question is decided by an extraordinary session of the Advisory Board when the number of members of the Advisory Board is reduced below 10 persons and that of the members of the executive committee below 3 persons In such cases, the advisory board is obliged to initiate completion of the number at the delegating organizations
- Majority votes of a quorum of the Advisory Board are binding A two-thirds majority is necessary for recalling the entire Executive Committee and Board of Supervision as well as of their chairmen
- The sessions of the Advisory Board can be summoned by its chairman as well as the chairman of the Board of Supervision The sessions are led by the chairman of the Advisory Board who prepares the minutes of the sessions and submits the decisions to the supervisory state authority

c) The Executive Committee of the Foundation consists of 5 persons Its members are selected by the Advisory Board for a period of 5 years

The Executive Committee

- decides in all questions not being under the jurisdiction of the Advisory Board on the basis of the Foundation document or of a separate decision of the Advisory Board,
- realizes the goals of the Foundation and administers the Foundation property accordingly,
- creates and maintains the internal organization and functional system in order to realize the aims of the Foundation,
- exercises the rights of employer over the director of the Work-organization (appointment, release, salary etc),
- submits an annual report to the Advisory Board about the activities of the Foundation organization and about its economic results
- The Executive Committee elects its chairman from its members It decides by means of a simple majority of votes In case of a tie, the vote of the chairman decides A declaration of acceptance given by the appointed person is necessary for the acceptance of membership in the Executive Committee

- The members of the Executive Committee have a civil law responsibility for their activities
- The Advisory Board decides on all rules of contractual matters. In the absence of other stipulations, the right of contract is exercised by the chairman of the Executive Committee, and he also has the right to transfer this right to other persons (to members of the executive committee or to the members of the Work-organization). A book of representation should be kept about the authorization of the right to sign contracts

d) The Advisory Board will elect a Board of Supervision from its members. The Board of Supervision consists of 5 members. A separate declaration of acceptance is necessary for the acceptance of such an assignment.

The Board of Supervisors

- is obliged to control normality of the functioning of the Foundation organization and inform the interested boards /Executive Committee, Advisory Board/ in case of any discrepancy,
- is obliged to control and report on the annual report of the Executive Committee,
- has the right to summon the Executive Committee or the Advisory Board, to inform the supervisory organ in case of discrepancies, as well as to make complaints in case of any corrupt practices,
- has the right to suspend functioning of the Executive Committee in case of grave irregularities, and to appoint an extraordinary manager for administering the matters. At the same time, it must initiate an extraordinary session of the Advisory Board,
- is obliged to suggest summoning the Advisory Board also in case of reducing the value of the stock capital to half

6) **The beneficiaries** of the Foundation are, according to the aims of the Foundation

- employees, employers and their organizations considering or intending to start a Share Ownership Program of Employees at their own company and to create participation and internal communication systems accordingly as well as to obtain information about them. In its information and advisory activity, the Foundation favours companies having joined the Foundation but it has no right to deny its assistance from any other party approaching it
- The practical utilization of the Foundation's resources by the Advisory Board related to the circle of beneficiaries is controlled by the Board of Supervision. Whenever they are contrary to the targets of the Foundation and endanger their reali-

zation, it has the right to initiate the alteration or abolition of the principal decision and to inform the supervising state authority of this action

7 Financial Management the Foundation

The founders stipulate that the property of the Foundation and its growth should be governed by the organizations governing the Foundation (Advisory Board, Board of Supervision, and Executive Committee)

In the framework of this financial management,

- the organs of the Foundation are obliged to maintain as well as increase the capital value of the Foundation property. It is possible to use - as a general rule - property objects for the purposes of the Foundation, as well as to make use of the profit resulting from the utilization of the property
- The property objects included in the property of the Foundation can - as a general rule - be alienated. However the previous approval of the Advisory Board is necessary for the alienation of a property object representing a value considerable compared with the value of the Foundation property, i.e. reaching its 10 percent. The Advisory Board decides in its own competence up to what value the property objects can be alienated, obtained or accepted by the Executive Committee or the Work-organization, with the purpose of fulfilling the targets of the Foundation
- For the book-keeping system of the Foundation, the related decrees of the Minister of Finance should be applied. The information system and the inventory system should be decided by the Executive Committee, taking the value of the starting property into consideration
- Considering the legal stipulations, it is possible to separate special funds within the property of the Foundation, depending on their destination. Their utilization can be limited to special tasks within the general aims of the Foundation. In the agreements concerning acceptance of the donation, the economic conditions related to the special fund can be utilized for the special target. The contract about the special funds with the new members joining the foundation is concluded by the Advisory Board
- As the Foundation is responsible towards external organizations for its total property - i.e., also with the separate special funds - any claims on the foundation property - as a general rule - are met from the individual property parts (sides) proportionally. A stipulation deviating from this general rule can be valid if it is determined by the parties in the contract of donation
- The founders stipulate that if the nominal value of stock property of the foundation - to be maintained by the Foundation as aim of its existence - is halved, the Advisory Board, the Board of Supervision as well as the Executive Committee - se-

parately or together - are obliged to initiate dissolving of the Foundation. The decision concerning dissolving of the Foundation is made by the Advisory Board, but the approval of the supervising authority is necessary for its validity.

- The Executive Committee prepares annually a report to the Advisory Board on the management of the property of the Foundation.

8 Conditions of joining the Foundation

- It is possible for organizations or private persons to join in the realization of one part of the Foundation's goals or in their individual special targets. In case of their joining, they put a property suitable for the given purpose at the Foundation's disposal, and they have the right to stipulate their conditions in a contract, within the stipulation of the Foundation document.
- The Advisory Board has the right to decide about acceptance of the joining offer, defining at the same time also the conditions under which it accepts the offer. The joining agreement is signed on behalf of the Foundation by the chairman of the Advisory Board and the chairman of the Executive Committee.
- If the joining conditions are contradictory with the aims of the Foundation and endanger their realization, the organs of the Foundation are entitled to make a complaint to the supervising state authorities. Depending on the standpoint of the authorities in the questions of the complaint, the organs of the Foundation are obliged to initiate modification or cancellation of the agreement.

9 Other conditions

- If the Foundation fails for whatever reason, the Foundation property should be attached to another foundation having aims similar to those of the Foundation. The final decision must be made about this question by the supervisory authority.

Budapest, November 27, 1989

[signed by the founders]

Metrimpex deals mainly in foreign trade of mechanical instruments. It has expanded its operations as a trading house to domestic trade, services and transport. Metrimpex had a gross turnover of HUF 3 billion and pre-tax profit of HUF 90 million in the first six months of 1992. In 1991, the company had pre-tax profits of HUF 225 million on gross turnover of HUF 12 billion.

EMPLOYEES ARE STILL ENTHUSIASTIC

Metrimpex Ltd. engaged in the export and import of instruments manufactured in Hungary is one of the companies owned 90 percent by its staff. We have asked Dr. Tivadar Tomolák, president-director general, about this still uncommon method of conversion and the experience to date.

When was the conversion launched?

In March 1991 the State Property Agency ordered the firm to be privatized. This was completed on October 8 when the ESOP organization signed a contract to buy the firm.

Didn't any foreign or domestic investors apply? Why was ESOP the method chosen?

In addition to us there was one Hungarian applicant - Dunaholding - and a firm from New Zealand. We have no information on the construction they suggested. From the beginning we made an effort to prevent foreign involvement in the new company. We were afraid that if a rival company bought Metrimpex it would decide sooner or later to wind it up or to alter its core business. There was another alternative - a widespread one - that the more effective parts of the company would convert into limited companies and break away. This was prevented by the management. We thought Metrimpex should remain as one unit. At that time the ESOP measure was passed and we considered it the best possible solution. Our ESOP consultant firm, Riverside Budapest Investment and Consulting Ltd., considered this type of privatization feasible in our case.

As I understand it, the firm's equity is HUF 700 million. Although the 400 employees had probably taken out the Existence Credit, it must have been a difficult task for them to put up the 25 percent own resources. Did they receive assistance from the company? By the way, how enthusiastic were they about the ESOP?

Even at the first inquiry nearly 90 percent of the employees said yes to the ESOP and almost all of them joined the ESOP organization. They had taken an active part in drafting the articles of association - that's why it was prepared within such a short time. Incidentally, the employees will not have to pay the full 25 percent of the HUF 700 mil-

lion. Only 88 percent of the equity was put up for bidding. 10 percent was retained by the State Property Agency (SPA) to be sold for compensation vouchers and two percent went to local government authorities. In terms of the rights set down in the ESOP articles of association, 60 percent of the shares are held by the employees and the rest by the management. Part of this particular 25 percent was also paid by the limited company. The employees still had a considerable part to pay for. Not everyone had to pay the same amount, of course. The size of the stake available to employees depended on the time spent at the company and their positions and incomes in 1992.

When converting the company, did you think of a mixed construction in which part of the company shares would have been bought by the employees in ESOP, and part of it by the management in MBO? After all, if 40 percent of the shares are owned by the management, this can be regarded as a covert management buy-out. Can the employees exert any control over the company at the moment?

In the case of Metrimpex Ltd. we cannot speak of MBO in any form as it is not the management but the employees who have the majority stake. At the company's general meeting the ownership rights of the ESOP organization are asserted by three representatives, two of whom were appointed by the ESOP general meeting. We did not have a mixed construction in mind, partly because there was not much time and partly because we did not want to split the staff.

How is a decision made by a general meeting? Who is present?

The general meeting is attended by the board of directors, the supervisory committee, the auditor, the representatives of the ESOP organization, as well as the SPA and the local authorities as shareholders. As the majority of shares is owned by the ESOP organization, they dictate what should happen.

Who are the current representatives of the ESOP organization?

The ESOP general meeting has appointed a managing clerk and a foreign-trade executive to represent the ESOP. They control two-

thirds of the votes that the ESOP is entitled to. The company's board of directors has delegated the deputy business director general into the ESOP executive body; this person controls one third of the votes.

What are the conditions set down in the ESOP Articles of Association in connection with staff members' selling their stakes and the potential buyers?

The ESOP organization admits as members only those who have worked at Metrimpex for at least two years. The ESOP organization is entitled to the right of preemption, that is, it has the right to purchase the shares of employees going into retirement or leaving the company. The shares bought back by the ESOP organization are then available first for the other employees of the limited company, followed by ESOP members and finally the rest of the owners. That's why no shares have been reserved for new admissions. If an employee wishes to join the ESOP but no shares are available, he or she has to wait until some become available through, say, somebody's retirement. Currently, ESOP members can trade with the majority of shares the ESOP has bought out, since the percentage bought on the E-Credit is mortgaged to the Post Office Bank and the Savings Bank Ltd., who have granted the advance. So ESOP members may now sell only the shares at nominal value which they have acquired from their own resources. They become the actual owners of the shares only after fully repaying the E-Credit and the interests.

From the dividends?

That's our objective. And probably we'll be able to reach it. Metrimpex is expected to close 1992 with profits again. Its position is stable in other respects as well, being a foreign-trade firm, it has naturally been shaken by the collapse of Hungary's traditional Eastern markets, but - although its turnover for 1992 is only about one third of the figure for three years ago - it has never been loss-making.

E V

Masped Magyar Altalanos Szallit manyozasi Vallalat (Hungarian General Freight Enterprise) is the only company to date where – if the State Property Agency (SPA) accepts the tender of the employees of the company – privatization would be carried out exclusively through ESOP (Employee Share Ownership Program) and MBO (Management Buy-out) We talked over the two schemes with Istvan Kautz, the chairman-general manager of Masped, and Eva Ferencz, executive manager of the ESOP organization.

ESOP IS NOT MBO IN DISGUISE

– How did the transformation of Masped start?

– Originally the company used to be a state-owned enterprise managed by an enterprise board. It submitted its transformation application to the SPA in November 1991 and it was transformed into a joint-stock company on January 1. Of the stocks 89.9 percent went to the SPA, 5.3 percent to the employees – property vouchers were converted into shares – and 4.8 percent to the local government. In October 1992 the Board of Directors of the SPA announced a limited tender for the purchase of Masped. About 30 foreign and domestic professional and institutional investors participated at the tender and – as they had previously indicated to the SPA their intention to buy – representatives of Masped were invited as well.

– What did their application contain?

– We established a consortium the shareholding company with a share capital of HUF 10 million set up out of members of the ESOP organization founded by the employees and of the management, respectively for effecting the management buy-out submitted a joint offer. The SPA put up for sale 79.9 percent of the shares (it retained 10 percent for the exchange of compensation vouchers) according to our plans 51 percent will be bought by the ESOP organization and 28.9 by the management.

– How did you get the idea to buy Masped in that way?

– We know of a number of cases in which ESOP was actually an MBO in disguise – and that is what we wanted to avoid. Sometimes the distribution of shares was tied to the amount of own resources paid in but it resulted in acquisition of stocks mainly by the management. We believed that the proportion we chose would make it possible for the employees to acquire stocks in proportion to their contribution to profits and accordingly to have a say in running the enterprise. On the other hand with its 28.9 percent of the shares – 2.5 percent suffices for the right of veto – the management will be able to prevent potentially wrong decisions which would be

Masped had a turnover of HUF 9 billion and a pre-tax profit of HUF 325 million in 1991. Masped anticipated a turnover of HUF 12 billion, and a pre-tax profit of 421 million for 1992.

contrary to the long-term interests of the company. Western experiences were made available to us by the Resz-Vetel (Take-Part) Foundation which also took part in the elaboration of fair and just by-laws.

– Which principle was applied at Masped for the distribution of shares among the members of the ESOP organization? Who could buy shares?

– Anyone who has been with Masped for at least six months. The amount of shares distributed according to the timetable of repayment depends on the number of staff, the size of the own resources paid in and net wages as well as the so-called responsibility scores of employees which can be calculated on the basis of their position at the enterprise.

– But this is also a scheme favoring the management, isn't it? After all, they are the ones who can acquire a higher amount of shares, also because they have a higher net salary.

– This method of the distribution of property ensures the distribution of shares in proportion to performance: no one of the employees in the ESOP can accumulate more than one percent of shares.

– How can employees take part in the decisions of the company?

– Each shareholder may come to the shareholders meeting and take a vote in proportion to the amount of shares he owns. The voting right attached to shares not yet distributed belongs to the executive of the ESOP organization, but still, the executive can only vote on issues for which he was authorized at the general assembly of the ESOP organization.

– So the total of shares won't be distributed among employees?

– No, that is one of the aspects where we differ from the Hungarian practice – if we can

call practice those few cases when employees bought their company. We kept to gether 25 percent of the shares and that will stay in the ownership of the ESOP organization even after the employees will have completely repaid the Existence Credit they got. New employees will be able to buy Masped shares out of that 2.5 percent and the dividend of it shall create resources enabling the employees who are leaving to sell their shares – if they want to.

– In order to buy the enterprise both the employees and the management want to apply for E-Credit. Masped has a substantial equity – isn't it difficult to present own resources?

– Indeed the equity capital of the company amounts to HUF 2 000 65 billion. All 340 employees of Masped joined the ESOP organization. Employees paid HUF 13 million as own resources even if for such a sum – own funds amount to only two percent – it was not easy to gather so much money. The 16 managers of the enterprise-management buyout will also finance the purchase out of the E-Credit. The company will repay the loan out of profits. They all have the chance to do it too. Masped had a turnover of HUF 8 billion in 1991 and approximately HUF 9 billion in 1992. The latter means the transport of three million tons of goods and the provision of services to 6000 customers.

– What are the further plans of Masped? Have employees participated at all in working them out?

– So far Masped has been involved only in international freight organization but our new plans include setting up domestic warehouses and outlets. We have already opened offices in 10 rural towns. Nevertheless we are not changing our profile. Staff numbers were increased by 10 percent in 1992 and if domestic freight transport proves profitable then in the future we may employ even 50 percent more people than last year. I cannot tell you more – it is up to the assembly to decide on the strategy.

E V

The rules for Existence Credit changed on January 1, the details appeared in PRIVINFO No 4/1993

Recently, experts in the Ministry of Finance have been working on the amendment of an ESOP procedure adjusted to the conditions of the E-Credit According to PRIVINFO's information, the work will be finished at the end of March or in mid-April As ESOP organizations formed before then will have to use the current rules, we explain the procedure below, and as soon as the new conditions are known, we shall provide an update

THE INTERPRETATION OF THE ESOP ACT

For Article 1 of the ESOP Act

An ESOP organization can be formed wherever employees of a public limited company or limited company registered in Hungary – in the manner regulated by the ESOP Act – exclusively in the company by which they are employed – wish to purchase state-owned shares or business shares

An ESOP can also be started when a state-owned company subsidiary or the company of individual legal entities is transformed

It is also possible to organize an ESOP prior to transformation. In such cases it is not necessary for the whole enterprise to be transformed into an economic association. Instead, the state-owned holding company can withdraw the property of the separated organizational unit and transform it into a company with the express aim of forming an ESOP there.

Then the acquisition of shares or business share by employees is effected by purchase after the company created in the withdrawn unit has been registered.

On the basis of the initiative of the Organization Committee on behalf of the State Property Agency it is advisable to make a decision on the withdrawal of the property of the separated organization unit

– if the purchase initiative fits into the government privatization objectives and branch concepts (in such cases it is also necessary to ask the opinion of the minister of the branch concerned. That has to be fitted into the process of the procedure from the point of view of both time and content)

– if the transformation of the company as a whole is not advisable in terms of the economy, its survival in an unchanged form is impossible or undesirable because later on the potential collapse of the enterprise would devalue even its still viable and marketable units and could prevent its sale completely.

Employees are eligible for participation in the ESOP if they have been working for the company or its legal predecessor for at least half of the legal work time and have been employed for at least six months.

As a condition for participation in ESOP even ESOP articles cannot prescribe the existence of employment for more than five years.

Participation in an ESOP is the basic right of all employees (provided they satisfy the conditions stipulated in the articles).

A written statement must be given on the intention to participate and it is possible to give up that right in writing.

Signing the commission given to the Organization Committee is also considered a written statement if its content includes the statement on the intention to buy.

Participation in an ESOP does not offer guarantees for the continuation of employment.

Simultaneously with the termination of employment the right of an employee to participate in an ESOP also ceases.

For Article 2 of the ESOP Act

An ESOP can be started by the voluntary organization of employees with the participation of at least 25 percent of the work force.

To accomplish that (in the case of an ESOP not yet formed) employees give the three-member Organization Committee a commission in writing whereby they authorize its members picked from among themselves what steps they should take on behalf of the employees – as their clients – in order to obtain the desired share ownership.

The contents of the commission in writing

To negotiate with owners to form the conditions of the sale for the case of the establishment of the organization to agree upon the manner of service and consideration on the conditions of a potential payment in installments to agree on the additional conditions of the contract due to negotiate with the credit institution on a loan request to have a feasibility study done to prepare the draft articles and coordinate their contents with the employees to prepare the plenary meeting resulting in the establishment of the organization in such a way that at least 40 percent of the total work force of the company should attend it for support.

The authorization will be acceptable to those responsible in the SPA if it has been signed by 25 percent of the employees concerned.

It is the task of the Organization Committee to have the feasibility study prepared that contains the size and value of the employee share acquisition intention and payment conditions available (presentation of own resources) whether or not they wish to use the employee allowance-possibility defined in the Property Policy Guidelines (in the case of a loan) what repayment conditions it is able to meet or what payment in installments can the ESOP organization take on subsequent to its establishment.

The feasibility study must clearly state whether the financial situation of the company enables the successful effectuation of ESOP (The company is not under bankruptcy or liquidation proceedings.)

The feasibility study also helps employees to be able to decide (in a wider circle) whether under the expectable purchase conditions

they can reasonably undertake share acquisition in the framework of ESOP

From the technical point of view the feasibility study is controlled by the company and its grounding attested

Attestation at the company can be effected by those authorized to sign

The company is obliged to furnish data necessary for the preparation of the feasibility study

For costs of the study

If a consulting firm is employed the cost of the preparation of the feasibility study must be paid in advance by the ESOP Organization Committee provided that the company does not do so on its own record

Following the establishment of the ESOP organization the company is obliged to bear costs related to the preparation of the feasibility study

If the activity of the ESOP Organization Committee fails and the ESOP organization is not formed then the costs of the feasibility study must be born by the employee community (commissioning the Organization Committee)

For Article 3 of the ESOP Act

With a signed copy of the completed feasibility study the Organization Committee can request a loan from a financial institution or may give an offer for payment in installments to the owner of the property share

The method of the credit examination

Financial institutions have elaborated in their own rules (Procedure on granting E-Credit and deferred payment allowances for ESOP organizations) which documents are necessary for the credit examination

Basically, these are

- 1) The commission in writing of the ESOP Organization Committee (the court resolution attesting to the registration of the ESOP organization – if there is one already) the minutes of the foundation meeting of the ESOP Organization on the basis of which it can be established that 40 percent of the employees of the company have declared the foundation of the organization and established its articles
- 2) The interim agreement reached with the State Holding Company containing the purchase price of the desired property for the case of the foundation of the ESOP organization
- 3) Feasibility study
- 4) Documents related to transformation
- 5) Documents concerning the business management of the company for sale
- 6) Business plan (for the term of the loan if possible but for a minimum of three years)
- 7) Assurances serving as collaterals for the loan and documents on the guarantees
- 8) Other documents prescribed by the decision-making system of the financial institution concerned

As a result of the credit examination the financial institution may issue a promissory note for the loan or the owner of the property share (if he is willing to accept payment in installments) may make a statement to the effect that he will accept the participation proposal if the organization is founded

The promissory note for the loan or the statement demonstrates the intention of the financial institution to grant a loan or the selling intention of the vendor. After the foundation of the organization the contents of the promissory note or the vendor's statement cannot be deviated from any deviation can be made only with the assent of all the parties concerned

The procedure of the Organization Committee at the SPA

The Organization Committee can address the responsible Directorate of the SPA with the authorization received from the employees the feasibility study the promissory note for the loan the purchase proposal (deferred payment request) as well as with the draft of its prospective articles and initiate the withdrawal of the property of the separated unit of the state-owned enterprise and its transformation into a company with the aim of forming an ESOP

In that case or in the case of a claim for deferred payment the SPA Directorate concerned will have to study the feasibility study with special care

The method of share or business share buyout from an already registered company will also occur in the framework of a similar procedure

The purchase proposal of the ESOP Organization Committee submitted to the SPA must contain the definition of the property share the ESOP wishes to buy (the name of the separated unit of the enterprise or the face value of the company shares or business shares they want to buy) the purchase price as well as the conditions of payment

The Organization Committee can turn to the SPA with a request for an interim agreement which for the case of the formation of the ESOP organization contains the willingness to sell the wished property share to the ESOP if the ESOP proposal wins the tender

The interim agreement must contain the size of the property share the ESOP buyout intention is directed at the purchase price or buying rate they want to buy at respectively if they want to claim payment in installments

The SPA (or – in the decentralized privatization procedure – the consulting firm commissioned by the SPA) asks its own consulting organization the Property Evaluation Bureau for an opinion and on the basis of that it declares whether the purchase proposal is acceptable

The responsible directorate of the SPA makes the statement but the decision on the content of the statement is made by the Management Meeting

The proposal submitted by the ESOP Organization Committee takes part in the tender announced by the SPA

Then the SPA decides on the legal possibility and whether it will have the collateral equivalent to two percent of the value of the property share applied for deposited

If the proposal (submitted by the ESOP Organization Committee) wins the tender the conclusion of a contract may take place

At the plenary meeting (shareholders' meeting) of the company the responsible representative of the SPA shall approve the formation of the ESOP organization

Allowances available to employees desirous to acquire share property within the scope of ESOP

The SPA forms the purchase possibilities of ESOP organizations by taking into account the employee allowances contained in the current Property Policy Guidelines That can apply to any quantity of property but the employee allowances can be used only up to the extent defined in the Guidelines

Member of the management just like other employees may take part in an ESOP initiative

The acquisition of property within the scope of ESOP shows a number of similarities with the privatization method of Management Buyout but because of the difference in the contents of the two it is necessary to differentiate between them

So that the decision-making body of the SPA can see clearly what type of privatization method it is deciding upon the material submitted with it should contain the number of the management staff wishing to participate in the ESOP and the size of the property share they wish to acquire

The simplest way for this is to enclose with the purchase proposal or with the tender application the elaborated provision of the articles containing the claim formulated in item f) of Article 9 of the ESOP Act – the manner and distribution principles for the property share owned by the organization when it becomes owned by the participants

The terms of allowances granted to the employees and to companies founded by them respectively to the ESOP organization are treated equally by the owner organizations and the allowances extended in different manners are taken into consideration together

The extent of the allowance to be given on charge of the state-owned property must not exceed the amount equivalent to 10 percent of the equity indicated in the opening property balance sheet of the state-owned enterprise in transformation or the amount corresponding to the total of 12 months gross wages. The extent of the allowance is determined by the lesser amount of the two. If 10 percent of the equity capital amounts to less than the value of the total of 12 months gross wages then – on the basis of a justified request – the Board of Directors of the State Property Agency may raise it to 15 percent

In the case of a buyout initiated by a group of employees respectively if not all the employees participated in the favorable purchase program the possible extent (sum) of the allowance has to be established proportionally taking into account the number of employees concerned and the total number of the workforce. This also applies to Management Buyout

For those who did not use the allowance it may also be extended at a later stage

The allowance can be extended during the transformation of a state-owned enterprise or the privatization of economic associations formed with its participation – including companies founded by the state-owned enterprise prior to its transformation or subsequent to it founded by its legal successor

The State Property Agency decides on the extension of the allowance

The calculation of the total value of allowances extended shall be effected on the basis of the worksheet introduced by the Executive Manager's Instruction No 1/1992 of the SPA. The annual total basic wages of the employees and the value of the equity property have to be written on the sheet as well as the market value of the normal shares (business share) and employee shares offered to the employees. Normal shares (business share) can be paid with cash and with the conversion of the purchased property vouchers whereas employee shares can be paid with cash and with the conversion of free property vouchers

The extent of the acquisition of employee share ownership

The ESOP Act does not limit the extent of acquisition of share ownership of employees. Beyond the extent of allowances defined

in the Property Policy Guidelines employees can acquire state property in the same way as external investors

The tendering procedure is governed by Articles 76-80 of Act No 4 of 1992 as well as the rules of the State Property Agency on Tendering Procedures (on tendering)

Although the law does not make it obligatory that for tender announcements the potential foundation of an ESOP organization has to be indicated in order to have a fair procedure it is still advisable to proceed in that way when a tender is announced by the SPA (or on its commission)

In anticipation the application of an ESOP organization on the announcement of a 30-day tender deadline is necessary

Special rules effective for the application of the tendering procedures

1) Pursuant to the rules of the SPA On Tendering Procedures the proposal of the employees submitted within the framework of ESOP can be accepted without competition – depending on the value limit defined in the Operation Rules of the SPA – on the basis of the decision of the Management Meeting or the Board of Directors if there are no other tenderers within or outside the invitation for tender offers or a previous tender was closed without results for lack of tenderers

2) In the case of a limited tender the Board of Directors of the SPA shall determine if the Organization Committee or the registered organization should be invited in addition to other applicants

3) The letter of intention of the ESOP Organization Committee can also be considered as a tender application if it was organized before the expiry of the tender deadline

However even in these cases it is necessary to prove the existence of own resources as well as the submission of a professionally well-founded and attested feasibility study which in its contents satisfies the conditions of the announced tender and contains the profitability necessary for realization

4) The sum to be deposited as a condition to participate at the tender equally applies to all applicants thus to the ESOP Organization Committee and organization too. That is not more than two percent of the purchase price stated in the tender announcement, or if that has not been stated two percent of the offered price

Extraordinary rules contained in the tender procedure can be applied only if the tender had been announced and in the meantime the employees presented their claim to the foundation of an ESOP organization. Its purpose is to prevent the ESOP organization being formed from being handicapped to other applicants

For Article 4 of the ESOP Act

For the purpose of employee share ownership acquisition within the scope of an ESOP the law forms a legal entity which is set up on a voluntary basis and operates with self-governing character and whose participants are recorded according to the rules

The organization can only be established for the purpose of employee share ownership acquisition and while it exists its activity can only be directed to that aim

A minimal condition of the foundation of the organization is that at least 40 percent of the employees of the company should declare the foundation of the ESOP organization at the foundation meeting (members meeting) establish the articles and elect its executive and representative body

The most important document of the founded ESOP is the articles which must unambiguously contain operational rules in order to prevent legal disputes later on

Following the declaration of the foundation of the ESOP organization the adoption of the articles and the election of the executive body the plenary meeting shall relieve the members of the Organization Committee as they have completed their task

For Article 5 of the ESOP Act

After the foundation of the organization its registration has to be requested at the court since it thus turns into a legal entity and may acquire rights and obligations

The minutes of the foundation meeting the articles of the organization and the approval statement of the company have to be enclosed with the request

If legal conditions are satisfied the court cannot refuse registration

For Article 6 of the ESOP Act

The registration request is dealt with by the county (capital) court where the organization is located in an extraordinary non-trial procedure

Regarding that the general legal supervision over the ESOP is referred by the Act to the competence of the Attorney's Department the resolution on registration has to be forwarded to the Attorney's Department as well That is done by the court making the registration

So that the articles submitted to the court should always reflect the actual state any changes in the details must be reported within 30 days That has to be done during the operation of the executive body of the ESOP organization

For Article 7 of the ESOP Act

The supreme body of the ESOP organization is the general meeting of all the participants (of ESOP)

The definition by law of the basic decision-making competences results in a regulation of a guarantee character Thus no deviation is allowed from referring to the competence of the general meeting all that is listed in the law

Thus in the articles of ESOP organizations the following functions must be referred to the exclusive competence of the general meeting

- the establishment and amending of the articles
- the definition of the annual budget
- the election and recall of the executive body the establishment of the remuneration of its members
- the adoption of the annual report of the executive body
- the establishment of the size of the property to be transferred to the ownership of the participants
- decision on the approval of the loan contract respectively of conditions for payment in installments
- decision in all matters referred by the articles to the exclusive competence of the general meeting

The general meeting has to be called as needed but at least once a year

It is considered an extraordinary circumstance and makes it obligatory to call the general meeting if the court so disposes on the basis of an attorney's action or if one-third of the participants require it

The general meeting also has to be called if the articles provide that right for a group (less than one-third) of the participants but the reason and the purpose of the convocation has to be indicated in those cases as well

In the manner defined in the articles the general meeting can also be held in the form of a partial general meeting

For Article 8 of the ESOP Act

The members of the executive body are elected by the general meeting for a determined period of time by secret voting

(This constitutes an assurance that the operative direction shall be exercised by the most suitable persons enjoying the confidence of participants)

The executive body represents the ESOP organization against third parties through its member elected by the general meeting and named in the articles

If the articles do not indicate otherwise then all members of the executive body are entitled to executive management

Anyone who is not banned from involvement in public affairs can become a member of the executive body

The executive body elects its chairman from among its members

Since the company has guarantor's responsibility the law allows the company to delegate one-third of the members at most

The number of external persons may not exceed half of the members of the executive body

Members of the executive body are liable for their activity according to the general rules of civil law which means that for potential damages to the ESOP organization they are liable with their whole property

For Article 9 of the ESOP Act

The articles of the ESOP organization are the most important document of the organization

The Act lists the basic requirements that the articles must contain

These are

- the name aim and seat of the organization and the name of the company the property share of which the organization wants to purchase
- the name of the representative of the organization
- the manner of the convocation of the general meeting (also regarding the protection of minority rights) quorum the way to proceed for lack of quorum the conditions and manner of exercising voting rights the voting procedure in matters within the exclusive competence of the general meeting
- the number of members of the executive body the manner of their election their competence and operation term
- the method and extent of payments by participants
- the method and distribution principles of the acquisition of the property share by participants
- the repurchase rules of property share acquired by participants and the manner of exercising preemption rights in the case of their marketing

ESOP

- the manner of publishing resolutions
- the rules for joining for other employees subsequent to the foundation of the organization
- the rights and obligations of participants
- the rules for the alienation of the property share remaining in the ownership of the organization subsequent to the complete repayment of the loan or of the installments
- the principles for the distribution of the property in the event of the termination of the organization
- everything that participants wish to regulate by the articles

The regulation governing the principles and manner of the transfer of the property share owned by the organization to the ownership of participants is of extreme importance. It is important since on the basis of this the SPA can decide if it is really an employee share ownership acquisition or if the intention of the purchasers – in an undesirable manner – conceals another kind of privatization veiled as ESOP.

- The draft document submitted must correctly state that*
- *the planned rules for joining do not contain excessive conditions – excluding the average extent of own resource-payments necessary to start an ESOP – for those wishing to join the organization following its foundation*
 - *the rules for the distribution of the paid up property share do not give excessive advantage to one group of participants*
 - *the articles should not provide the possibility for a concentrated acquisition of property for one group of employees*

The articles may also regulate whether the organization should be maintained following the acquisition of property share (completion of repayment)

The law only indicates the number of years spent in employment as a basic condition for joining

However the articles may also contain other regulations concerning the circumstances and administration of joining

For Article 10 of the ESOP Act

An unlawful resolution of the general meeting or the executive body of the organization may be contested at the court by any of the participants within 20 days of their learning it

The opportunity to contest resolutions ensures protection for participants who remain in a minority within the organization

Contesting it does not prevent the execution of the resolution however in a justified case the court may suspend it

For Article 11 of the ESOP Act

General legal supervision over the organization is exercised by the Attorney's Department but it can examine its operation only from the point of view of lawfulness

The Attorney's Department cannot make an obligatory resolution concerning the ESOP organization. If lawfulness cannot otherwise be ensured the attorney may file a court action

For Article 12 of the ESOP Act

On the basis of the action of the attorney and of a participant the court may regarding the principle of gradualness – in the interest of the restitution of lawful operation

- *annul the unlawful resolution of the organization and order to a new one made*
- *in order to restate the lawfulness of operation the court may convoke the general meeting*
- *suspend the operation of the organization and appoint a supervisory commission to control it*

For Article 13 of the ESOP Act

The organization is liable for its debts with its entire property

Concerning their own property participants are not liable for the debts of the organization except for the property share purchased with a loan respectively in installments until repayment is complete

For Article 14 of the ESOP Act

The property share can be purchased from the State Holding Company by paying up from own funds – constituting a minimal sum – defined in the act respectively with a favorable loan received for the remaining part of the purchase price or by deferred payment on the basis of an agreement with the State Holding Company

The rules of using compensation vouchers

In the case of a sale by the State Holding Company compensation vouchers should be considered at face value and at the joint increased value defined in Compensation Act No 27 of 1991 as own resource necessary for the loan or for payment in installments

If the E-Credit is used the purchaser may perform the extent of the own-resource payment defined in Government Decree No 28 of 1991 (March 21) amended by Government Decree No 59 of 1992 (March 26) completely with compensation vouchers independently from the extent marked for compensation

In the case of the sale of property shares in the course of the transactions of the State Property Agency – by public or limited tenders (with the exception of public submission of offers) – besides cash purchases the possibility of buying with compensation vouchers has to be indicated as well. In the judgment purchase with compensation vouchers is considered equal to cash payment

The competent transaction directorate may occasionally propose to the Board of Directors the acceptance of compensation vouchers in a proportion exceeding that defined in the Compensation Act (10–20 percent). There has to be a concrete definition of those cases when the acceptance of compensation vouchers in a proportion exceeding the extent provided in the act may be limited by the extent of property acquisition by the person of the owners or by other reasons

The rules for using own resources

The condition of property acquisition within the scope of an ESOP is for the organization to possess own resources. The extent of own resources depends on the average of the purchase price per participant

That means that the per capita share of the purchase price of the property share purchased by the organization has to be considered for the definition of the (obligatory) extent of own resources

Depending on the value of the purchase price divided by the number of participants in the ESOP the requirement level of the minimum of own resources changes

Up to HUF 5 million own resources must constitute two percent of the purchase price

For values ranging from HUF 5 to 10 million own resources must be HUF 100 000 + they must pay for 15 percent of the part above HUF 5 million

For a value above HUF 10 million own resources must be HUF 500 000 + 25 percent of the part above HUF 10 million

The extent of own resource payment may also exceed the legal minimum

The own resource payment obligation is the same for the purchase of shares and business shares alike

Own resource payment has to be effected not individually (separately by each of the participants) by the ESOP organization. However, that does not rule out the possibility for participants to pay a sum corresponding to own resources one by one respectively for participants to make individual payments and it does not rule out either that either a natural or a legal entity may provide financial assistance

Property shares purchased by using own resources are not encumbered by a restraint on alienation nor by the preemption or repurchase right of the organization. The owner freely disposes of property share purchased in that way

The rules of share property acquisition by using a loan or payment in installments

In order to complete its own financial resources the ESOP organization may take a loan from a financial institution

From the point of view of the purchase of the property share owned by the State Holding Company for the ESOP the source of paying the purchase price is first of all privatization loan or payment in installments corresponding to the conditions of the E-Credit and to the deferred payment allowances

Rules concerning E-Credits taken up for such purposes are contained by the procedure signed by the Hungarian Banking Association, the National Bank of Hungary, the National Bureau for the Development of Small Businesses, the Ministry of Finance and by the State Property Agency

For the purchase of property share financed by a loan or by using the deferred payment facility the term must not exceed 10 years out of which two years constitutes the period of grace

That means that during the first two years it is possible to postpone the repayment of the principal but the interests of the loan must be paid even then

The organization may not alienate the property share acquired by using a loan or a deferred payment facility – except for transference to participants

In the case of payment in installments the State Holding Company or the crediting financial institution is entitled to legal mortgage right over the acquired property share until repayment is completed

That mortgage right is originally mortgage right guaranteeing the bank loan, the application of which is extended by Paragraph (1) of Article 20 of the Act also to the property share sold by the State Holding Company

Profits (dividends) falling on the property share purchased by using a loan or payment in installments must be used for repaying the remaining debt

For Article 15 of the ESOP Act

The conditions of the loan scheme and deferred payment allowance for share property acquisition within the scope of ESOP are contained in Government Decree No. 28 of 1991 (Feb. 21) amended

by Government Decree No. 9 of 1992 (Mar. 26) in the bank of its use rule No. 2 of 1992 published by the National Bank of Hungary (Financial Gazette No. 7) as well as in the ESOP Act

The E-Credit and the deferred payment scheme can be used for financing an ESOP if the receiver of the loan satisfies the requirements formulated in the rule concerning the E-Credit respectively in the ESOP Act

These are the requirement of own resources – to the extent stated above – and the definition of the term (according to what has been stated in Article 14)

If there is an intention to purchase on credit the Organization Committee has to enclose the promissory note of the bank granting the E-Credit. The composition of the documentation necessary for credit examination differs according to whether property acquisition is the result of self-privatization, spontaneous privatization initiated by the enterprise itself or of investor-initiated privatization

An E-Credit can be granted for the sale of state-owned property shares up to the extent in which the consideration – on the basis of the statement of the State Holding Company or its commissioner – serves the repayment of state debt

For covering privatization costs arising during the sale of the property share announced prior to the sale – otherwise obligations charged on the purchaser – neither E-Credit nor deferred payment allowance can be used

Pursuant to the ESOP Act the Organization Committee can also make an offer to the SPA for payment in installments, the interest conditions of which correspond to those of the E-Credit with the exception of the interest margin

For Article 16 of the ESOP Act

Beyond what has been defined in the Act (Articles 14 and 19) the ESOP organization cannot perform economic activities, thus it does not fall within the effect of the Act on Corporate Tax (Act 15 of 1991, Paragraph (1), Article 13)

From the point of view of reporting and book-keeping accounting rules for other organizations should be applied

Government Decree 157 of 1992 (Dec. 4) regulating particularities of the preparation of annual reports and of book-keeping obligations of housing cooperatives, houses owned by tenants, social organizations and institutions founded by them, foundations, law firms, offices, water associations and organizations formed within the scope of the ESOP was published in Hungarian Gazette No. 122 of 1992

In addition to the sum transferred from the company, the revenues of the organization may come from payments by participants and by other (natural and legal) entities, as well as from the dividend (yield) due on the property share owned by the organization, moreover from income resulting from the alienation of the property share

Only expenses directly related and necessary to the achievement of the aims of the organization may be accounted for as operation costs of the organization

For Article 17 of the ESOP Act

The organization exercises its membership rights arising from the ownership of the property share through its representative according to the articles. However, other participants may also be entrusted with the exercise of voting rights – in the manner stipulated in the articles

For Article 18 of the ESOP Act

The executive body has to open a share account for the participant where the value corresponding to the face value of the property shares to be transferred to the ownership of participants has to be indicated. This technical solution ensures the value-record corresponding to the face value of the property shares (gradually) transferred to the ownership of participants.

The share account functions in such a way that parallel to loan repayment or to payment in installments certain sums are transferred to the share accounts of the employees.

Share account is a uniform name and it has to be applied even if the organization buys a business share.

Participants become owners in such a proportion in which they wanted to participate or in the proportion in which the articles make it possible for them concerning the acquisition of property. The employment term spent in the ESOP is a particular differentiating factor.

The shares (or business share) is transferred to the ownership of participants if the sum on the share account reaches the face value of the share respectively in the case of a business share it corresponds to the minimal value of the basic deposit falling on the business share (that is HUF 100 000) (Paragraph (1) of Article 159 of Act 6 of 1988).

So-called traction sums not reaching that amount do not mean an obligation of the ESOP organization towards participants. The property share behind that is the property of the ESOP organization.

Consequently sums transferred to the share account on the basis of the articles respectively the Act must be in harmony with the face value (base deposit). That also means that if the articles connect the sum transferable to the share account to the sum of loan repayment (payment in installments) or to that of payments by participants then in order to be able to comply with Paragraph (2) of Article 18 this has to be settled at the level corresponding to the face value (e.g. by a correction proportionate to face value/consideration).

The sum on the share accounts of participants must not exceed the value corresponding to the face value of the property share already repaid (in the case of a business share the value of the base deposit already repaid).

The traction sum generated during the application of what has been stated in Paragraph (6) of Article 18 has to be recorded on the share account separately from sums arriving to the share account during repayment.

This provision of the Act ensures the transfer of property proportionate to repayment.

Thus interest repayment has to be deducted from the sum periodically repaid by the organization and the remaining part can be transferred to the share accounts in the same proportion as the face value of the property share stood to its turnover value at the time of the purchase.

The general meeting has to decide on the actual sum to be transferred to respective share accounts from the sum accountable to the credit of participants on the basis of principles defined in the articles.

The organization is obliged to transfer to the ownership of participants property shares purchased by using own resources without delay proportionate to individual payments. If this cannot be performed in full (the total paid up is not enough for the buyout of a complete property share) then the organization has to record the consideration of the property share remaining in its ownership on the share account in the same proportion.

Depending on whether the organization provides the own resources out of payments by the employees or out of another source the destiny of the property share acquired with own resources is formed in a different way.

If own resources are paid by the employees themselves then property shares purchased with that money have to be transferred to their ownership immediately proportionate to individual payments.

When this rule is applied distribution proportions are defined by individual payments.

The actual sum depends on the size of the property share purchased by using own resources this is contained by the formula: consideration of the property share minus the loan used (respectively the sum of the payment in installments).

The consideration of the property share has to be considered when the property share purchased by using own resources is given into ownership. If the face value (base deposit) of the property shares does not fully ensure ownership transfer then the remaining sum has to be transferred to the share account (These sums can be recorded on the share account by a correction in the proportion face value/consideration).

If own resources were paid not by participants then the corresponding rule of the articles has to be applied for the ownership transfer of the property shares bought with own resources constituted from foreign resources.

For Article 19 of the ESOP Act

Property shares owned by the organization or the participants (except for property shares purchased by using own resources) cannot be alienated until the complete repayment of the loan respectively of the installments.

The crediting financial institution respectively – in the case of payment in installments – the State Holding Company is entitled to the right of pledge (as the Holding Company has no other property that serves as collateral in the case of non-payment).

These property shares continue to be managed by the organization but that does not affect shareholder (membership) rights arising from the legal relation of association or membership.

The application of the restraint of alienation

Until full repayment of the loan or installments the restraint of alienation is effective as a general rule from which the law allows for deviation in only two cases.

1) If a participant retires or dies during the repayment period the restraint of alienation ceases for property shares already transferred to his ownership and the organization is entitled to preemption rights. That means that if the retiring participant or the inheritors of the deceased wish to sell property shares owned by them then they must first offer it to the organization.

2) If the participant relationship of an employee ceases during the repayment term for any other reason preemption right is generated for the organization. The organization shall repurchase property shares transferred to the ownership of the participant within a period of time (six months at most) defined in the articles.

The application of preemption right

The organization shall exercise its preemption right on the value defined in the articles which must not be less than half of the turnover value.

The purchase price does not have to be paid by the organization immediately and in one sum. If an employee unlawfully terminates

his employment or his employment is terminated by an extraordinary notice by the employer then it can perform payment within five years at most or in other cases within two years also in installments

If the organization does not validate its repurchase right the acquired property shares shall continue to be managed by the ESOP even then and the restriction on mortgage and alienation shall be effective throughout the repayment term

This is necessary so that the organization can undertake its repurchase obligation in such a way that it is able to perform it according to its financial situation. During the repayment term its primary task is to fulfill its obligations towards its creditors because participants can only acquire ownership in that way.

For Article 20 of the ESOP Act

If the organization neglects its payment obligation then the creditor or the State Holding Company can try to recover its claims on the basis of the Council of Ministers Decree 39 of 1984 (Oct 3)

Since this constitutes an exception from general procedure rules a court procedure is not necessary. The creditor bank or the cessionary State Holding Company can itself sell the property encumbered by mortgage right according to the rules of court execution.

For the purpose of using this possibility so that the State Holding Company can recover the whole of the existing debt it must *previously* stipulate (in the contract) the right to withdraw the deferred payment allowance.

If the income from selling the property shares does not suffice for the repayment of the debt then the organization has to be cancelled in order to maintain the security of the economy.

In the case of an unsuccessful execution the bank or the State Holding Company is obliged to notify the court without delay and simultaneously with informing the Attorney's Department the court shall terminate the organization with immediate effect.

Appeals can be lodged against the termination resolution within 10 days.

A further consequence of the failure of recovery is that if there are no other collaterals the crediting financial institution or the State Holding Company shall be able to use its right to validate its claims against the company as guarantor.

For Article 21 of the ESOP Act

If it is not the State Holding Company which sells the property share to the organization then deviation is possible from the provisions of Paragraphs (4)-(6) of Article 14 of the act.

The requirement for certifying own resources does not have to be applied the interested parties may freely agree on the selling conditions of the loan and of the payment in installments.

For Article 22 of the ESOP Act

If on the basis of the provisions of another act another organization is entitled to a determined part of the privatization in come of the State Holding Company (for example in the case of the privatization of enterprises founded by local governments) then a payment in installments can be extended for that sum under the same conditions as those of the favorable credit scheme regulated in the ESOP Act.

For Article 23 of the ESOP Act

If the State Holding Company sells property shares to the ESOP organization then Paragraph (1) of Article 21 of Act 1 of 1989 (on the transformation of economic organizations and economic associations) does not have to be applied.

The new privatization acts do not provide for the retransfer of the share amounting to 20 percent of the consideration of sold property shares and membership rights to the company.

For Article 24 of the ESOP Act

The ESOP organization shall be terminated if it has transferred property shares owned by it and fulfilled its task and its survival is not justified.

The organization also has to be terminated if the company is terminated without a legal successor because it is unable to operate without financial resources.

The procedure for that is that the executive body is obliged to convolve the general meeting within 30 days. The latter decides on the termination of the organization and on the distribution of its property.

It is also possible to terminate the organization even before the repayment is complete (ESOP Act Article 20) in the case of termination because of insolvency the approval of the creditor financial institution respectively of the State Holding Company is indispensable.

For Article 25 of the ESOP Act

The act took effect on July 14 1992.

For Article 26 of the ESOP Act

The legislator assists the realization of share property acquisition within the framework of an ESOP with tax allowances. Thus it has amended the acts on the personal income tax of private individuals and on the corporate tax.

1) From the point of view of personal income tax shares (business share) acquired in an ESOP shall be considered free securities beyond the own share paid up by the participant all as long as the private individual does not alienate it.

2) A private individual participating in an ESOP can use investment allowances from his after-tax income after payment for the current year (according to general rules) but the amount may not exceed 30 percent of the total income.

3) From the point of view of corporate tax a company is entitled to tax-base allowance where state-owned property – in a wider sense – is privatized within the framework of ESOP using either a loan or deferred payment.

Accordingly the tax-base allowance shall be extended to the case when the state-owned enterprise or a wholly or partially state-owned company sells its property share acquired in another company and it is acquired by the ESOP founded by the employees.

Namely sums transferred to the ESOP organization in the current year – for the sole purpose of helping it achieve its basic aim – can be deducted from the tax-base of the company.

20 percent is the limit (1) and those concerned are also entitled to this allowance in the case of a deferred payment scheme.

Last June, the Hungarian Parliament approved legislation on the Employee Share Ownership Program (ESOP), which enables employees to buy into their company with the help of preferential loans. Under the rules an ESOP can be launched if at least 25 per cent of the employees support it, while an organization to manage the ESOP can be met up with the consent of the shareholders of the company, which will act as a guarantor of the management organization's liabilities.

The ESOP management organization is considered established if at least 40 per cent of the employees join the ESOP.

In order to secure preferential loans, the amount the employees themselves must contribute depends on how large a stake they wish to purchase. For up to HUF 5 million worth of shares, they have to produce two percent of the price while, above that sum, they are required to contribute 15-20 percent from their own pockets.

In the past few months interestingly the number of ESOP buyouts has increased with remarkable speed. Even for firms of relatively high value the State Property Agency gave priority to the ESOP proposal over cash-paying applicants. That is presumably explained by the fact that - mainly for firms incorporating intellectual capital - company survival seems more certain than if it went to the hands of foreign owners.

This is especially true of foreign trade enterprises known as *impeves* where the ESOP action usually goes hand in hand with management buyout. These commercial houses are extremely important for the Hungarian economy since a strengthening economy will need experienced foreign trade with a thorough knowledge of the markets carrying out marketing on one hand and furnishing market research information on the other. But the situation is roughly the same for smaller trading firms and companies with a stable business management which do not need a substantial capital injection in order to develop.

ESOP Ltd

The ESOP was passed as an act by Parliament in June 1992, but relatively few people used the opportunity in the initial months. The lack of interest was perhaps explained by the fact that few consulting firms deal with this

DIVERSE ESOP

kind of privatization. ESOP Ltd is a rare exception in this field. The small limited company has expressly specialized a consulting firm exclusively in ESOP transformations. However it is not easy to discover ESOP Ltd for those who wish to take part in the action. The limited company is not included in the list of official consulting firms of the State Property Agency. According to Executive Manager Miklos Lengyel the consulting firms of the SPA are committed to the Property Agency to some degree whereas ESOP Ltd wants to preserve its complete independence.

Aranypok Co.

Aranypok Co. was among the first to be created within the scope of an ESOP buyout. The limited company provided consulting for the ESOP organization. The making of that deal is viewed as a considerable achievement, especially since it was feared that the remaining chain of Aranypok could follow the rest. However according to financial calculations it was advisable to keep together the 17 shops Aranypok had left after spontaneous privatization together with the company headquarters and wholesale and foreign trade activity as the company had lost much blood by selling its best shops. In September 1992 the new - or renewed - joint-stock company held its first general meeting where it turned out that in addition to expecting profit from its Hungarian business the company also wanted to deal with foreign trade in the field belonging to its profile.

Herend

ESOP Ltd's most exciting assignment has been the privatization of Herend. Herend is a factory in a unique situation: thus there was an unambiguous determination that the plant which represents valuable traditions must be kept in national ownership. But since it markets exclusive products the plant is particularly vulnerable to changes in the market. It was important that in order to achieve as much profit as possible should not result in placing on the market more goods than are justified.

For decades Herend has been choosy with customers and production restrained by stern

self-restriction whenever they decide demand is not worthy of the reputation of the high-quality china. The ESOP scheme of Herend has been ready for a year and business plans and the feasibility study reflect the business policy of the factory. Only its realization is delayed because the factory is transferred from the SPA to the State Holding Company. Months may be spent by processing the documentation.

The ESOP also has a disadvantage: a fair amount of risk for subsequent business management. It may occur that under the pretext of ESOP in reality the company is bought by a small circle with others lending only their names to the transaction. The law allows for the articles to determine the re-distribution of the property. But on the other hand the set of conditions of the articles has to be elaborated professionally and impartially. Ethical proportions are very important in this case. That is why the articles have to define the maximum size of the property one person may acquire. For Herend for example that proportion is below two percent.

OREX

The best illustration of the diversity of ESOP privatization has been supplied so far by the mixed doubles of Ora es Ekszer Kereskedőház (Clock and Jewels Trading House) and OKHB (National Commercial and Credit Bank Co.). The SPA announced a public tender for the OREX shops and the ESOP organization and the bank submitted a joint application. The solution has its advantages for both parties. OREX offered its staff of eminent professionals and business know-how whereas the bank supplied the money necessary for the increase of the share capital. According to ESOP Ltd this case may set a good example in the series of ESOP actions. ESOP can be a good privatization tool especially in those cases where subsidiaries wish to separate from the mother company or where this is the only possibility for becoming independent. Such are the aspirations of the paper plant of Piszke or of the cheese factory of Répcelak which are currently preparing for the elaboration of the ESOP concept.

Zsuzsa Ban

The Hungarian Parliament approved legislation on the Employee Stock Ownership Plan (ESOP) in June 1992

Under the law an ESOP can be launched if at least 25 per cent of the employees are in favour. The ESOP management organization will be considered established when at least 40 per cent of the employees are part of the ESOP. In order to secure preferential loans, ESOP members themselves must contribute 2 pc of the purchase price for up to HUF 5m worth of shares and 15-20pc above that sum.

The first phase of the decentralized privatization process, which started in October 1991, involved 437 companies with assets worth 22 billion forints. The second involves 278 companies with assets of about HUF 70bn. In the first phase, companies with assets under HUF 300m and less than 300 employees were being privatized with the aid of more than 80 consulting companies. Larger companies, with assets of between HUF 800m and HUF 900m, were brought into the second phase of the programme.

The SPA planned to end decentralised privatisation in December 1993 with companies that have still remained unsold to be privatised through other schemes. Of the 749 companies which could have been drawn into the programme, 534 were finally selected by the end of last year. 292 of these have been fully or partially privatised, providing nominal income of HUF 18 897bn to the SPA. 170 privatisation tenders are currently underway, with tenders for an additional 30 companies to be invited before December 31, 1993 in order for the privatisations to be carried out before the contracts between the SPA and the adviser companies expire.

ESOP: a successful privatization technique - SPA

It was two years ago that the Hungarian government submitted to Parliament its draft law on ESOP, the Employee Share Ownership Programme enacted on July 14, 1992. Since then, ESOP has gained an increasingly important role among the set of tools of privatization applied by state property managing organizations implementing privatization policy, primarily, the State Property Agency. The report below summarizes this process.

Up to September 30, 1993, the State Property Agency had concluded purchase and sale contracts with ESOP organizations in a total of 64 companies (29 limited and 35 shareholders) making up 13.3 percent of the 488 partially or fully privatized companies. Thirty-six percent of the ESOP organizations are active in industry, 26 per

cent in commerce and 19 percent in the building industry, but they include book publishers and other companies offering material and intellectual services.

ESOP sales became more frequent in 1993 due to the fact that the first privatization program was completed on March 31. Close to half of the companies privatized by ESOP were sold within self-privatization programs.

The picture of the geographical breakdown of ESOP organizations shows a strong concentration of close to 40 percent of companies with an ESOP share located in Budapest. However, several of them have national networks or facilities in the provinces (e.g. Aranyok, Orex and Amfora). The concentration of property sold to ESOP organizations is even more distinctly concentrated. More than half

the total of ESOP property shares is owned by organizations in Budapest. On average, 70 percent of company employees have become participants, so when tried, ESOP is seemingly popular.

The subscribed capital of ESOP organizations ranges between several millions to billions. The ownership share bought out ESOPs has been decreasing, whereas the amount of subscribed capital has been on the increase. In the 59 companies involved, 58.2 percent of the subscribed capital was sold to ESOP organizations. The capital strength of limited companies is smaller (20 percent of the property sold the ESOPs is in 27 limited companies) than that of joint stock companies. The result of these trends is that the organizations of those employed in limited companies own a larger share

(69.7 percent) than those employed in joint stock companies (77.8 percent)

Another feature of ESOP privatization is that the larger the stake transferred the longer the transaction period. ESOPs in limited companies on average became owners nine months after the transformation of the enterprise while this period was more than a year (averaging 13 months) in the case of joint stock companies.

Sixty percent of ESOP organizations were established at companies employing less than 200 but 22 percent of the employees involved only work at these companies (Table 1). An indicator of the popularity of the form is that more than half of the employees have become proprietors as participants of ESOP organizations at four fifths of the companies. Employees have become proprietors in a larger proportion in limited companies (71.8 percent) than in shareholders companies (67.0 percent). In total 11,000 persons have become share owners in the companies employing them.

The second table shows that ESOP organizations have acquired their property on average at 90.6 percent of nominal value. The SPA has not sold its property cheaply as only the ESOP organizations of limited companies could purchase their property at under 50 percent of nominal value but these made up only 5 percent of total sales. Employees of 14 companies acquired ownership between 50 and 75 percent of face value acquiring 31 percent of the total property sold under the ESOP programme. In this group joint stock companies make up the majority. Seven joint stock companies and two limited companies have purchased property above a 75 percent but below nominal value. In 32 percent of the known cases purchase and sale took place at nominal value and 30 percent of the property exchanged owners. Sixteen percent of the property sold to ESOP organizations was sold to the proprietary associations of employees at approximately 47 percent above face value (5 limited and 3 joint stock companies). On average ESOPs became owners in 76.2 percent of limited and 94.4 percent of joint stock companies.

In addition to local governments becoming proprietors after transformation, state enterprises to companies the SPA maintained a stake after sales to ESOP organizations this amounted to 10.9 percent in limited companies and 27.3 percent in shareholders companies (Table 4). In these companies the ratio of other owners is insignificant. Corporate property makes up 5.5 percent of the subscribed capital in three companies and other Hungarian property makes up 7.3 percent of the subscribed capital in 12 companies. Foreign investors have as yet not risked their money in the companies partially bought out by ESOP organizations. However it is known that a number of foreign investors have indicated a willingness to buy the state property share remaining after ESOP purchases.

Employees have acquired majority ownership in 80 percent of the cases that is they have a decisive vote in 46 companies. However major differences occur between limited and joint stock companies. Five limited companies have bought up 100% stakes of their companies through ESOP but no joint stock company is yet in the exclusive ownership of employees. In an additional 16 limited companies ESOP organizations have a majority share. Of the joint stock companies employee organizations have majority share in 25 cases with the ownership share ranging between 50 and 75 percent more frequent than among limited companies.

At this point this scrutiny has reached one of the most interesting stages viz the economic performance of the companies for 1992 from the balance sheet figures. Unfortunately data are insufficient for a time proportionate comparison (Table 3).

Of the 64 companies 36 closed 1992 with a profit 8 ended in the red and 15 at zero balance. Taking losses into account in total they have produced a profit of more than HUF 800 million. Approximately 95 percent of the profit was generated by joint stock companies and slightly less than half the losses were accumulated by two limited companies alone. Losses for Limited companies in 1992 totalled

HUF 7 million. One limited company produced a loss of up to 20 percent of its nominal value and at four limited companies losses amounted to 5-10 percent of the own capital. Most of the profitable companies in fact made only limited profits 14 of the 36 making a profit of less than one percent of their own capital and in another five cases this indicator did not exceed two percent. However for five companies this figure was up to 10 percent.

Companies with an ESOP stake achieved profits of HUF 1.5 billion. Business activities were closed with a positive result in 38 companies and with negative balance at 12. Finally financial operations also indicated a positive balance however these contributed to improve the result only in the case of 26 companies and resulted in lower profits at 24 companies. Losses in financial operations exceed losses generated in the course of business activities. In addition extraordinary results also increased the profit of some companies.

Of the companies 21 were able to pay a dividend amounting to nearly two-thirds of the after-tax profit. Only four companies allocated their entire taxed profit on dividends five companies distributed more than 50 percent of profits and 12 companies less than 50 percent.

The liquidity index indicates the daily financial state of the companies. Among the companies under scrutiny liquidity shows a variable picture. In three companies the stock of liabilities exceeds the stock of working capital. In another 16 cases it is below the normal level (100-150 percent). Two thirds of this group consists of limited companies. In the case of 27 limited and joint stock companies liabilities do not even reach half the working capital. The average value of liquidity is 181 percent, relatively favourable for companies with ESOP as the value of this index was 14 percent in companies under SPA concern in 1992.

One important indicator is produced by the development of supplier debts and buyer claims. On average the stock of buyers is 163.8 percent of the stock of suppliers in the companies.

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under scrutiny. This is lower at limited companies (137.0 percent) than at joint stock companies. A value below 100 percent occurred at 10 companies, mostly joint stock concerns. However, at 18 companies the amount not paid by buyers exceeds supplier debts several times over. This is highly unfavourable as the collection of claims is one of the most critical points of the Hungarian economy, ridden as it is with the danger of bankruptcy.

The size of liabilities compared to own property also shows a wide spread. Liabilities less than 10 percent occur at six companies. Debts of 19 companies do not exceed 20 percent, the settlement of which is still considered to be bearable. However, liabilities exceed the value of own property at 10 companies. In addition, liabilities range between 20-60 percent at 15 companies and is an alarming 60 to 100 percent at nine companies.

22.6 percent of liabilities are classified as long term, although forty-two companies are totally free from any long term liabilities. Long term liabilities exceed 50 percent at two companies. However, the picture is largely distorted by the fact that 63 percent of these debts have accumulated at a single company (MetrimpeX).

SUMMARY

With a view to their activity size and other characteristic features, the range of companies with ESOP organizations is extremely varied. Moreover, on the basis of the 1992 snapshot, nothing can be stated for sure as their economic performance largely depends on the economic situation of the whole country, but obviously the efforts of employees and their management at these concerns is crucial.

The scrutiny of economic indices implies that these companies, on a national economic comparison, have performed well to average and the majority have been able to keep up with successful companies operating under other ownership structures. With these companies compared to the majority of companies sold by the SPA, the chances are even better for receiving loans drawn for acquiring property and maintaining viability. Especially so if, according to international practice, opportunities offered by a new management techniques and labour organizations attached to ESOP are also utilized. However, it will only be possible to confirm such conclusions in two or three years, when with the expiration of the grace period, ESOP organizations begin to pay off their loans. Nonetheless, from the figures presented here, ESOP can be regarded as a successful privatization technique.

Table 1

BREAKDOWN OF ESOP ORGANIZATIONS ACCORDING TO NUMBER OF EMPLOYEES

	Number of		
	limited companies	joint stock companies	total
Below 50 persons	8	2	10
51-100	10	6	16
101-200	6	7	13
201-300	3	3	6
301-500	1	4	5
501-1000	0	7	7
1001	1	2	3
No data	0	4	4
Total	29	35	64

Table 2

BREAKDOWN OF ESOP ORGANIZATIONS ACCORDING TO PROPORTION OF STAKE SOLD

Rate (percent)	Number of companies	Nominal value of stake (HUF '000)	Sales price (HUF '000)
Below 50	6	583 980	185 000
50-74.9	14	3 312 689	2 111 151
75-99.9	9	1 909 814	1 715 045
100	17	3 155 520	3 155 520
100.1-149.9	6	352 132	380 669
Above 150	2	1 356 396	2 124 500
No data	10	0	0
Total	64	10,670 531	9 671,885
<i>Average price</i>	<i>90.64</i>		

Table 3

PROFITABILITY OF COMPANIES WITH ESOP OWNERSHIP SHARE

Profitability	Limited companies		Joint stock companies		Total	
	Number of companies	Profit (HUF '000)	Number of companies	Profit (HUF '000)	Number of companies	Profit (HUF '000)
Profitable	13	50 705	23	915 129	36	965 834
Zero balance	8	0	7	0	15	0
Loss making	6	57 741	2	52 875	8	110 616
No data	2	0	3	0	5	0
Total	29	-7036	35	862 254	64	855 218

Table 4

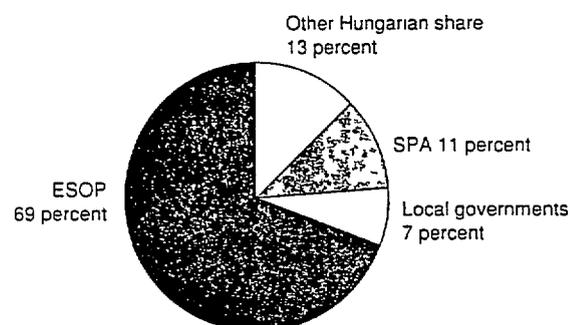
BREAKDOWN OF SUBSCRIBED CAPITAL OWNERSHIP IN COMPANIES WITH ESOP

OWNERS	Limited companies		Joint stock companies**		Total	
	Subscribed capital		Subscribed capital		Subscribed capital	
	Amount (HUF 000)	Percentage	Amount (HUF 000)	Percentage	Amount (HUF 000)	Percentage
SPA	373 140	10.87	4 667 765	27.28	5 040 705	24.54
Companies	0	0.00	1 118 661	6.74	1 118 661	5.45
Local governments	246 870	7.19	1 12 814	6.57	1 370 664	6.67
ESOP	2 372 924	69.11	9 147 020	53.46	11 519 944	56.08
Other Hungarian share	440 614	12.83	1 07 040	6.15	1 493 654	7.27
Total	3 433 528	100.0	17 110 100	100.0	20,543 628	100.00

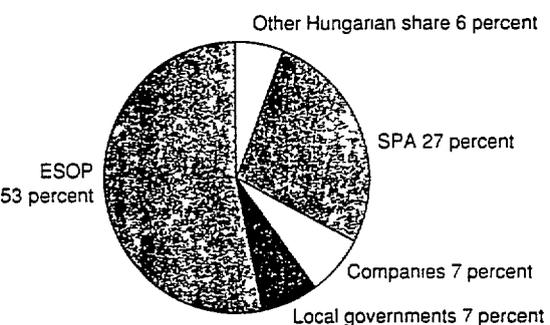
* Data on 26 limited companies

** Data on 31 joint stock companies

BREAKDOWN OF SUBSCRIBED CAPITAL OWNERSHIP IN COMPANIES WITH ESOP - LIMITED COMPANIES



BREAKDOWN OF SUBSCRIBED CAPITAL OWNERSHIP IN COMPANIES WITH ESOP - JOINT STOCK COMPANIES



2ND ESOP CONFERENCE INTEREST DECLINING?

Many claim that ESOP, the Employee Share Ownership Programme is the most effective method to inspire employees (also being owners) to work efficiently and effectively. Foreign experience exists to buttress these arguments. However, others say that some of the ESOP organizations already established will collapse like house of cards in three or four years, when their inability to pay off loans will be exposed. It is also difficult for the SPA to make a decision. It is obviously a point of interest that domestic citizens should become owners, yet it is also undeniable cash payments are more advantageous than ESOP. The following article summarizes some of the opinions heard at an ESOP conference last December. Although the number of ESOP organizations has increased since the first conference held in early 1993, interest in this second conference was subdued.

Those addressing the conference included *Dr Tamas Szabo* minister without portfolio responsible for privatization, *Dr Lajos Csepi* managing director of the SPA, *Janos Lukacs* managing director of the Resz Vetel Foundation, member of the SPA's Board

of Directors and a handful of foreign specialists.

The minister explained that the government supports employee ownership but no one should entertain illusions. It has to be acknowledged that ESOP organizations are unable to raise the capi-

tal lacking and the financial resources necessary for technological development and they are unable to implement the required raise of capital without a professional investor. In the past year ESOP organizations had been established at 65 companies involving stakes of HUF 20 billion. Of this HUF 12 billion was purchased by a total of 12 000 employees. About the contracts the minister said that deals had been concluded at an average rate of 90 percent and some 70 percent of the employees joined in the ESOP schemes after the related resolution had been made.

There were several reasons why the ESOP technique had not played a major role in privatization earlier. *Lajos Csepi* told the conference but it was by no means the case that the SPA had refused to support employee ownership. He stressed that Hungary needs competitive businesses and the SPA is busy seeking adequate investors to assist with this aim. The final choice is not always an ESOP organization and it is understandable that employees sometimes feel hurt. At

ESOP

the same time it has to be accepted that some Hungarian businesses will shortly become unviable without extra capital and new markets and ESOP organizations are unable to cope with the challenges.

Property managing organizations have started a programme which aims at facilitating loan settlement in installments by employees under conditions similar to the E loan. *Janos Lukaacs* announced it was necessary he said as banks and financial institutions often refused to grant credits to ESOP organizations because of insufficient funds. Moreover a resolution was made at the SPA a few months ago that no mortgage would be allowed to be registered against the assets and property of the whole of the company. Banks in spite of the legal possibility do not accept the guarantee provided by the whole of the company.

As *Istvan Kautz* president-general manager of the Masped Rt said the fundamental problem of the operation of an ESOP organization is that the money to be paid back by installments simply has to be generated by the company. The prime capital of Masped employing 300 was 2.6 billion with a pre tax profit of HUF

400 million last year. The SPA announced an exclusive tender for its privatization in the beginning of 1993. Invitations were extended amongst others to the representatives of the ESOP and MBO organizations established by then. The tender was won by the combined offer of the two organizations with ESOP purchasing 51 percent and 28.8 percent going to the MBO. *Istvan Kautz* considered this a good breakdown. The assets were distributed in a democratic manner and the company did not become unmanageable. The ESOP led Masped has far reaching plans for the future intending to work partly as a financial institution including financial leasing and factoring. New offices are to be opened in 10 provincial cities and markets in the CIS countries are to be sought out. In their view it is most important to utilise E loans and they are even prepared to forego bonuses if necessary.

Dr Andras Bartha president general manager of the Aranypok Rt stressed two points. Firstly he said a primary condition for the success of ESOP privatization is that management should be better in privatization than any consulting company. It knows the

company better but it also has to study the Law on ESOP. Because this is not always the case some rather mixed statutes have been created. Another very important condition is that only companies already operating well can be purchased via ESOP. If this consideration is ignored catastrophe awaits in the third or fourth year debt repayment with ESOP concerns collapsing one after another. *Andras Bartha* also called attention to some additional problems. One is that many of the holders of voting right still don't understand the genuine interest of the company and are intent upon an immediate raise in salary and not in a few years time. Another source of conflict is that the salaries of the officials of the ESOP organization are set by co workers with much lower incomes.

Invited guests (including those from the UK and USA) also presented their experiences. In the West there are giant companies with majority employee ownership which increases their loyalty towards their company in a natural way. In their view of Eastern Europe the system worked out in Bulgaria was cited as a good example of employee share ownership.

Here PRIVINFO carries the SPA regulation on the order of competition procedures. It is important to be aware of the regulations on bidding competition. Act LIV of 1992, the most important legal regulations governing the current privatization process, declares that it is possible to sell, lease or put in property management state property only through bidding competition. According to the law, the SPA (irrespective of certain cases listed there) is compelled to announce tenders for these. Therefore, everyone involved in privatization in some way is advised to become acquainted with the following regulations. Its publication is all the more timely as the regulations changed in December 1993. One new feature is that tenders should be submitted to a public notary in all cases. As of January 17, 1994, earnest money earns interest during the period of deposit.

REGULATIONS OF THE STATE PROPERTY AGENCY ON THE ORDER OF TENDER PROCEDURES (for bidding competition)

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REGULATIONS ON THE ORDER OF TENDER PROCEDURES

Chapter I Title 1

Objective and effect of the regulations

1. The objective of these regulations is to set the general rules of bidding competition under

- Act LIV of 1992 on the sale, utilization and protection of property in temporary state ownership (hereinafter referred to as the Act) and

- ordinances No. 7/1991 as amended and supplemented and No. 8/1991 and No. 2/1992 by the general manager of the State Property Agency, thus assuring the conclusion of well founded contracts serving the utilization of state property assigned to the SPA in the most efficient form and pertaining to this protection of the integrity of competition by guaranteeing identical and equal conditions for competitors.

2. (1) The State Property Agency (hereinafter the SPA) decides on the sale, putting to management or leasing of state property assigned to it, furthermore on commissions pertaining to related tasks through bidding competition/tendering procedure (hereinafter tender).

(2) When defining the conditions of transformation of the state enterprise, trust or trustee enterprise running the property in its portfolio or even after that, if necessary, if justified by the size or economic importance of the enterprise or if several offerers are known who are acceptable as partners, the SPA is entitled to require a tender procedure for the acquisition of shares by an external entrepreneur as defined in Paragraph (1) of Section 40 of the Act.

(3) When judging contracts under the authority of Act VI of 1990, the SPA, especially if the importance of the contract or other circumstances ensuring the freedom of the competition justifies it, is entitled to prescribe a tender procedure.

3. Competition can be realized through a bidding competition or the invitation of bidding offers (hereinafter invitation for offers). In the case of invitation for offers, there is no tender announcement (advertisement). When inviting offers by ensuring identical conditions, at least three offers should be invited. Otherwise, regulations related to tender must be adequately applied for inviting tenders with a view to deviations included in these regulations.

4. (1) The ruling described in Paragraph (1) of Clause 2 does not have to be applied.

a) if the SPA sells the state property up to a preferential proportion defined in the Property Policy Guidelines to employees. State property exceeding this proportion can be acquired by employees in an identical way as other external investors.

b) for sale of shares with public offering pursuant to the securities law

c) in the case of converting credit (receivable) to membership right

d) if the SPA previously ensured options for external investor(s)

e) if the second tender announced by the SPA also ended without result because there were no suitable applicants

f) if the manager of the shop run in a system according to a contract described in Act LXXIV of 1990 announces his purchase intention according to conditions set by the legal regulations and the shop can be transferred to him in the form of purchase at a set business value

g) when selling state property through bidding

h) if the SPA transfers the state property to the business partnership not as a non cash contribution

i) if the SPA utilizes the property as a means of exchange to acquire other property or to waive the membership right due to the local government in a transformed company

j) if a contract is to be concluded with consultants for handling the bidding competition if it does not involve commission related to capital mediation portfolio management and looking for investment partners

k) if the state property is sold by a property manager selected by the SPA through competition and in a contract concluded with the SPA he undertook to pay a previously set amount for the sale of the membership right

(2) In the course of selling a business part of a limited liability company a bidding competition can be abandoned pursuant to a decision of the Board of Directors of the SPA if there is a realistic danger that in view of the preemption right set by the company law a low purchase price is expected in the competition

(3) On the basis of a decision by the Board of Directors an offer by employees under the Employee Share Ownership Program can especially be expected without competition if no other offer is submitted to the invitation for bidding offers or a previously announced tender was closed without success for a lack of offers

Title 2

FUNDAMENTAL PRINCIPLES

The principle of equal chances

5 The tender announcement should ensure equal chances for each participant so that the necessary information is available and the conditions of competition are applied during the competition. The announcer must set the content of the tender so that offerers can make an appropriate offer and the tender offers submitted duly and in time can be compared

The principle of publicity

6 (1) During the tender procedure the announcer should ensure full publicity for those participating in the competition. The announcer must ensure the requirement of publicity according to these regulations even if the tender is closed (invitation) or occurs through inviting bidding offers. The announcer must publish this fact simultaneously with publishing such tenders (invitations for offer) in a way that does not violate the closed character of the competition bidding

(2) Each of the offerers has the right to acquire all information made available by the announcer. Accordingly all information should as far as possible be made available for the competitor which does not hurt business secrets and which is usual and necessary in business life for the competitor to make a well based offer

The principle of provisioning

7 (1) The announcer after publishing the invitation for tender or in the case of announcing a closed (exclusive invitation) tender after disclosing the announcement to those invited respects the tender conditions announced has to comply with the tender procedural order previously published and is compelled to ensure the integrity of the decision making process pursuant to the announcement of the tender and its evaluation. The above is duly applicable for the invitations for competitive offers

(2) The announcer can exercise its rights of provisioning pursuant to the tender thus especially the subsequent amendment of the conditions of the tender announcement the withdrawal of the tender and the amendment of the regulations of the published procedural order under the legal regulations pertaining to bidding competition and under the present tender procedural order so that it does not hurt any essential rightful interests of the persons involved in the tender

(3) The applicant by his behavior or action under the effect of the tender announcement or regulation with special regard to taking over the competition announcement acknowledges the regulations of the announcement are binding on himself

(4) Rights ensured by these regulations must be exercised in harmony with its regulations and according to the requirements of goodwill

Title 3

DEFINITIONS

8 In applying these procedural orders the following definitions should be applied according to the following interpretation

a) Announcer (the one inviting offers) the State Property Agency or another person acting on assignment of the SPA (e.g. property manager authorized with sales rights) and in the course of company-initiated simplified privatization procedure the consultant acting in his own capacity in cases of property protection the business organization involved

b) Offerer (bidder) any domestic or foreign natural person and legal entity business partnership without legal entity and individual entrepreneur including the case when persons qualified as offerers according to these regulations establish a consortium or any other occasional association (hereinafter consortium) aimed at making joint bidding offer. Those bidding in a consortium have universal obligations during the tender procedure

c) State property membership rights of the state run in businesses representing defined ownership share (business part share) state owned assets and rights of property right suitable for business

d) Public invitation for offer invitation for bidding for the purchase taking into management (subscription) taking into

TENDER PROCEDURE REGULATIONS

leasing (leasehold) of state property (property share) through publishing a tender announcement carried by the printed press or other means of communication to be published for a not previously determined range of potential buyers

e) Closed (invitational) tender (invitation for bidding of tenders) announcement for the purchase (taking into management (subscription) taking into leasing (leasehold) of state property (property share) so that only those are allowed to submit offers for the tender who have been invited by the SPA

f) Pre qualification procedure such a two or several round tender in the first round of which the announcer surveys the performing abilities expertise suitability and financial reliability of the offerers. On the basis of the first round the announcer compiles a list according to which the actual bidding takes place in the second round through a closed (invitation) tender or invitation for bidding offers in a targeted circle of investors or consultants. No price offer can be requested in the first round of the pre qualification procedure

g) Single round tender a tender in which all the tender conditions are set down in the tender announcement and the offers submitted accordingly form a part of the contract to be concluded

h) Alternative offer an offer made by the applicant during the period open for making an offer so that in addition to an offer corresponding to the conditions of the tender he also submits an offer differing from the arrangement or structure of the tender announcement

i) Several round tender a tender in which the announcer selects the participants of the next round from the applicants who have made valid offers in the first round and asks them to amend their offers

j) Unification of offers if the tender announcement or the announcer allows it offerers who made a valid offer in the first round and bidders who acquired a participation right in the second round can submit a joint offer

k) Notification (information) information relevant to the tender must be sent to those involved by letter telefax telex or telegram or in justified instances by phone one officially signed copy of which must later be mailed. If legal regulations or these internal regulations don't rule otherwise information with a legal effect on the person involved or affecting the interests of the applicant in substance must be disclosed to him within three days of its existence (taking effect)

TYPES OF TENDER

9 (1) The tender can be open or closed (invitational)

(2) A closed (invitational) tender can be announced if the character and importance of the state property under the competition and the fulfillment of tasks related to its most efficient utilization necessitates the participation at the tender of pre defined investors or business partners or it is justified on the basis of other reasons of competition policy (e.g. preventing buy up with hostile purposes). A closed tender aimed at selecting a consultant can also be announced in the absence of the above conditions

(3) Tenders are open except in the case when the Board of Directors of the SPA decides to announce a closed (invitational) tender. During an open tender the range of bidders can also be narrowed if this is justified by special business interests or considerations of competition

(4) The tender can be managed in keeping with secrecy (placing the name of the applicant in a sealed envelope and handling the financial conditions of the tender secretly separately from other conditions) or featuring the name (firm) of the applicant by signing the name (publicly in view of every detail of the tender). The way to handle the tender must be disclosed at the announcement of the tender

ANNOUNCEMENT PUBLICATION OF THE TENDER

10 (1) The tender is announced by the SPA or a person a consultant or a company assigned by the SPA

(2) The open tender should be announced in two national daily newspapers and the regional daily newspaper according to the situation of the subject of the tender. The announcer can also arrange to announce the tender also in a foreign financial economic journal (journals)

(3) In the tender announcement the announcer defines the date related to the submission of the tenders so that there are at least 45 days between the day of the publication of the announcement and the deadline for submitting the tenders. For state enterprises exceeding the value limit of property protection should be announced with a 45 day time interval. In the case of invitations for bidding offers or pre qualification procedures or tenders of consultants at least 15 days must be ensured for the offerer to make an offer

(4) On a closed (invitational) tender the announcer notifies the offerers involved simultaneously and directly

11 Tender can be announced for 100 percent of the related state property (property share) or for a determined part (parts) in view of the thorough consideration of all the circumstances of the case

12 The tender can also be announced in two or more rounds. In this case offerers selected (according to considerations previously defined and published by the announcer) as a result of the first round can participate in the second or next rounds. In the second round only those tender conditions can be amended which have previously been marked by the announcer. In other conditions the offers made in the first round remain valid

13 (1) During the tender procedure with the exceptions described in Paragraph (2) the announcer must not change the procedural or other rules (regulations) applicable during decision making which he disclosed to the bidder either through announcement or personally

(2) The announcer is allowed to change the rules (regulations) or any of them disclosed to the applicant (applicants) mentioned in Paragraph (1) only once during the tender according to the following

a) the announcer if he reserved the related right for himself can amend exclusively the conditions defined in the detailed tender announcement so that it is not disadvantageous for the bidders or

b) by extending the deadline of submitting the tenders with appropriate justification. The deadline can only be extended

(3) The announcer publishes the amendment pursuant to Paragraph (2) according to regulations related to the publication of the tender announcement and those pursuant to inv

TENDER PROCEDURE REGULATIONS

ting offers so that he notifies those involved in writing without delay. The notification should state how the announcer will handle the tenders submitted earlier in view of the changes.

(4) The tender announcement can be amended only so that at least 15 calendar days upon the amendment are available for the applicant to submit an offer.

(5) The period for submitting tenders in justified cases can be extended on one occasion by a maximum of 30 days. The announcer discloses the deadline thus extended in a manner similar to the tender announcement at least 15 days before the expiration of the original deadline or notifies the participants of a closed (invitational) tender in due course but at least seven days before the expiration of the original deadline.

(6) The announcer must not amend the tender announcement within 15 days prior to the expiration of the final deadline of submitting a tender.

14 (1) The tender announcement (tender invitation invitation for offers) must include

a) the name, headquarters of the announcer of the tender; furthermore, if the announcement of the tender takes place on assignment of the SPA, a reference to this fact.

b) the objective of the tender, its character (open or closed/invitational), the number of rounds (one, two or more) furthermore, whether the offerer can apply for the tender in secret or by signing his name.

If the tender has to be conducted in secret (by handling the name of the bidder in a sealed envelope, hereinafter secret tender), special reference should be made to this circumstance.

c) the description of the property, property part (business part, share) to be put to property management (leasing) or to be sold as the subject of the tender.

d) place, method and date of the submission of tenders.

e) duration of the tender period.

f) the place where questions related to the tender can be asked and eventual further information is available.

g) when making a detailed tender announcement or prospectus or information documentation available, the place, mode, date and cost of viewing them.

15 In addition to data appearing in the tender announcement, the detailed tender announcement has to contain

a) data of the property, property part to be sold; furthermore, information necessary to prepare offers.

b) a list of contents of the tender announcement and its supplements.

c) a detailed procedural order.

d) the schedule and set of considerations of judging the offers, with special regard to

– objective and subjective elements, their comparative weight in decision making.

– place and date to open the offers and the place, mode and deadline of announcing the results, if the evaluation of the tenders is conducted without publicity, special reference should be made to this fact.

– the persons permitted to attend the opening of the tender.

– dates related to the judging of the tenders, and

– the name of organization entitled to judge the tenders.

e) the possibility of accepting alternative tenders and the method of handling them.

f) the official language of the tender.

g) an eventual preemption right related to the subject of the tender or conditions pursuant to exercising it.

h) reference to maintain eventual official prescriptions:

1) in connection with performing services, a possibility for employing subcontractor or its conditions.

2) conditions of property management (leasing) and sale, set of requirements pursuant to business policy (also including related technical, commercial and legal conditions).

k) any other data which the announcer deems necessary.

(2) In certain cases, the announcer can prescribe that the offerer, when submitting his offer, should enclose a draft contract or what kind of restraints can be attached to the draft contract sent by the announcer. On such occasion, the announcer orders how the restraints defined in the draft contract be taken into account during judgment.

(3) The tender announcement should define the number of copies to be submitted by the offerers, its form and the place where it should be submitted, with reference to the fact that they must unambiguously define which of the offers is the original. If a difference occurs between the copies of the offers submitted in several copies, the original should be taken into account.

(4) If the tender is aimed at the full or partial sale of a business organization, the tender announcement must also contain the important balance sheet figures.

(5) When selling securities, the related regulations should also be taken into consideration.

(6) The value of the state property (property part) announced for sale, with the exception of cases defined by law, should be assessed by a registered auditor.

16 (1) If the SPA is the announcer or the company is the announcer and the SPA prescribes the application of these regulations for the company, the tender announcement and the booklet containing the tender conditions should be presented to the tender bureau of the SPA for counter signature before publication.

(2) In cases described in Paragraph (1), the tender announcement can be published in a valid manner with the counter signature of the tender bureau.

17 (1) If the tender announcement is aimed at transferring titles related to exercising such activities which has a direct effect on the fulfillment of an obligation of some local government set by law or involves the exercising of rights due to the local government or performing its task, the opinion of the local government involved has to be asked for before publishing the tender announcement.

(2) If the local government involved forms an opinion, its substance must be made part of the tender announcement without delay.

(3) These regulations have to be duly applied for other state organizations (e.g. National Supervisory Board for the Protection of Historic Monuments).

18 If the announcer intends to let over a part of the yield (dividend, share) on the basis of a property management (sales) contract to be concluded as a result of the tender upon performance according to contract, the entity compelled to the service, a reference should be made to this fact in the conditions of the tender announcement.

19 (1) Under the company initiated simplified privatization procedure, the consultant should refer to the tender anno-

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uncement with special regard to

- a) the limits of the rights and titles of procedure set by contract
- b) the special supervisory rights due to the SPA in connection with keeping the provisions of the tender

(2) In property protection cases if need be all data related to the desired direction mode and other conditions of the utilization of state property has to be disclosed in the tender announcement which is required for preparing a well founded offer

20 (1) If the tender announcement does not state otherwise the bidder must keep secret the fact of his participation at the tender or the withdrawal of his tender or the content of his offer until the publication of the result of the tender

This provision is not extended to facts made available to the financing bank

(2) In the tender announcement the announcer is entitled to lift the obligation of confidentiality described in Paragraph (1) so that he marks the tender conditions that can be made public by the bidder and the range of publicity (participants of the tender or third persons media) In this respect provisions of Section 13 are not applicable

(3) The announcer handles the content of the offers in secret until the tender is closed and does not disclose any information on their contents either to outsiders or participants of the tender The bidder can relieve the announcer of this obligation in writing but he may forbid the disclosure of certain figures even on this occasion

(4) The announcer can disclose the name of an applicant participating in a closed tender only if every involved bidder has approved the disclosure in writing Other information on the offerer can be disclosed to other offerers or to a person not participating in the tender only with the explicit written approval of the offerer

(5) The announcer must make available all information data disclosed and other service provided to one of the bidders to the rest of the offerers in the same manner

(6) At the request of the bidder and for him with the aim of making the tender conditions more accurate information can be provided in addition to that made available in the tender offer but only with content that does not hurt the equal chances of the other offerers and the provisions related to the evaluation of the offers and their handling Such information must not result in the amendment of the original tender condition (conditions)

(7) If the announcer prepares a detailed documentation for the preparation of the offers he has to ensure that it is available at the date of the announcement of the tender

Title 3

TENDER COLLATERAL

21 (1) Participation in the tender can be linked to giving collateral (e.g. earnest money hereinafter collateral) which has to be made available to the announcer simultaneously with submitting the offer or until a date and in a way set by the announcer in the tender announcement

(2) With the following exceptions the collateral should be refunded after the withdrawal of the tender announcement the establishment of the invalidity of the offers or the evaluation of the tender During the deposit the earnest money does not bear interest *

(3) The collateral need not be refunded if it has been transformed into a side obligation guaranteeing the concluded contract according to the tender announcement furthermore if the offerer withdrew his offer during the offer period or the conclusion of the contract failed by his fault or by another reason which emerged in his sphere of interest This provision must also be duly applied if the offerer withdrew his offer before the expiration of the period open for submitting the offers

(4) At the request of the announcer the offerer must certify the content of his tender The announcer if he expressly maintained this right in the announcement is entitled to obligate the offerer to grant further collateral in addition to those described in Paragraph (1) in especially justified cases

Title 4

OFFER PERIOD, RIGHT OF DEVIATION

22 (1) The offer period of the bidder begins when the deadline for submitting the tenders expires

(2) The offerer must maintain his offer until a date defined in the tender announcement but at least up to 30 days upon the expiration of the deadline for submission except if the announcer concludes a contract with the offerer winning the tender within that period

23 (1) The offerer can amend his offer only if

a) the tender announcement ensures the opportunity and the announcer calls the offerer for amendment with a set deadline

b) as a result of the first round of a several round tender he acquired the right for participating in the second round he can amend the tender submitted in the second round with limitations set in Paragraph (2) In other cases deviation from the original offer is invalid

(2) In cases defined in Point b) of Paragraph (1) the tender announcement has to determine the extent and mode of the deviation and which parts of the tender can be amended In the absence of such a provision the offerer can amend only the financial part of the offer including the purchase price the payment schedule and the collateral The amendment of other offer conditions is invalid in such a case the offer is partially invalid in its part involved by the amendment and is replaced by the offer condition made in the first round of the tender

* As of January 17 1994 earnest money does bear interest The SPA accepts the individual tenders only if the earnest money set in the tender is deposited by the offerers up to a payment deadline set in the tender announcement onto the following accounts opened for the SPA for the purpose at the Hungarian Foreign Trade Bank

Domestic persons who are legal entities in forint 203 606 0 7007

Domestic natural (private) persons in forint 203 606 0 7014

Foreign natural persons and/or persons who are legal entities in foreign exchange 0002 808 99

Domestic natural (private) persons in foreign exchange 0003 806 99

The Hungarian Foreign Trade Bank pays 1 16 and 17 per cent interest and charges a mere 1 015 percent of service costs after turnover This clause is not contained in the regulations for bidding competition because its amendment requires a resolution by the Board of Directors of the SPA Official resolution will be made in a few weeks

(3) Up to the expiration of the period open for submitting tenders the offerer has disposition over his offer according to these regulations or the conditions of the announcement

(4) Provisions of Paragraphs (1) and (2) cannot be applied if the announcer calls on the offerers to make a new offer following the first evaluation pursuant to Section 46/A

Title 5

WITHDRAWAL OF TENDER
EXCLUSION FROM THE TENDER

24 (1) The announcer is entitled to withdraw the tender up to the date set for the submission of the tenders. The announcer is compelled to announce the related decision according to regulations pertaining to the publication of the tender announcement or in the case of closed tender he has to notify the offerers on the decision in writing without delay

(2) In the case of withdrawing the tender if the tender documentation and the prospectus made available was linked to some charge the announcer has to refund the fee to the bidder if the bidder returns the documents

25 (1) If the offerer or other person in his sphere of interest breached the confidentiality of the tender the offer of the bidder has to be excluded

(2) Non performance or inadequate performance of the conditions disclosed in the tender announcement or the documentation (prospectus) furthermore the grave violation of data providing obligations and other obligations burdening the offerer according to the procedural order draws exclusion from the tender

(3) If there is no bidder who fully corresponded to conditions appearing in the tender offer the announcer after closing the tender can regard the tender as a bidding offer submitted in the course of an invitation for competitive bidding and can handle the offers accordingly. In such a case the announcer pursuant to his decision entitled to judging the tender can conclude a contract with the offerer who submitted the best offer if the tender corresponds to the minimum requirements during an invitation for competitive bidding or can decide to announce a new tender. The best offer has to be selected after the thorough weighing of all the circumstances of the case. Thus special attention should be paid to the financial economic and employment policy conditions and requirements related to the most favorable utilization of the state property (property part) being the subject of the tender. In the case regulated in this paragraph the offer period of the applicant involved exists according to the regulations

26 The offerer can withdraw his offer any time until the expiration date open for submitting the tender in keeping with the burden of consequences defined in the procedural order

27 The offerer cannot demand any payment from the announcer for drafting his offer and must not pose any payment demand pursuant to his offer under any other title

Title 6

TENDER OFFER

28 (1) The tender offer has to contain the detailed and legally compelling statement of the offerer with special regard to

a) conditions included in the tender announcement
b) the mode of utilizing the property serving as the subject of the tender or the performance of the service as defined in the tender announcement

c) the amount of the purchase amount of compensation
(2) If the tender establishes the obligation of granting collateral the offer is valid only if the offerer can certify that he made available the collateral to the announcer or a person as signed by the announcer as defined in the announcement

29 (1) The offerer is entitled to forbid the publication of certain figures disclosed in his offer even after the evaluation of the tender. The offerer cannot forbid the disclosure of his name the compensation and the deadline of performance

(2) If the procedural order does not rule otherwise the offer has to be submitted closed (e.g. in a sealed envelope) and on the envelope a reference to the given tender must appear

Chapter III

Title 1

RECEIPT, OPENING AND DISCLOSURE OF
THE TENDER OFFERS

30 (1) During the arrival of the tenders the receiver writes the exact date the tender offer is received on the sealed envelope containing the tender with the simultaneous certification that the tender offer is received

During the period open for submitting the tender the offers should be submitted to a public notary

(2) The public notary makes out a document on the circumstances of the submission and opening of the offers and clauses after the opening. The tenders submitted up to the expiration of the deadline have to be opened in the presence of the body/persons conducting the evaluation and every supplement (thus for example the tender offer itself and the enclosed supplements) of the offer documents have to be given a serial number of evaluation

(3) In the absence of a different provision of the tender announcement the opening of tenders takes place in the presence of the members of the committee and the public notary in a closed manner. The tender announcement can state that the representative of the announcer the offerers or their proxies and other persons invited by the announcer can also be present at the opening of the tender (public opening). The presence of a public notary should be assured if the opening is closed if the tender announcement prescribed it or in any other case deemed necessary and justified by the announcer

(4) The proxy of the offerer has to certify his right of representation and its extent with a public document or a private document with full certifying power. The body conducting the evaluation makes a decision on the legality of the representation without debate after listening to those involved

(5) If a public notary is present at the opening of the tenders his task is especially to

a) certify the regular proceeding of the opening of the tenders and makes out a public notary's document on its regularity
b) supervises the offers as to they correspond to formal requirements set by the announcement

c) if the tenders are opened in public directly after their submission he offers an opinion on the circumstances of submission

TENDERING REGULATIONS

Title 2 Judgment of the tender

(39) Bids submitted to a tender and valid are judged depending on the decision of the announcer by the AV Rt or the enterprise or business organization involved or a commission consisting of their employees (hereinafter those entitled for judgment)

40 1 If the AV Rt is the sole judge of the tender the general manager of the AV Rt appoints the judging persons or organizational unit

(40) If the announcement does not rule otherwise bids have to be judged within 30 days. The announcer is entitled to extend the judgment deadline by way of a unilateral statement. The deadline open for judging the bids must not be 90 days even after extending it. Those involved have to be notified of the extension of the deadline for judgment. If the announcer exceeds this deadline the tender is null and void

40 1 The person/representative of organization or consultant participating in the judgment of the tender must not be

(a) in kinship to or close relative (point b) of paragraph 685 of the Civil Code)

(b) direct superior or subordinate on the basis of employment

(c) employee under a contract

(d) owner (partial owner) if the bidder is a legal person or firm of the bidder who has submitted a bid

40 2 Provisions of 40 2 must be applied even if an unbiased evaluation of the case cannot be expected from a participant of the judgment of the bid for any reason (bias)

40 3 The participant of the judgment of the tender has to report without delay if he has any conflict of interest as described in points 40 1 and 40 2

40 4 These provisions have to be duly applied for every person participating in the evaluation of the bids

(41) In case of debated cases of conflict of interest and bias the Tender Commission decides

41 1 From among the bids the bid with the best basis and offering the most favorable conditions in its totality has to be selected

41 2 If the bids are evaluated by a commission established by the enterprise or business organization the result established by those entitled for judgment become valid with the written approval of the AV Rt. If the AV Rt disagrees with the proposal of those entitled for judgment it can further detail the considerations of judgment (within the set of conditions disclosed in the invitation to tender) or may order the invitation of a new tender

41 3 At judging the tender those entitled for judgment shall decide whether the tender was successful

41 4 The tender is unsuccessful if

(a) no bid was submitted by the set deadline or the bid cannot be evaluated on the basis of the invitation to tender

(b) none of the bids submitted correspond to the requirements of the invitation to tender or to any other provisions related to the tender and the bids or the fee substantially differ from the expectations of the announcer and the announcer did not make use of his possibility ensured in point 26 2

(c) for a two round tender none of the bidders appeared in the second round or none of the bidders invited to the second round made an offer that could be evaluated and which would have corresponded to the requirements described in the invitation to tender. This provision has to be applied duly for tenders with more than two rounds

(d) the announcer due to any act related to the integrity of the tender or grossly violating the interests of the rest of the bidders decided to qualify the tender null and void

(e) the AV Rt made use of its right ensured in point 41 2 to order the announcement of a new tender

(f) after being called upon the bidder failed to withdraw or correct the reservations made in his bid

(g) in the case described in clause (40)

(42) If the necessity to clarify certain issues emerges during the evaluation of the bids the announcer may request information from the bidders. However the submitted bids can not be modified even then the related approval of the announcer is invalid

42 1 The announcer can use the bids only for evaluation. In the event of utilization with any other purpose a separate agreement has to be concluded with the bidder

42 2 At the evaluation of the bids if similar conditions are agreed to the bidders (competitors) shall be preferred in the following order

(a) a business organization or cooperative established for management functioning with the participation of at least 25 percent of the employees of the business organization involved

(b) an organization established by participants of the Employee Share Ownership Program in the business organization involved

(c) the employee of the business organization involved as individual entrepreneur

(d) the property manager

(e) the previous property manager in the event of the termination of a property management contract provided the contract was terminated for reasons that cannot be brought up against the property manager

42 3 The order defined in subpoints (a) (c) of point 42 2 has to be duly applied in case of the sale of state property with special regard to the employee investment model

(43) After the evaluation of the bids the announcer can call on the bidders to modify their bids if the bids are of the same or similar content or if the announcer expects a better result from the new invitation to tender

43 1 The announcer may invite for the new tender every participant of the previous round or the number of the bidders he qualified the best. The announcer does not have to disclose the name and number of bidders invited to tender

43 2 The new invitation to tender pursuant to the announcer can be realized by the application of requirements of validity governing in the first round or by negotiations conducted with the bidders

43 3 In the invitation the announcer can define those conditions in relation to which the bidder can make a new offer. In the absence of this the bidder can modify any of the conditions of his previous bid

43.4 The announcer may ask to certify his solvency and pecuniary situation

43.5 The announcer may continually request new offers from the bidders until bidders submit bids containing better conditions

43.6 Afterwards the announcer decides on the final order of the bids submitted

(44) The commission making the judgment must compile a summary report on the judgment of the tender in which the main considerations taken into account at the evaluation of the bids and their justifications are described this is approved by the announcing organization

44.1 The summary report has to contain

(a) the objective and character of the tender the state property (property part) being its subject as well as the data related to the publication of the invitation (announcement) of the tender (competitive bids)

(b) a short description of the handling the number of bids submitted and essential data related to their content

(c) a reference to the observation of legal regulations appearing in the invitation to tender and other official decrees

(d) the main considerations of evaluation (judging) the bids opinions on the individual bids

(e) the summary evaluation of the result of the tender procedure marking the bids proposed to the first three places if there is an opportunity or if the tender was declared successful

44.2 Enclosed with the summary report shall be the minutes taken on the opening and presentation of the bids together with its appendices as well as the documentation of the original invitation to tender

Title 3

Special rules pertaining to the tendering of the external consultants proxies and suppliers of the ÁV Rt

(45) The general manager acting in his exclusive individual capacity pursuant to the provisions of the Organizational and Operational Regulations and internal regulations in case of contracts within a value limit under the decision-making authority of the general manager can establish simplified individual rules of tendering rules described in these regulations which are not in contradiction with the fundamental requirement of tendering

Title 4

Publication of the result of the tender

(46) The announcer publishes without delay or at a date set in the invitation to tender the result of the tender or invitation for competitive bids and accordingly the occurrence of transferring to management leasehold sale or assignment for sale in the daily newspapers defined in point 10.1 together with the justification of the decision

46.1 In case of an exclusive tender the data described in the previous point must be presented directly to the bidders This can take place by inviting every bidder together or sepa-

rately to each in writing No justification is required for an exclusive tender

46.2 If the announcement does not rule otherwise the official announcement of the result of the tenders announced by the ÁV Rt takes place after the conclusion of a contract On that occasion every fact of importance related to the tender has to be disclosed to the bidders and the public except if the ÁV Rt obligated itself to keep the information confidential for a justified reason

SECTION V CONCLUSION OF CONTRACT

Title 1 The conclusion of a contract

(47) The announcer can conclude a contract only with the bidder who won the tender

47.1 The winner of the tender is the bidder who on the basis of the judging submitted the most appropriate bid in its totality from the point of view the evaluation considerations described in the announcement related to the utilization of state property and the ownership interests of the state

(48) If a condition of concluding a contract with the winner of the tender as a result of the tender under the effect of these procedural regulations is that he has to establish a business organization in Hungary the winner of the tender announced has to obligate himself in the contract to be concluded that he will effect the requirements set down in the property management (sale) contract to be concluded on the basis of the invitation to tender in the deed of foundation of the business organization to be established (established) by him If he fails to do so the announcer is due the right of immediate termination This fact shall be referred to in the tender announcement and the contract to be concluded

48.2 A foreigner has to guarantee to the announcer the contractual performance of founding a company domestically

If the conclusion of the contract with the winner of the tender failed the announcer is entitled to conclude the contract with the next bidder under the same conditions or to announce a new tender

(49) The decision making authorities according to value limit at the conclusion of contract are defined by the General Manager's Directive on liabilities drawing financial effects agreed to contractually by the ÁV Rt and rules of remittance and financial investments in harmony with the Organizational and Operational Regulations

SECTION VI CLOSING PROVISIONS

(51) The provisions of these regulations have to be applied for tenders announced or competitive bids invited after March 1 1994

(52) Simultaneously with the enactment of these regulations the Regulations on the rule of tender procedures of January 1 1993 lose force

TENDER PROCEDURE REGULATIONS

d) assures that the identifying serial number of evaluation is shown in the register furthermore the name and number of the daily newspapers in which the tender announcements were published along with the date of publication

e) certifies the register prepared on the evaluation of the tender

i) assures that the protests objections and notes announced at the opening and disclosure of the tender are set down in the register

(6) The public notary is not entitled to make a decision influencing the substance of the tender

31 At the public opening of the offers the name and headquarters (address) of the offerers have to be disclosed to those present together with the essential content of the offers with the exception of those figures whose publication has been forbidden by the offerer

32 At the opening of the offers and at their disclosure minutes should be taken

33 (1) The minutes taken at the opening of the offers has to contain

a) the place and date of taking the minutes the name and capacity of the persons participating at the evaluation and the name of the person taking the minutes

b) the subject of the tender the dates and place of the publication of the tender announcement the last day of the period open for submitting the tenders the number of offers submitted furthermore which offers were submitted by the deadline and which were not the serial number of evaluation of the offers the description and number of its work parts

c) resolutions and recommendations of the evaluating committee

d) the short description of the opening and disclosure of the tenders and the short version of the contributions and remarks of those present

e) all other information which either those participating in the evaluation or the public notary present deem necessary to set down

(2) In the case of a secret tender an enclosure to the register is also the register on taking over ensuring identification

34 (1) After opening the offers the announcer can ask information from the offerers in order to make the evaluation and the comparison of the tenders better conductible The questions of the evaluating committee and answers by the bidders to them have to be set down in writing This procedure must not result in changing the financial value undertaking and other essential statements formulated in the tender offer it can serve only their interpretation

(2) Persons participating in the evaluation (judgment) or the offers and consultants requested by them have an obligation of confidentiality They can use information gained in their capacity as participants in the evaluation (judgment) of the offer exclusively for the purposes of evaluating (judging) the tender

35 (1) In the case of a public tender a list must be compiled on the persons/organizations who took over the tender announcement and the information documentation or prospectus which should be enclosed to the register made on the opening of the offers

(2) Also an enclosure of the register is the records of the announcer prepared on the taking over of tender offers data necessary for identification (serial number on taking over the date of the postmark if there is any etc)

36 (1) After opening the offers the evaluation committee has to establish which offers are invalid

(2) If the announcer submitted an invalid tender because of formal reasons not involving the substance of the offer he can make up for the shortages voluntarily or at the announcer's request in a maximum of five business days The validity of the offer is established after the period open for making up for the shortage

(3) Those offerers whose tenders were made invalid can not participate in the further phase (phases) of the tender procedure

37 (1) The offer is invalid if

a) it was submitted by an offerer who was not entitled to participate at the tender

b) the tender was submitted after the deadline defined by the announcement or after the regularly extended deadline

c) the offer does not comply with the content of the tender announcement legal regulations or the present procedural order

d) in case of an obligation of granting collateral the offerer failed to make the collateral available to the announcer or did not follow provisions in doing so

e) does not define the offer price (fee) unambiguously or ties it to someone else's offer

(2) The invalid offer has to be regarded as if the related applicant had not made an offer under the given tender procedure The invalidity of the offer does not involve the validity of the tender

(3) An offer can be classified as invalid only with the involvement of a lawyer

38 The offer is valid if it complies with the tender announcement in every respect that is formal and content requirements alike

Title 2

EVALUATION OF THE TENDER

39 (1) Upon the decision of the announcer valid offers submitted for the tender are evaluated the SPA or the state enterprise or business partnership involved or a committee made up the employees of the above (hereinafter entitled for evaluation)

(2) If the SPA is the sole judge of the tender a person or organizational unit defined in the Organizational and Operational Regulations of the SPA makes a decision on the result of the tender

40 If the announcement does not rule otherwise the offers have to be judged within 30 days The period open for judging the tenders cannot extend past 90 days The period open for judgment has to be disclosed to those involved in the tender announcement If the announcer surpasses this deadline the tender is qualified as unsuccessful

41 (1) The representative of the person/organization participating in the judgment of the tender or the consultant can not be the applicant himself who submitted the tender or his a) relative or close relative (Civil Code 682 b)

TENDER PROCEDURE REGULATIONS

b) direct superior or subordinate on the basis of working relationship

c) his employee under a contractual relationship

d) owner (part owner) if the applicant is a person or company with legal entity

(2) Those described in Paragraph (1) have to be applied even if an impartial evaluation of the case cannot be expected from a person participating in the judgment of the tender at any reason (hereinafter partiality)

(3) Participants in the judgment of the tender have to announce without delay if any reason of conflict of interest against them exists as outlined in Paragraphs (1) and (2)

(4) These rules have to be duly applied to every person participating in the evaluation of the tenders

Any action on the part of the bidder against the integrity of the tender or gravely violating the interests of the rest of the bidders in any other way may cause the announcer to exclude the related offer from the tender

42 In cases of conflict of interest the announcer makes a decision or if the SPA is not the announcer the decision of the SPA is accepted as authoritative

43 (1) From among the tender offers the tender offering the best conditions in total and founded the best has to be chosen

(2) If the offers are judged by a committee created by a state enterprise or a business partnership the result set by the entity entitled for judgment becomes valid with the approval of the SPA. If the SPA does not agree with the recommendation of the entity entitled for judgment it may further detail the considerations of the judgment—within the set of conditions announced in the tender announcement—or may order the announcement of a new tender

44 (1) At the judgment of the tender the entity entitled to judge has to decide whether the tender was successful

(2) The tender is unsuccessful especially if

a) no offer was submitted by the set deadline or a single offer was submitted but cannot be evaluated according to the tender announcement

b) none of the submitted offers corresponds to the requirements of the tender announcement or to other provision(s) pursuant to the tender and the announcer has not utilized his opportunity ensured in Paragraph (3) of Section 25

c) in the event of a two round tender no offerer appeared in the second round or none of the applicants invited to the second round made an offer suitable for evaluation which would comply to the requirements set by the tender announcement. This provision has to be appropriately applied for tenders with more than two rounds

d) the announcer decided to invalidate the tender as a result of the action of the offerer concerning the integrity of the tender or damaging the interests of the rest of the bidders in some other way

e) the SPA utilized its right ensured in Paragraph (2) of Section 43 to order the announcement of a new tender

f) after a call the applicant has failed to withdraw or correct his reservations made in his offer

g) in a cases as described in Section 40

45 (1) If the necessity emerges in the course of the judgment of the offers to clarify certain issues the announcer can

ask for information from the offerers. However the submitted offers cannot be amended even then related approval of the announcer is invalid

(2) The announcer can utilize the offers exclusively for judgment. In case of utilization with another purpose a special agreement has to be made with the offerer

46 (1) At the evaluation of the offers in the event that identical conditions are offered bidders (offerers) should be preferred in the following order

a) with the 25 percent participation of the employees of the business partnership involved a business partnership or cooperative established for property management

b) an organization established by participation of the Employee Share Ownership Program of the business partnership involved

c) the employee of the business partnership involved as individual entrepreneur

d) the property manager

e) in case of the termination of the property management contract the earlier property manager provided the contract was terminated for reasons not attributable to the property manager

(2) At the sale of state property the order defined in Points a) c) of Paragraph (1) especially in the case of the employee investor initiated model has to be duly applied

46/A (1) Following the judgment of the offers the announcer can call on the bidders to amend their offers if the content of the tenders is identical or similar furthermore if the announcer expects more favorable result from the new invitation of offers

(2) The announcer can call on every participant of the previous round for making new offers or a certain number of the bidders he judged to be the best. The announcer must publish the name of those called on submitting new offers however he does not have to disclose their number

(3) According to the decision of the announcer the new invitation for offers can be realized by applying the validity requirements of the previous round or at negotiations conducted with the bidders

(4) In the announcement the announcer can define those conditions relative to which the offerer can make a new offer. In the absence of this the applicant can amend any condition of his previous offer

(5) The announcer may also ask the offerer for certification of his solvency

(6) The announcer can ask newer offers from the bidders until the applicants no longer submit offers containing better conditions

(7) After that the announcer decides on the final order of the offers

47 (1) The committee conducting the evaluation has to prepare a closing report on the judgment of the tender which is approved by the announcing organization

(2) The closing report must contain

a) the objective of the tender its character and the state property (property part) serving as the subject of the tender as well as data related to the publication of the tender (invitation for competitive offers) call (announcement)

TENDER PROCEDURE REGULATIONS

b) the short description of the procedure the number and status of the offers submitted and the main figures related to its essential content

c) a reference to compliance to legal regulations and other official provisions appearing in the tender announcement

d) main considerations of the judgment (evaluation) of tenders opinions on the individual offers

e) a comprehensive evaluation of the result of the tender procedure naming the offerers recommended for the first three places provided there is an opportunity or the tender was qualified as successful

(3) Enclosed the closing report should be the register on the opening and disclosure of the tenders together with its supplements and the documentation of the original tender announcement

Title 3

PUBLICATION OF THE RESULT OF THE TENDER

48 (1) The announcer announces his final decision related to the judgment of the tenders at a date set by the tender announcement or without such immediately. If possible the offerers have to be invited to the announcement. The offerers not present at the announcement should be notified of the decision without delay.

(2) The announcer has to announce the final result established after the evaluation of the tenders so that the first three placed can be named.

(3) If the announcement does not rule otherwise the official announcement of the result of the tender announced by the SPA takes place after the conclusion of the contract.

Then every important fact related to the tender has to be disclosed to the applicants and the general public the only exception being that the SPA undertook the obligation of secrecy with some well founded reason.

49 The announcer should publish the result of the tender (or invitation for offers) and accordingly the occurrence of the putting into property management leasing sale or assignment for sale together with the reasoning of the decision in the same two national daily newspapers which carried the tender call (announcement).

50 In the case of a closed (invitational) tender the announcer discloses the data defined in Section 49 simultaneously and directly to the participants in writing.

Chapter IV

CONCLUSION OF CONTRACT, CLOSING PROVISIONS

Title 1

CONCLUSION OF CONTRACT

51 (1) The announcer can conclude a contract only with the offerer having won the tender.

(2) The winner of the tender is who on the whole made the most appropriate offer according to the evaluation considerations appearing in the announcement from the point of view of the utilization of state property and to the ownership interests of the state.

(3) The SPA may deviate from the rule defined in Paragraph

(1) if the tender announcement contains a possibility for this

52 The contract has to be concluded 30 days upon the announcement of the result of the tender at the latest. The contract has to be concluded so that the offer period of the winner of the tender is still underway.

53 (1) If a condition of concluding a contract with the winner of the tender as a result of the tender under the effect of the present procedural order is that he establish a business partnership in Hungary the winner of the announced tender has to obligate himself in the contract to be concluded to effect the requirements set in the property management (sales) contract to be concluded on the basis of the tender call in the deed of foundation of the business partnership to be established (established) by him. If he fails to fulfill this the announcer is entitled with the right of cancellation with immediate effect. This should be referred to at the tender announcement and the contract to be concluded.

(2) A foreigner must guarantee for the announcer the fulfillment according to contract of the establishment of an economic partnership by him in Hungary.

54 (1) Upon giving state property into property management (leasing) or selling it the sides formulate the content of the contract to be concluded on the basis of the published tender conditions and the offer of the offerer who won the tender.

(2) When compiling the content of the contract especially in view of obligations undertaken the procedure should take place according to the managing director's ordinances in force.

55 If conclusion of a contract with the winner of the tender fails or after signing the contract the winner fails to fulfill the contract and therefore the announcer abandons his intention to conclude a contract the announcer is entitled to conclude a contract with the next offerer or to announce a new tender.

Title 2

CLOSING PROVISIONS

56 (1) The present internal procedural order takes effect on June 22 1992. Its provisions have to be applied for tenders announced upon its taking effect.

(2) The regulations of the procedural order have to be applied when the tender is announced by the SPA jointly by the SPA and the enterprise or business partnership involved furthermore when the announcer is the state enterprise and reports the tender announcement to the SPA for approval in accordance with Section 27 of Act LIV of 1992.

(3) If every party involved agrees the rulings of the regulations can be applied for tenders announced before it entered into force.

57 As regards the sale of state property through auction the Auction Regulations approved by the Board of Directors of the SPA on January 9 1991 are authoritative.

58 This procedural order has to be made available to everyone involved. Furthermore it should be officially translated into English French and German.

59 In the event of the sale of assets of a majority state owned company the present regulations must be brought to the company's attention.

Europe's largest ESOP organization has been born with the establishment of Centrum's ESOP organization. At its founding general meeting 3500 employees – 70 percent of the total number of employees – joined the organization. The founding general meeting approved the organization's statutes of foundation, elected the organization's board and signed the consortium and syndicate contracts with the professional investors, and Strategia Kft, consisting of the management. In theory the purchasing consortium is now free to sign the contract with the State Property Agency (SPA), take a loan from the bank and fulfill its obligations.

It took a long time to reach a decision on the sale of the 51 percent stake of the registered capital of Centrum Aruhazak Reszvenytarsasag (Centrum Department Stores Rt). The board of the SPA decided that the consortium consisting of the company's ESOP and MBO organizations could purchase the retail chain, one of Hungary's largest. Of the company's HUF 5 billion registered capital, HUF 2.55 billion face value shares were offered for sale. The buyers will buy the majority stake at face value, that is for HUF 2.55 billion.

Although the SPA board declared the tender unsuccessful, it decided that the sale and purchase contract can be signed with the ESOP/MBO consortium, which would better ensure the company's long-term future. The consortium will pay HUF 420 million in cash, HUF 756 million with compensation vouchers, and HUF 1.3 billion with E-Credit. The consortium also undertook to appear on the stock exchange in the spring of 1995.

External capital will also be involved. 13 supplier companies of Centrum – professional investors – will raise the company's equity by HUF 900 million within one year. In addition, Canadian businessman An-

The Centrum department store chain consists of 25 department stores and has total assets of HUF 9 billion. The company had turnover of HUF 16.3 billion last year (HUF 15.4 billion in 1992) and achieved a pre-tax profit of HUF 300 million (HUF 450 million in 1992). Centrum is expected to have total turnover of HUF 19.5 billion this year and to achieve a pre-tax profit of HUF 450 million.

EUROPE'S LARGEST ESOP ORGANIZATION

drew Sarlos has sent a letter of intent on raising the equity by HUF 1.2 billion. Gellert Group, which has already been operating successfully at several retail outlets, would also be willing to invest HUF 250 million.

COMPETITIVE BIDDING IS STILL THE BASIC METHOD OF PRIVATIZATION

Head of the SPA's Tender Office, Emilia Rikker, pointed out concerning the Centrum decision that the SPA is selecting the new owners through competitive bidding. The SPA's Tender Regulations stipulate the procedure in detail, but the SPA has the option of signing a contract with somebody else if the tender is unsuccessful.

The law on property remaining in temporary state ownership stipulates that after two successful tenders, the SPA is entitled to sign a contract with anybody it finds appropriate.

During the evaluation of the bids submitted for the purchase of the 51 percent stake of Centrum Aruhazak Rt, the evaluation committee gave the highest score to Nemzeti Aruhazanc Kft (National Department Store Chain Kft). However, although the ESOP/MBO consortium earned a lower score, its business

offer was better, thus it has become the successful bidder. The consortium undertook to fulfill obligations which were not included in the initial tender conditions, thus it was impossible to take them into consideration during the evaluation. The tender had to be declared unsuccessful to prioritize these conditions.

It was not the first decision of its kind in SPA's privatization practice. Rikker said, "Sometimes, for instance, two fundamentally different bids are submitted to an open tender. One of the bids meets the formal conditions but offers an unacceptably low purchase price, while the other offers a good purchase price but it is not valid because of formal shortcomings. In this case, the SPA requests further information from the bidder. If the bidder is unable, for example, to obtain a promissory note within five days, the stake on offer must not be sold to the bidder within the framework of the given tender, and the successful bidder would be the one with a significantly worse bid. That is when the SPA declares the tender unsuccessful and takes the opportunity to sign a contract with the bidder submitting a better bid. Such decisions have been made so far in five to eight percent of the privatization contracts."

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OREX Watch Jewelry Trading House Rt was established by the transformation of the state-owned Watch and Jewelry Trading Company on December 31 1991. Forty of 100 retail units of the legal predecessor were sold according to Act LXXIV of 1990 at auctions while the remaining shops were operated by the shareholding company.

The privatization of the company was attempted before its transformation but no acceptable bids emerged and so the SPA decided to privatize the company in two stages. The Board of Directors decided to announce an open tender for the sale of the state held assets for which the professional consultant Quaestor Broker House Rt was selected via tender. The SPA concluded the contract with the consultant on May 13 1992. The announcement for the open one round tender was published in the dailies Uj Magyarorszag and Magyar Hirlap in June 1992 with an August 31 1992 deadline for submission of the bids.

The face value of the state held assets to be sold was HUF 606 500 000 or 84.24 percent of the registered capital. Two offers were submitted by the deadline the tender opening took place on September 1 1992.

THE TWO BIDDERS

- A group consisting of Euramerika Capital Corporation Jeweler Jewelers and Distributors Inc and Hemingway Holding AG.

The offer only formally complied with the stipulations of the tender invitation but lacked real figures and conditions which could be evaluated financially.

- OREX ESOP Organizational Committee and the Hungarian Commercial and Credit Bank Rt (OKHB).

The bidders submitted an offer for a share package with a face value of HUF 725 000 at a 75 percent rate. Of this OKHB intended to buy shares with a face value of HUF 105 000 000 for HUF 78 750 000 in cash and the ESOP organization shares with a face value of HUF 420 000 000 for HUF 315 000 000 in E Credit.

In accordance with the tender invitation OKHB also offered a HUF 80 million capital raise in cash within 60 days of the conclusion of the contract. In addition they requested a buying option for three years to buy the remaining HUF 81 500 000 worth of shares at a 75 percent rate. As a guarantee they attached OKHB's declaration of intent guaranteeing both the raise of the initial capital and the E-Credit. Based on the offer the value of the investment totalled HUF 473 750 000.

Their short term plans included the implementation of the franchise system in their retail and wholesale activities establishment of a cash and-carry department and a warehouse store. In addition after Budapest they also wanted to start pawning activities in five shops in the provinces. The consortium's short and long term objective was to reduce import and increase export with

the help of its own industrial capacity yet to be established.

Long term plans targeted the establishment of a real trading house with a uniform image. To this end they scheduled the redesigning of at least three shops annually. Another goal was the maintenance of the employment level.

SPA DECISION ON THE SALE

On October 14 1992 the Board of Directors announced the joint offer of the ESOP organization of OREX Rt and OKHB Rt as the winner of the open tender. At the same time it authorized the SPA to conclude a contract with the bidders based on the following terms:

- 1) Shares with a face value of HUF 525 000 000 are to be sold.
- 2) Within 60 days after signing the contract a capital increase of HUF 80 million should be made in cash.
- 3) Smaller shops up to 25 percent of the total units should be sold separately according to the rules of pre privatization.
- 4) For the remaining shares buying option can only be granted at a 100 percent rate.

The SPA and the consortium signed the purchase agreement on May 20 1992 the buyer fulfilled its payment obligations and effected the capital raise.

Privatization of Orex Rt.

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Privatization of Korona Rt.

In the IV Asset Handling Tender Hungaroholding Rt was commissioned to sell 62.7 percent of the state held shares of Korona Trading and Entrepreneurial Rt with a face value of HUF 228 549 000 as well as the retail units and assets of the company. The SPA concluded the contract with the consultant on March 25 1993.

The tender invitation for the state owned share package was published on June 18 1993 in the national dailies Pesti Hirlap and Magyar Hirlap and in the Fejer County Hirlap.

The only bidder submitting an offer was the ESOP Organization of Korona Trading and Entrepreneurial Rt. The offered purchase price totalled HUF 255 million which is equivalent to a 111.6 percent rate.

The ESOP requested the reduc-

tion of this purchase price by the amount of the discount due to the employees i.e. by HUF 16 865 000.

THE BUSINESS PLAN

According to the business plan prepared by the committee of the ESOP organization the shareholding company would continue its retail activities as its main profile. In order to increase market share and efficiency they would like to promote a chain store image. They plan to narrow the profile however the assortment of the remaining profiles would be widened. The above and the increasing proportion of central procurement would allow an increase in the purchase volume resulting in the improvement of price payment and delivery terms. Besides the existing foreign trade ties they wish to

develop cooperation with the traders of the neighboring countries. Central procurement that is the increase of wholesale turnover will equip the company for developing the Korona price category in Szekesfehervar and the surrounding area.

Under the present market conditions they do not plan to increase the profit margin but to achieve higher profits through increased sales.

Short term plans foresee developments which do not require investments. Investments are to be made only at a later stage by involving the capital of domestic and foreign producers. As for employment the plans are mainly confined to the reorganization of the existing workforce by increasing the number of productive staff.

Privatization can be considered successful since the ESOP organization has 288 members (92 percent of the employees) and the prepared business policy guarantees the company's successful operation in the future.

The SPA concluded the sales contract with the ESOP organization on November 22 1993 and the buyer fulfilled its contractual payment obligations by the deadline stipulated.

Hungaroholding Asset Handling Rt was commissioned by the State Property Agency on March 25 1993 to sell 85.5 percent of the state-held shares of Zeta Trading Rt of Nagykanizsa with a face value of HUF 316 340 000 as well as the corporation's individual retail units or warehouses.

Hungaroholding Rt invited an open one round tender for the sale of the share package on June 7 1993. The tender announcement was published in the dailies Magyar Hirlap Uj Magyarorszag and Zala County Hirlap.

Twelve bids were submitted by the deadline four of them for the purchase of the state-held shares of the corporation and eight for its retail units.

The purchase price offered by the ESOP Organizational Commit-

tee amounted to HUF 440 000 000 139 percent of the face value.

By the time of submission 64 percent of the staff - 325 employees - announced their intentions to establish an ESOP organization.

THE BUSINESS PLAN

The bidders surveyed the market positions analyzed the estimated tendencies for the period of 1993-95 and prepared a business policy and technical development plan accordingly.

Business plans focus on developing the wholesale activities continuing and expanding production launched in 1992 and shortening the distribution chain through central procurement. As a result the balanced supply and moderate pricing are expected to lead to increased profit margins and sales revenues.

They wish to continue the reconstruction started in 1993 since this is in harmony with the business plans. They also wish to foster the existing uniform Zeta image with a brand name trading chain. In the

short run they plan to reduce the staff by a few percent

Long term plans envision the establishment of shopping centers

on busy roads with good parking facilities involving outside resources

The sales contract was signed

by the SPA and Zeta Trading Rt's ESOP organization on December 16 1993 and the buyer fulfilled his contractual payment obligations

The State Property Agency made a decision on the sale of the SPA held shares of Zalaiparker Rt on August 18 1993. The invitation for an open one round tender was published in the dailies Magyar Nemzet and Zalai Hirlap on August 31 1993 in Pesti Hirlap on September 2 and on the next day in all three papers

Offers could be submitted for the purchase of the state held share package with a face value of HUF 424 225 000 accounting for 60.73 percent of Zala County Industrial Product Trading Rt's registered capital. A share package with a face value of HUF 69 872 000 representing 10 percent of the registered capital was to be sold for compensation vouchers. Tender conditions also enabled the bidders to pay some of the remaining amount in compensation vouchers and to use E-Credit for the amount of purchase price exceeding the earnest money.

The only bid received concerned the whole share package. It was submitted by a consortium consisting of the ESOP Organizational Committee of Zala County Industrial Product Trading Rt. Andras Barta and his partners as a group of private investors and Budapest Bank Rt.

The offered purchase price amounted to HUF 450 000 000 equalling a 106.08 percent rate

PLANS FOR BUSINESS POLICY, EMPLOYMENT, DEVELOPMENT

According to the basic activities of Zalaiparker Rt the bidders wish to continue the retail trade of a wide scale of clothing and miscellaneous industrial products. They also want to promote the company's wholesale and foreign trade activities. They wish to operate the corporation as a competitive chain which can satisfy market demands

Privatization of Zala County Industrial Product Trading Rt. (Zalaiparker Rt.)

The future slogan of Zalaiparker Rt's business philosophy is Zalaiparker belongs to the customers. To this end they wish to accomplish the following comprehensive strategic plans

- to increase the efficiency of flexibility and asset utilization by seizing the opportunities stemming from the chain store form
- to halt the decrease in market share and determine the market segments where growth can be achieved

- to further centralize procurement in order to take advantage of less expensive sources of supply
- to introduce a uniform

Zalaiparker price for their major products

- to review profitability continuously with the bar-code system
- to promote the commercial and technical development by involving outside financial resources

They have the following plans for employment

- due to the expansion of retail and wholesale activities the number of employees is expected to grow
- according to their medium and long term plans they create new jobs

in the new units to be built outside the county

- the centralization of procurement and price calculation tasks with the use of computers shall be a major factor in keeping the employees working in the main office
- temporary employment problems are to be solved by the expansion of the part time labor system

Concerning the development of the store chain they place a high priority on the development of the existing chain. Medium term plans include involvement in the construction of shopping centers on the outskirts of cities and they also intend to open stores outside the county

As a member of the consortium Budapest Bank Rt undertook to raise the registered capital by HUF 70 million within 180 days after signing the contract

The Board of Directors of the State Property Agency declared the tender successful on December 8 1993. The preliminary sales contract between the State Property Agency and the consortium was signed on December 22 1993 according to which the final contract shall be signed following the registration of the ESOP organization

THOUSANDS OF HUNGARIAN OWNERS IN CENTRUM

Strategia Kft the company formed by the management of Centrum Aruhazak Rt transferred 23 percent of its 25 percent stake in the department store chain to a consortium of food and clothing suppliers

The Centrum department store chain, which has registered capital of HUF 5 billion consists of 25 department stores and has total assets of HUF 9 billion The company had turnover of HUF 16.3 billion last year (HUF 15.4 billion in 1992) and achieved a pre tax profit of HUF 30 million (HUF 450 million in 1992) Centrum is expected to have total turnover of HUF 19.5 billion this year and to achieve a pre tax profit of HUF 450 million

What has recently happened to a Hungarian company is a real Central Eastern European success story the ESOP organization and the consortium of Strategia Kft was able to buy 51 percent of Centrum Department Stores Rt's shares

It was precisely one year ago that we indicated to the State Property Agency that we were fed up with the uncertainty surrounding Centrum's privatization and wanted to make steps ourselves remembers Mrs Tamas Denes head of the company's economic department who also heads the ESOP organizational committee We asked each of our 1200 employees about their opinion of our plan Three thousand of them agreed instantly to set up an ESOP organization and submit a bid for the Rt

According to the regulations 25 percent of the employees may already form an ESOP organization at Centrum besides the 3000 employees 230 medium- and high-level managers also

decided to take part in privatization. The SPA intended to sell 51 percent of the assets amounting to HUF 2.5 billion. The employees had HUF 420 million cash, HUF 720 million worth of compensation vouchers and the rest was settled from E. Credit.

Everybody for the business organization

How could the employees win the tender against well known multinationals that also wanted to get involved in the privatization of Centrum?

Because we wanted it so badly. The SPA's decision was just since our employees have been building the future of our company even under the difficult circumstances of the recent years.



We prepared a medium term business plan for overcoming the difficulties of our 25 member chain store and started to renovate the retail units even though we did not know who the new owner would be. And the company survived.

Capital has lined up

The Central Eastern European success story has not ended yet. Even before the sales contract was signed by the State Property Agency and the buyer, it had increased in value. An American businessman of Hungarian origin, Endre Sarlos, turned up and made a seemingly irrevocable promise for a HUF 1.2 billion capital increase to the representatives of the new owners. A

Hungarian and a Western bank are also waiting in line hoping that they may participate in the business with HUF 900 million.

One cannot even spend this much money

Each forint has a place. We would like to unify the image of the equipment, the assortment of our departments stores. By introducing the bar code system, we could significantly reduce our prices. We plan to install a new escalator in Corvin and want to transform the whole first floor into a supermarket. Reasonable prices, the best quality for the lowest price – this is our slogan. We have always been the store for the middle class, for families – and we will be targeting the same class in the future.

Will the customers also become owners?

What is going to happen to the remaining assets of Centrum Rt?

We requested a preemption right for them, and if everything goes well, we can buy part of them. Of the rest, 25 percent belongs to the SPA, 13.5 percent to the local authorities, the remaining part is preferential individual shares. It is also conceivable that the company will be introduced onto the Stock Exchange in 1995, most likely. However, the remaining assets will be sold under the Small Investor Share purchase Program. In this case, our customers would also become our business partners!

Retraining instead of dismissals

When privatization is completed by ESOP organizations, it usually also means preserving the jobs, although our colleagues also had to face the fact that they might be dismissed, even if they are owners, says Gyula Galla, social president of the Trade Union of Commercial Employees, who takes part in Centrum's privatization himself. For us, it is a security that the ESOP and MBO insists on continuing the basic activities, that is, retail trade, therefore guarantees the present number of jobs.

On the other hand, the unification of the assortment and procurement will make staff reduction inevitable in the future.

We think that instead of dismissals, we can only resort to retraining. This way, our gains double. First, we keep our experienced colleagues, and second, their retraining does not cost as much as the training of a new employee hired from off the street.

In 1993, the Hitelgarancia Rt (Loan Guarantee Rt) judged more than 400 guarantee requests. Banks asked for a total of HUF 6.6 billion guarantee for HUF 11.3 billion worth of loans, but the Rt extended only HUF 3.7 billion guarantee for HUF 6.8 billion worth of loans. The Loan Guarantee Rt had to refuse some of the requests because business plans were not well founded. The HUF 8 billion guarantee limit of the Rt is to increase to HUF 10 billion this year. The Rt has received a government promise that its prime capital will be raised by HUF 1 billion at its general assembly at the end of March.

First year of Loan Guarantee Rt.

The Loan Guarantee Rt (prime capital HUF 3.5 billion) was established in 1992 by the state (57 percent), 25 banks and 40 savings cooperatives (36 percent) and interest representation organizations of various businesses (seven percent). The function of the Rt is to extend paying guarantee to loans extended by financial institutions to small and medium size ventures for a guarantee fee. Through this banks' credit risk is reduced and thus they can provide loans for viable ventures which don't have enough resources to fund the loan.

When judging the guarantee, the Rt does not discriminate according to activity, type of business, loan arrangement or regional situation. *Bela Nador*, head of department in the Loan Guarantee Rt, explained, the same conditions apply to everyone. The Rt's guarantee can be utilized by natural persons classified as native according to foreign currency regulations, business partnerships and cooperatives owned by them (provided the other owners or members are also natives according to foreign currency rules) and ESOP organizations without any limit to activity. A condition of paying guarantorship is that the number of full-time employees at the requesting company does not exceed 300 at the time of drawing the loan. (There is no such limit with ESOP organizations.)

For business organizations under bankruptcy or liquidation procedure, the Rt does not extend guarantee. It also refuses guarantees for the given transaction where the debtor has already asked for or received the guarantorship elsewhere. Those who have previously utilized the service of the Loan Guarantee Rt or another institution and have failed to fulfill their payment obligation within three years will also be turned down.

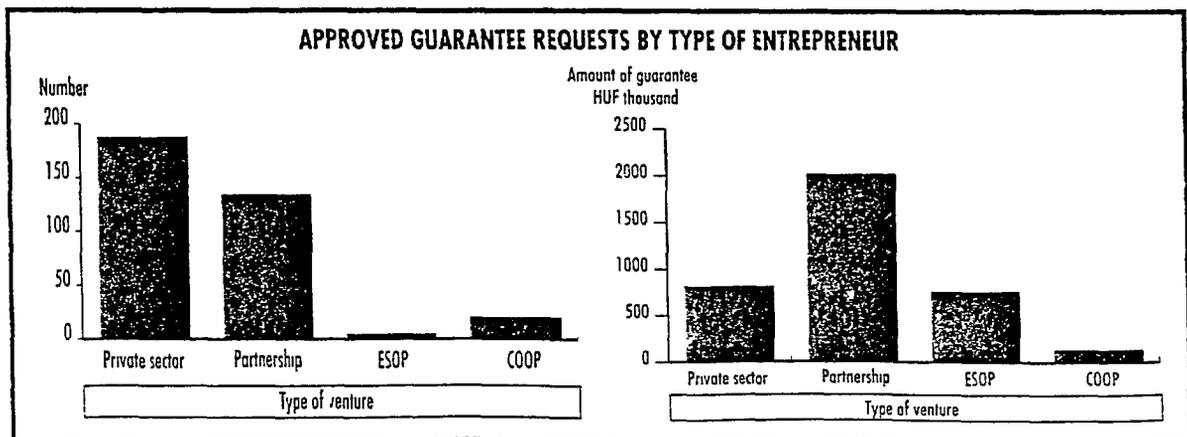
The collateral security of the Loan Guarantee Rt must be requested by the bank after it has judged the loan request and the disbursement of the loan is impeded only by adequate funding. Collateral security can be used by commercial banks and specialized financial institutions with a share ownership of at least HUF 10 million nominal value in the Rt and savings cooperatives with a HUF 1 million share package in the Rt.

"ASSURED" LOANS

The Loan Guarantee Rt extends guarantee for development loans (which can be from own resource, National Bank of Hungary, financed or any other loan of the financial institution), privatization loans (e.g. Existence Credit, ESOP arrangement), reorganization loans and working asset loans of an at least six-month period extended to small and medium size ventures. If the Existence Credit is rental right is related to sale during pre-privatization or the credit drawer has already concluded the purchase and sale contract for the asset to be purchased with the utilization of Existence Credit and it has taken effect, the Rt should not extend paying collateral security.

APPROVED GUARANTEE REQUESTS BY TYPES OF LOAN

Type of loan	Number	Distribution (%)	Guarantee (HUF thousand)	Distribution (%)
E Credit	112	31.37	885,205	23.74
ESOP	16	4.48	759,276	20.41
Export	1	0.28	14,943	0.40
Japanese	104	29.13	805,125	21.64
World Bank	39	10.92	184,370	4.96
Reorganization	71	19.89	936,971	25.18
Development	13	3.64	136,321	3.66
Working asset	1	0.28	647	0.02
Total	357	100.00	3,720,859	100.00



BANKS ENTITLED TO REQUEST COLLATERAL SECURITY

Hungarian Credit Bank	Commercial Bank
OTP Bank	Budapest Bank
Postabank	Hungarian Foreign Trade Bank
IBUSZ Bank	Agrobank
Creditanstalt	General Banking and Trust Co
Dunabank	WestLB (Hungaria)
Innofinance	Inter Europa Bank
Investbank	Iparbankhaz
Konzumbank	Central European Credit Bank
Kvantum Bank	MHB Daewoo Bank
Mezőbank	Hungarian Savings Cooperative Bank
Leumi Credit Bank	Realbank
Cominbank	Polgar Bank

Guarantee can also be requested for foreign currency loans but even then the paying collateral security is extended in forint savings. This time the guarantee corresponds to the amount of the principal plus interest and fee calculated in forint at the medium rate of the National Bank of Hungary valid at the time of the conclusion of the contract and the collateral security does not extend to the rate risk stemming from the change of the foreign exchange rate. The maximum period of loans ensured with paying collateral security is 15 years with forint and foreign currency loans alike.

EXTENT OF COLLATERAL SECURITY

The maximum extent of guarantee extended by the Rt with a single applicant for loan is HUF 100 million and 80 percent of the loan drawn (amount of principal plus interest plus fee) at most. A single applicant for loan may request loans disbursed with the collateral security of the Rt provided that the actual amount of paying guarantees extended by the Rt does not exceed HUF 100 million at the same time.

APPROVED GUARANTEE REQUESTS BY GUARANTEE AMOUNT

Guarantee amount	Number	Distribution (%)	Collateral security (HUF thousand)	Distribution (%)
Below HUF 1 million	48	1.45	57 960	0.97
HUF 1-20 million	261	75.11	1 457 130	38.62
HUF 20-50 million	31	8.68	895 654	24.02
HUF 50-80 million	9	2.52	585 401	15.75
80-100 million	6	1.68	567 781	15.26
HUF 100 million	2	0.56	200 955	5.40
Total	357	100.00	3 720 859	100.00

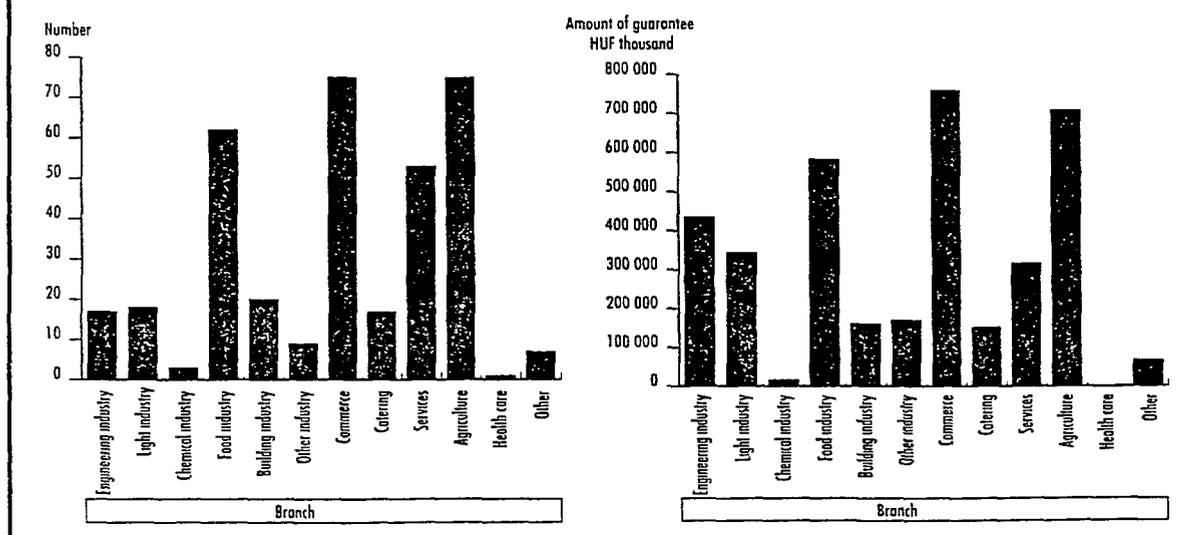
For the E Credit the amount of interest plus fee must not exceed 25 percent of the principal within that the amount of fees should not exceed four percent of the principal guaranteed.

DISTRIBUTION BY GUARANTEE PERCENTAGE

Guarantee amount	Number	Distribution (%)	Collateral security (HUF thousand)	Distribution (%)
20	4	1.12	14 786	0.40
20-50	94	26.33	1 198 133	32.20
50-70	155	43.42	1 325 169	35.61
70-80	49	13.73	644 727	17.33
80	55	15.41	538 045	14.46
Total	357	100.00	3 720 859	100.00

The paying guarantorship of the Rt does not extend to the amount of the fee of collateral security, the surplus interest charged for arrears on the part of the debtor and the amount of interest subsidy at reorganization loans.

APPROVED GUARANTEE REQUESTS BY ACTIVITY



COSTS OF COLLATERAL SECURITY

Applicants for the loan have to pay a fee for collateral security which consists of a one time administration fee and a paying collateral security fee payable annually.

The one time administration fee has to be paid at the submission of the request and its proportion is one percent of the paying collateral security requested but at least HUF 20 000. If the request is refused the Rt refunds 50 percent of the administration fee or if the administration fee exceeds HUF 200 000 the amount exceeding HUF 100 000 is refunded to the requestor of the loan.

For E Credit the one time administration fee is lower but it is not refunded by the Rt in case of refusal. The proportion of fees by applicants for loan:

- HUF 5000 in for loan promissory made out for an amount below HUF 5 million
- HUF 20 000 for a loan promissory made out for an amount of HUF > 50 million
- HUF 100 000 for a loan promissory made out for an amount exceeding 50 million

The paying guarantee fee payable annually is set on the basis of the debt assured by guarantee and is one to three percent of this. The fee has to be paid for the first time within eight days of concluding the guarantee contract and its projection base is the receivables existing at the time of the conclusion of the contract. Later the fee has to be paid once a year by January 25 on the basis of receivables which existed on December 31 of the previous year or in the case of E Credit on the basis of the mean annual receivable ensured by paying guarantee. For the magnitude of the guaranteed loan decreases proportionately by every installment as the collateral security always extends over the originally undertaken ratio of the current debts.

In 1993 the average ratio of the paying collateral security payable annually was two percent that of working asset loans three percent annually.

RESOURCES OF THE LOAN GUARANTEE RT

In 1993 the Rt was able to grant an HUF 8 billion paying guarantee. When setting the extent of guarantee the prime capital (currently HUF 3.5 billion) is taken into consideration its yield (for the prime capital is bearing interest as a bank deposit or security investment) revenues from guarantee fee extent of risk (70 percent on the average) reguarantee by the Small Entrepreneurs Guarantee Fund (its extent is 70 percent meaning the actual risk of the Loan Guarantee Rt is about 30 percent) as well as the expected proportion of failure which has been estimated at 35 percent.

As the prime capital cannot be consumed the deposit portfolio has to bear such a yield which after deducting operational costs funds the fulfillment of payment obligations necessitated by eventual failures. Calculating with a 35 percent ratio of failure and in view of the 70 percent reguarantee of the Small Entrepreneurs Guarantee Fund the Loan Guarantee Rt has to possess at least 10-11 percent of the current amount of guarantee to be able to perform paying collateral security. No guarantee has been redeemed so far. Otherwise thanks to computerized records they have up to date precise information about to what extent the fund has obligated itself said Nador.

STATE MONEY FUND FOR REGUARANTEE

The obligations of the Loan Guarantee Fund have been reguaranteed by the Small Entrepreneurs Guarantee Fund a separated state money fund as of September 1992. The extent of reguarantee is 70 percent of those liabilities of the Rt which correspond to a contract concluded between the Rt and the Fund. This means that if the performance of the collateral security of the Rt comes due then only 50 percent of the amount is paid by the Loan Guarantee Rt and the remaining 70 percent of the receivables has to be settled by the Fund. For the liabilities of the Fund the central budget is the guarantor.

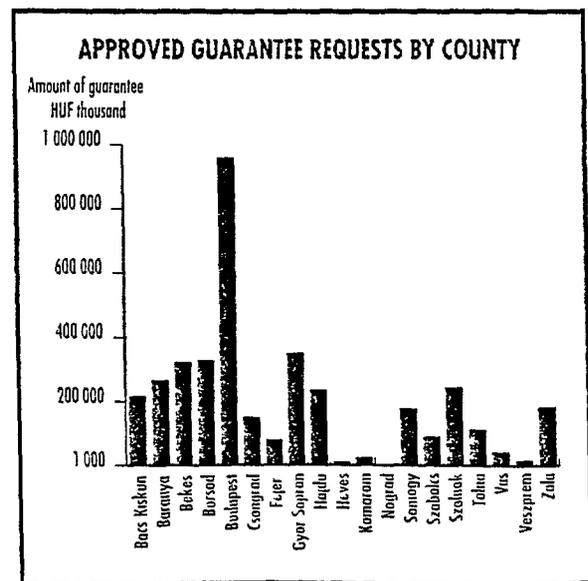
The primary source of the Small Entrepreneurs Guarantee Fund is an amount allocated by Parliament from privatization revenues says *Erzsébet Balas Sebestyén* the fund manager. The Fund can invest temporarily free financial assets into state guaranteed securities or can deposit it at the National Bank of Hungary and thus they can expect interest and rate gains. Their revenues will be increased by paying guarantee from the loan debtor as well as the part of the amount collected after redeeming the reguarantee as set in contract. However there has been no redeemed guarantee and thus redeemed reguarantee either so far.

In 1992 the State Property Agency paid HUF 2 billion of privatization revenues to the Fund. Sebestyén explained. The Fund acquired the HUF 4 billion revenues earmarked last year. HUF 2 billion came from the SPA and HUF 2 billion was transferred to the Fund by the central budget as advance payment for the SPA. In 1993 the Fund realized HUF 200 million in interest gains as the HUF 4 billion hit the Fund only in November and December.

Pursuant to the 1994 budget law the fund can expect another HUF 4 billion from privatization revenues.

For the time being the Small Entrepreneurs Guarantee Fund extends reguarantee only for the liabilities of the Loan Guarantee Rt. Later however this fund will extend loan preference to loans extended to purchase assets of ventures under bankruptcy or liquidation procedure. The arrangement is still to be drafted.

Zsuzsa Barna



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A conference held by the State Holding Company received the participation of members of Boards of Directors and Supervisory Boards of 162 companies under its supervision. Leading personalities of the holding company voiced at the conference their expectations of companies assigned to them.

A publication on employee ownership was available to participants of the conference. PRIVINFO also publishes here the policy of the State Holding Company related to employee ownership.

The government decree on the Existence Credit and the ESOP law were published in PRIVINFO 1993/9.

INTRODUCTION

The Board of Directors of the State Holding Company has set the objective of accelerating privatization processes. Therefore it is especially timely that in the interest of legal regulations and governmental expectations the Board of Directors of the State Holding Company draft its policy related to employee ownership.

The State Holding Co. has already discussed its concept concerning employee ownership but no adequate practice can be set without clarifying theoretical issues. In the following the legal frames of employee ownership acquisition, the objectives of the government's policy and the specific considerations of the State Holding Co. are summed up in the interest of harmony between the existing practice of the State Property Agency and the set of principles to be formulated by the State Holding Co. The timing of this is justified by the fact that the Board of Directors of the SPA requested in a resolution the management of the SPA to initiate at the State Holding Co. the drafting of a unified practice in the issue of employees' preferences.

LEGAL FRAMEWORKS OF EMPLOYEE OWNERSHIP ACQUISITION AND OBJECTIVES OF GOVERNMENTAL POLICY

Objectives of employee ownership acquisition

Although employee ownership acquisition is not a subjective right but the government under its policy aimed at establishing an ever wider range of private ownership stratum supports the ownership acquisition of employees by special preferences. Fundamental prin-

ciples to this are summed up by Parliament Decree No 99/1993 (XII 24) on the Property Policy Guidelines of 1994.

Objectives of employee ownership

are the efficient allocation of intellectual and human resources in the economic sense, the increase of the efficiency of companies by putting employees in an interested position and the expansion of privatization demand.

PRINCIPLES OF EMPLOYEE OWNERSHIP ACQUISITION

Fundamental principles

Regulation of employee ownership acquisition is based on the following fundamental principles: equal chances and lack of discrimination as well as proportion and uniformity.

The essence of the principle of equal chances and lack of discrimination is that any of the full-time employees of a given company are entitled to participate in the employee ownership program so every employee has a right to acquire ownership of the company employing him and to the same extent as his colleagues with regard to his performance.

When drafting the concepts of individual companies, the solutions applied should not be negative or discriminating for any of the employees. Under this principle employees may draw preferences even if they work at companies established by state enterprises or after transformation the companies established by the legal successor.

The principle of proportion and uniformity is that if not every employee takes part in the preferential purchase program, the possible ratio of preference has to be set in proportion with the number of employees involved and the total

Employee ownership at companies under the State Holding Company

number of employees at the company. The preference can also be provided later for those who have not yet drawn it. Therefore, not a single employee can gain advantage from the fact that some of his colleagues have not participated in an announced employee ownership program. The preference always has to be calculated for the individual. Enforcing this principle includes the problem that the per capita preference among the employees of individual companies can differ considerably irrespective of the period they have been employed at their companies or their performance. To avoid striking disproportion, the Property Policy Guidelines specify that total preferences are limited to 10 percent of the own capital appearing in the starting property balance of a transforming state enterprise or an amount corresponding to the 12 month mass of per capita gross basic wage. The proportion of preferences is set by the lower of the two limits.

The SPA's practice sets another restriction. Considering the varied proportion of the own capital and major differences of the wages of employees, it is useful to introduce the practice that the amount of the set and the extendable preferences must not exceed the product of the number of the actual full-time employees and the 140 percent of the national minimum wage calculated for an annual period. This limit is a restriction to some extent compared to the principle set by the Property Policy Guidelines. Amid the current circumstances of the Hungarian economy, this resulted in an average per capita preference of HUF 151 200 at the end of 1993. Because of the raise of minimum wages, it is expected to increase in 1994.

On the other hand, a significant difference of income between company

managers and employees has to be taken into consideration when utilizing individual preferences. Provided they want to acquire ownership, the per capita ratio of the extendable preference should be limited. Pursuant to the SPA's practice, the preference that can be individually utilized must not exceed five times the national annual minimum wage.

Supplementary principles

- Exceeding the total preference set in the Property Policy Guidelines that is 10 percent of the own capital or the 12 month gross basic wage is possible on the basis of a justified request (pursuant to a decision made by organizations exercising the state's ownership licenses) up to 15 percent of the own capital. This requires the individual approval of the Board of Directors.

- For companies retained in permanent state ownership at a 50 percent plus one vote ratio, the amount of shares that can be acquired by employees with preferences set by the Property Policy Guidelines can extend up to five percent of the company's subscribed capital due to the limited amount of property.

- The ownership organizations are obligated to handle preferences extended to various employee groups in a uniform manner. This means that preferences extended in various forms have to be calculated collectively when taking into account the maximum limits that can be extended.

- Pursuant to the Property Policy Guidelines, when selling ownership parts of a company transformed from a state enterprise, organizations exercising the state's ownership licenses can ensure a price preference and/or opportunity for payment in installment for employees up to 50 percent of the purchase price. When settling the purchase price thus

decreased in installments (with the exception of sale under ESOP, the Employee Share Ownership Program), the maximum installment period can be three years after paying 15 percent of the decreased purchase price in cash and the current interest rate of the E Credit can be charged for the amount outstanding of the purchase price. To settle the decreased purchase price, E Credit can be drawn and compensation vouchers can be utilized.

- When selling employee shares, the nominal value is the projection base. During the sale, price preference can be ensured up to 90 percent of the nominal value.

TECHNIQUES SUITABLE FOR IMPLEMENTING EMPLOYEE OWNERSHIP

The following techniques are suitable for implementing employee ownership:

- share purchase
- property note exchange
- ESOP program
- share purchase option

Employee shares and business parts

One of the methods of acquiring ownership by employees is to purchase shares or business parts in an operating company.

A) According to the Property Policy Guidelines, the state holding organization can extend a 50 percent price preference projected onto the purchase price. For the installment of the remaining 50 percent, E Credit can be drawn and compensation voucher can be accepted.

B) Pursuant to the provisions of the company law, special shares can also be extended.

(1) Employee shares can be issued free of charge or at a preferential price pursuant to the provisions of the statutes from the property exceeding the prime capital of the joint stock company with the simultaneous raise up to 10 percent of the raised prime capital. Owners of employee shares can exercise ownership rights as other shareholders. Ownership shares can be acquired exclusively by full time employees of the company and this type of share can be circulated only among them. Employee shares can be acquired by purchase and the extendable price preference can reach 90 percent projected onto the nominal value.

(2) Preference share. This share enjoys priority over every other type of share. The statutes can limit or exclude voting right attached to these shares. The statutes also enable the issue of preference shares relative to other types of shareholders rights. Preference shares can be issued up to 50 percent of the prime capital of the joint stock company.

(3) Interest bearing shares. Pursuant to the provisions of the statutes shares which bear interest set in advance can also be issued up to 10 percent of the prime capital. The owner of interest bearing shares is due interest payment calculated on the basis of the interest after the nominal value of the share up to a ratio as set in the share even if the joint stock company does not turn a profit in the given year.

Ownership acquisition through property note exchange

A special form of employee ownership acquisition is the exchange of property notes owned by employees to shares. The issuer of the property note obligates himself to pay a dividend to the holder of the property note after a nominal value set there depending on the ratio of the profit achieved by the issuer.

The legal regulation related to exchange is contained in paragraph 43 of Act XLIV of 1992. The exchange of the free property note to employee share raises a problem to what extent shall the property note given to the employee free of charge be calculated into the preferences. As a compromise solution it would be justified to take 50 percent of the value of the property note into account as preference.

ESOP

Act XLIV of 1992 rules on the Employee Share Ownership Program (see the Supplement). One condition for creating ESOP organizations is that 40 percent of the employees declare the establishment of the organization at the general meeting. The ESOP organization must compile a feasibility study for preparing the buy out in which the possibility of financial implementation is presented. The soundness of this must be certified by the signature of the company involved. The ESOP organization can draw an E Credit for the purpose of the buy out or can agree with the holding organization on payment in installments. The source of paying the loan is the dividend held by the ESOP organization payments by the employees participating in the ESOP and the amount transferred by the company for the ESOP. The latter can be accounted as cost at the company if its proportion does not exceed 20 percent of the pre tax result of the company. If the ESOP organization is not a 100 percent owner of the company the subsidy transferable tax free is proportionately less.

Share purchase option

Providing share purchase option may ensure a period of time for employees to weigh their intention of share purchase. Up to the limit of preferences set in the Property Policy Guidelines but for a maximum of three years option can be extended to employees for the purchase of shares at nominal value. The option granted employees become concerned with increasing the rate of the shares and with working efficiently at the same time. Thus the purchase option gives the employee the feeling of already being an owner.

THE STATE HOLDING CO'S POLICY OF EMPLOYEE OWNERSHIP

Introduction

The State Holding Co has to meet political requirements related to employee ownership (as also set by the Property Policy Guidelines) in harmony with general economic and privatization strategy demands set for it. Accordingly the Board of Directors of the State Holding Co has to define those principles and

tasks which are suitable for the concerted implementation of these objectives. When defining these principles it must be remembered that the primary task of the State Holding Co is the improvement of the efficiency of companies assigned to it by means of property management and privatization. It also means that the State Holding Co has to fulfill its financial obligations to the state and has to create a supply satisfying compensation voucher holders.

General principles of the State Holding Co's policy related to employee ownership

In view of the above the general principles of the State Holding Co related to employee ownership should be defined as follows:

1 In the case of companies under the State Holding Co priority should be given to the assurance of drawing in additional capital filling up working capital which means from the privatization point of view that letting employees acquire ownership may take place only after the entrance of the buyer out or the institutional or financial investor raising prime capital.

2 The fact that according to the State Holding Co's policy employees have an opportunity to purchase only after the entrance of an institutional investor ensures that the business value and sales price of the company based on genuine market judgement becomes public which at the same time enables the State Holding Co to set the rate of the employee shares and the ratio and limit of the preference that can be granted.

3 The State Holding Co especially supports the employee ownership acquisition at companies where it assists in allocating intellectual and human resources efficiently and in a purpose oriented manner in the economic sense.

4 Employee ownership objectives are served best if share types are selected which ensure the limited tradeability of the share. Thus the share is suitable for circulation only among employees (including the pensioners of the company) that is it cannot be acquired by an outsider third person. Accordingly the State Holding Co prefers employee shares.

5 The State Holding Co in view of its financial obligation towards eco

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economic management and the state under the existing legal frameworks supports those employee ownership acquisition arrangements in the first place which produce direct financial revenues for it even if over a prolonged period

6 The share package to be offered to employees can amount to the realistically assessed demand in order to prevent eventual lack of interest from endangering the market judgment of the company

7 Compared to the company's subscribed capital the employee ownership must not reach the ratio of a 10 percent ownership share in general. A larger scale property acquisition in the form of ESOP can be an exception to this principle if the company in question is small, clear and prospering, that is profitable and capital strong, and the genuine business value of the company is the expertise of its employees. These tend to be companies where some sort of special expertise prevails, such as R&D, research institute networks. With this arrangement attention should be paid to whether employees possess the managerial knowledge which ensures efficient company management. Therefore pro

fessional and market knowledge is required which, in addition to efficiency, guarantees an increasing number of orders, development and investment of the company.

8 The State Holding Co ensures participation in the ownership program at its announcement for every employee in full-time employment at the company employing them. It ensures the opportunity of purchase also to limited companies wholly owned by the employees mentioned, their ESOP organizations and other groups of employees, as well as the employees of business partnerships founded by the parent company.

Decision making mechanism related to employee ownership acquisition

The State Holding Co invites conditions from the companies. The conditions are drafted by the board of directors and the management of the companies jointly and in consultation with the interest representation organizations of employees. In particular, the State Holding Co considers it important that the company management consider the pro

posals, remarks and demand for information of employees, interest representations under legal frameworks as defined by rules in the Property Policy Guidelines.

In accordance with the currently valid legal regulation, exclusively the State Holding Co, as the organization entitled to exercise ownership rights over the shares to be sold, is authorized and obligated to decide on the time of ensuring employee ownership, the quantity of shares to be offered for this purpose, the forms, limits and ratio of preferences that can be extended, payment and subscription conditions and other formal and contentual accessories of ownership acquisition. This means that employees are not agents in a unilateral demand position against the State Holding Co, but the State Holding Co, as seller, decides on the sale in its own capacity after preliminary consultations (with the employees), taking into account market and other circumstances.

Pursuant to the State Holding Co's resolution on employee ownership, the project has to be implemented by the company itself and the property management department has to review it continuously and periodically.

As of July 1, 1993, the employees' ESOP organization is the owner of the Pest megyei Muanyagipari Kft, popularly known as PEMU

EMPLOYEES OWN PEMÜ

At the end of 1992 the State Property Agency offered for sale a 93.6 per cent stake of the company established with a registered capital of HUF 800 million and accumulated capital of HUF 660 million (Eleven local governments are the owners of the 6.4 per cent stake). The deadline for submitting the applications was January 15, 1993 and at that time more than 50 per cent of the employees supported the acquisition of ownership with ESOP. In their application they offered to buy PEMU's majority stake at face value which they wished to pay by taking out E Credit.

The tender booklet was bought by eight potential applicants but only three of them submitted applications which could be evaluated. Upon the opening of the tenders one of the bids turned out to be invalid. The second one although submitted by a Hungarian bidder could not compete with the ESOP bid because it was for only one line of business namely for the manufacturing of pipes.

The ESOP organization deposited the earnest money of HUF 20 million. Its business plan was the most comprehensive and it also undertook to pay the company's earlier debts and to continue the company's environmental activity. Thus in its decision of February 24, 1993 the State Property Agency announced that the ESOP organization won the tender.

We are well aware of what we purchased — says CEO *Bernat Sarlos* of PEMU — since most of the employees grew up with the factories they are locals or live nearby. For them PEMU is the only opportunity for an industrial job so it was not really a question for

us to bid for it. More than 50 per cent of the employees supported the setting up of the ESOP preparatory committee and 78 per cent of them became members of the ESOP organization. The structure of ownership is the following: the ESOP organization owns 56 per cent, 10 per cent can be obtained with option right by non-ESOP member employees, PEMU itself purchased 27.6 per cent and the local government has 6.4 per cent. Under the statute of the ESOP managers are not allowed to acquire special bigger stakes than anyone else. With this restriction we wanted to spare the management from the accusation that it acquired a major stake of the company for itself. No one can have a bigger stake than two per cent even with the stakes to be distributed annually.

ALTERNATIVES TO PRIVATIZATION

The Pest megyei Műanyagfeldolgozó Vállalat (Pest County Plastics Processing Company) was established in 1959. Its legal predecessor was an industrial cooperative producing plastic and metalware. Through more than 30 years it has undergone considerable changes and the former cooperative has turned into one of the major companies of the Hungarian plastics industry.

At the end of the 1980s in line with the production structure typical of the plastics industry the PEMU factories manufactured 30,000 kinds of products. In the meantime the traditional plastics profile was supplemented with

ready-made shoe manufacturing when the PEMU unit in Cegléd concluded a licence contract with PUMA.

The company had 2500 employees in 1990 and its profit came to HUF 4.2 billion. But besides its profit it also had considerable credit debts in the framework of the plastics industry restructuring program financed by the World Bank. PEMU carried out a technical development program worth USD 10 million. But economic conditions have since changed. Interest rates for example rose from four per cent to 23 per cent — and the prosperous company fell into a difficult economic situation overnight.

— Still back in 1990 when the idea of privatization was first raised everything seemed much easier. We knew that the first step in solving the economic tasks was to create financial stability which in practice meant the cutting down of credits. Compensating for the lost markets, finding new ones and preparing the privatization were also of vital importance. This took the past three years. We won a tender in which financed by the Dutch government the Dutch Felix and the Economic Consulting Kft examined the company in order to find its strengths and weaknesses. Based on this examination a strategic plan for a period of three years was prepared and the privatization alternatives were also worked out.

The examination showed first of all that the number of employees was extraordinarily high and had to be cut.

From the 2500 employees only 1300 are still employed by PEMU. During the staff reduction we tried to be as considerate as possible, we set up an interest coordination forum. Those

who were eligible we pensioned off with exemption of age and to others we strived to provide help for restarting. The next task was to create financial stability to which we succeeded in restructuring our credits. And as a result our annual interest burdens dropped to HUF 70 to 80 million a year.

When the privatization alternatives were drafted various solutions were raised such as the detachment of PEMU to various units, the transformation of factory units into limited liability companies and the operation of the center as a holding, as well as keeping the company together and to realize the then biggest possible employment ownership. The ESOP as such was not an approved method of privatization in 1990-91. The Ministry for Industry and Trade as well as the banks all supported the third alternative primarily because it made the debt service manageable. They knew that due to the company's big debts and diverse profile chances of attracting a serious professional investor were slim.

But by the time the invitation to bid was published Parliament had already passed the ESOP law which was a godsend to the employees of PEMU.

— I would not have liked to give my name to the detachment of the firm to privatizing the factories either — says the CEO — since for a state-owned company this together with our debts would have meant the end of the company. But with the ESOP I think that although we have taken great risks we can succeed in coping with the difficulties.

It doesn't make our situation easier that although the privatization occurred with the company the employees of PEMU still have considerably less productive potential than they thought before. For the State Property Agency only gave its consent to the setting up of the association on condition that the 49 percent stake of PEMU in the Dutch-Hungarian joint venture which had been set up for pipe manufacturing was put up for sale separately. The Dutch partner, the Vavin firm, originally had no intention of acquiring the full ownership of the company since this was not necessary to retain its dominant position. But finally it agreed to the State Property

Agency's favorable offer. The sale occurred as a transaction aimed at protecting property. Part of the revenue was used to reduce PEMU's debts, the other part went into the purse of the SPA as privatization revenue.

One eye is laughing and the other is crying says Sarlos, assessing the situation. Pipe manufacturing amounted to one third of our production value and in our business plans we also counted on the revenue from dividends after our stake. On the other hand we were practically pushed to the sideline of the domestic market where we held a leading position for 20 years. Strategically it was tough but it is also true that it helped us to overcome our short-term financial problems, we got rid of a debt of HUF 250 million. The decision was otherwise correct it did not come as a surprise for us for we learned of the conditions prior to the opening of the tender. Although we based our business plans to a great extent on the pipe-manufacturing which we expected to flourish we hope that we will also be able to remain on our feet with a streamlined PEMU.

STRATEGIC TASKS

We concentrate first of all on the marketing work — we think this is the field where we have the biggest reserves and arrears. The other important area is the quality control system which we would like to develop so that by the end of the year we could get the classification in compliance with the ISO standards accepted by a third independent party. This will inevitably increase our chances on the domestic and international markets alike. We have much to do in the field of cost effectiveness and in building up to date management and employee ownership information system. Making the proprietary way of thinking adopted and accepted and doing away with the fundamental contradiction of the interests between employer and owner are new tasks. So far we have only experienced the benefits, namely that our employees have become more considerate of the limits of economic possibilities and wage increases. The future will tell how we succeed in keeping a balance between the clashing interests

Foreign examples show that employee ownership results in a 30 to 50 percent improvement in efficiency. We would be satisfied with less 10 to 15 percent would do. But if we fail to reach that then we will face serious difficulties.

We continue to regard as important the manufacturing of ready-made shoes under the PUMA licence. We plan to link the distribution of the Hungarian PUMA textile goods and shoes and we have set up a special sales organization Puma Hungarian to this end. Our HUF 1 billion production would serve as the basis, some 80 percent of the joint trading firm. Our automobile spare part activity is on the increase, we are suppliers to the Hungarian Suzuki and Opel factories. This line of business of ours is expected to yield about HUF 1 billion and we will soon double it. We supply die cast products to several Western companies, our products range from garden furniture to plasticware and equipment for the catering industry. Industrial plastic goods continue to remain on our production list, we could partly compensate the loss of the export of shoe parts to the socialist countries with exports to the West and of course we are working on developing new products.

The protection of the environment is not an unimportant issue for the new owners of PEMU. With the privatization they had to undertake this problem as well. One or two years ago technically there was simply no way to solve the problem of air pollution. Now that modern solutions are available they inevitably have to work on them even though for the time being the emission is below the permissible level. The more pressing need at the moment is the elimination of the dangerous waste and the removal or reprocessing of the huge quantity of polyurethane soles.

Summarizing his plans for the near future Sarlos says: In the next two to three years we have to count on an expenditure of a total of HUF 150 million for environmental protection. Everything depends on how well we succeed in making PEMU one of the most profitable private companies of the country.

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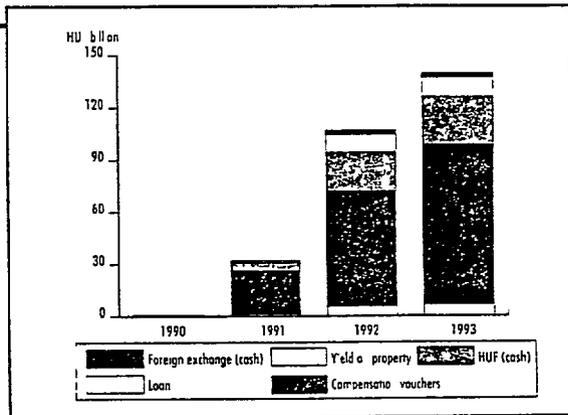
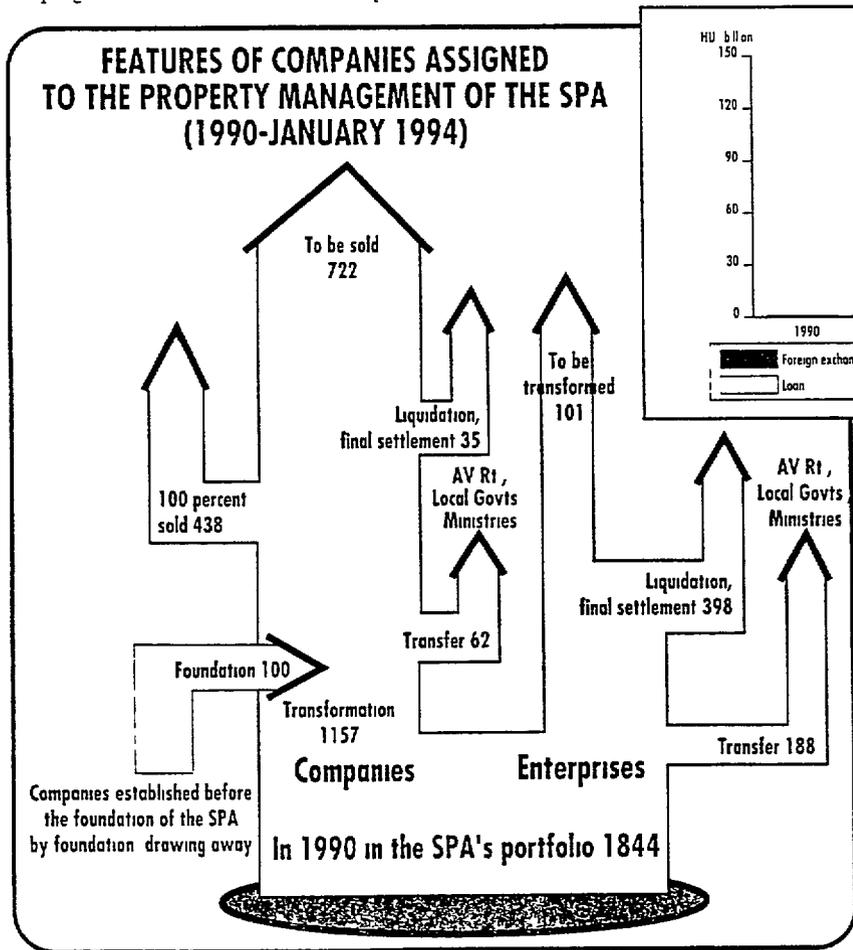
PRIVATIZATION AT THE STATE PROPERTY AGENCY 1990-1994

While preparations for privatization and its implementation went on hurriedly at the Property Agency during the previous four years the property still in state ownership went on functioning. Part of this was transformed into some corporate form yielding substantial revenues from year to year. When evaluating the following table it should be recalled that an increasing number of enterprises were transformed into companies. Thus the annually increasing figures indicate not only the increase in revenues but also the progress of transformation into companies.

**DEVELOPMENT OF REVENUES BY COMPANIES MANAGED BY THE SPA
(CUMULATIVE FIGURES)** HUF billion

	1990	1991	1992	1993
Yield on property	0	0.94	5.68	6.62
Foreign exchange (cash)	0.53	25.14	66.12	91.79
HUF (cash)	0.14	4.96	22.47	27.57
Loan	0	1.01	10.08	11.09
Compensation vouchers	0	0	2.26	2.26
Total revenues	0.67	32.05	106.61	139.33

FEATURES OF COMPANIES ASSIGNED TO THE PROPERTY MANAGEMENT OF THE SPA (1990-JANUARY 1994)



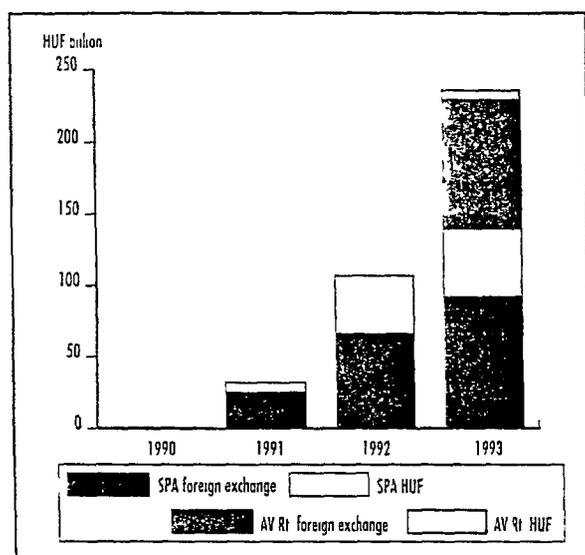
The SPA joined privatization in 1990 while the State Holding Company (AV Rt) managing business property in long term state ownership was established in 1992 becoming active in the following year. Beginning in 1992 privatization in Hungary (not including the less significant work of the Treasury Holding Organization) continued in two channels. The SPA sold business property in temporary state ownership while the AV Rt sold state property beyond the property stake in long term state ownership of the companies under its portfolio. As a result privatization revenues substantially increased in the course of

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PRIVATIZATION

the past two years. While the State Property Agency produced HUF 2 billion in privatization revenues in 1991, proceeds reached HUF 106.6 billion as a result of the work of the two organizations in 1992 and HUF 235.8 billion in 1993, the year of major privatization transactions.

**TOTAL REVENUES OF THE SPA AND AV RT
(CUMULATIVE FIGURES)**



HUF billion

	1990	1991	1992	1993
SPA foreign exchange	0.53	25.14	66.12	91.79
SPA HUF	0.14	6.91	40.49	47.54
AV Rt foreign exchange	0	0	0	89.71
AV Rt HUF	0	0	0	6.79
Total revenues	0.63	32.05	106.61	235.83

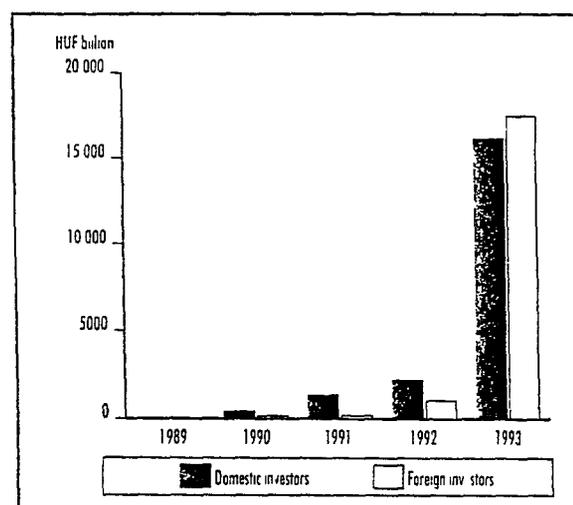
Basically, privatization in Hungary took place during the past five years on a market basis. This means that state property was transferred to new owners not free of charge or at minimum prices, but at essentially market prices. A substantial portion of revenues flowed into the state budget until 1992 or financed objectives which would have had to be funded by the budget. Relatively little money was spent on strengthening and reorganizing the companies to be privatized or the capitalization of partially sold companies so that they could go on with their business activity on a solid foundation. 1993 brought a major change in this respect when the capital raise at companies managed by the SPA increased substantially to reach HUF 33 billion in that year.

Raising capital has become significant primarily in the processing industry. The most widespread form of raising capital was the following privatization: the new foreign owner substantially contributed to the capitalization of the company he acquired to some extent. In this, however, the SPA and the

changes in the privatization policy have played a part. For in many cases it enabled a portion of privatization revenues to be reinvested in the company.

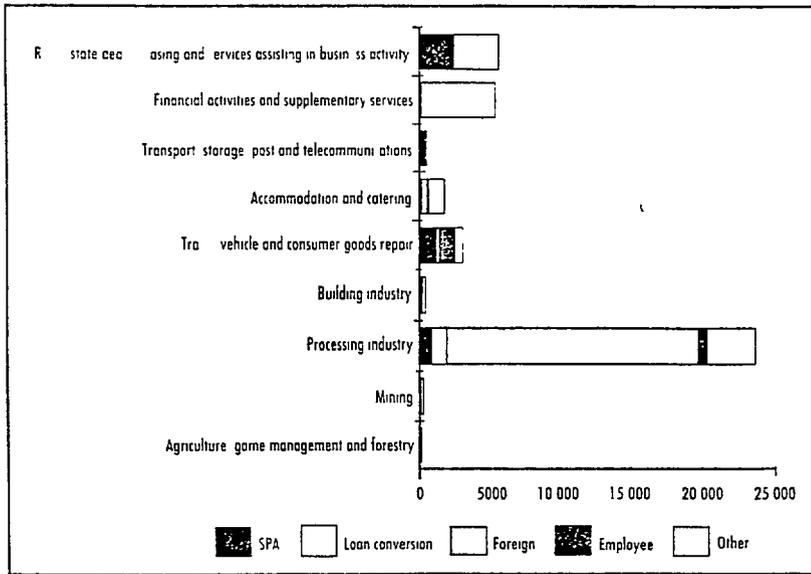
**CAPITAL RAISES AT COMPANIES MANAGED BY THE SPA
(CUMULATIVE FIGURES)**

Year	Domestic investors HUF million	Foreign investors HUF million
1989	11.00	0.00
1990	417.00	150.00
1991	1308.43	176.94
1992	2166.25	1017.72
1993	16167.73	17490.00



**CAPITAL RAISES
AT COMPANIES MANAGED BY THE SPA,
ACCORDING TO BRANCH**

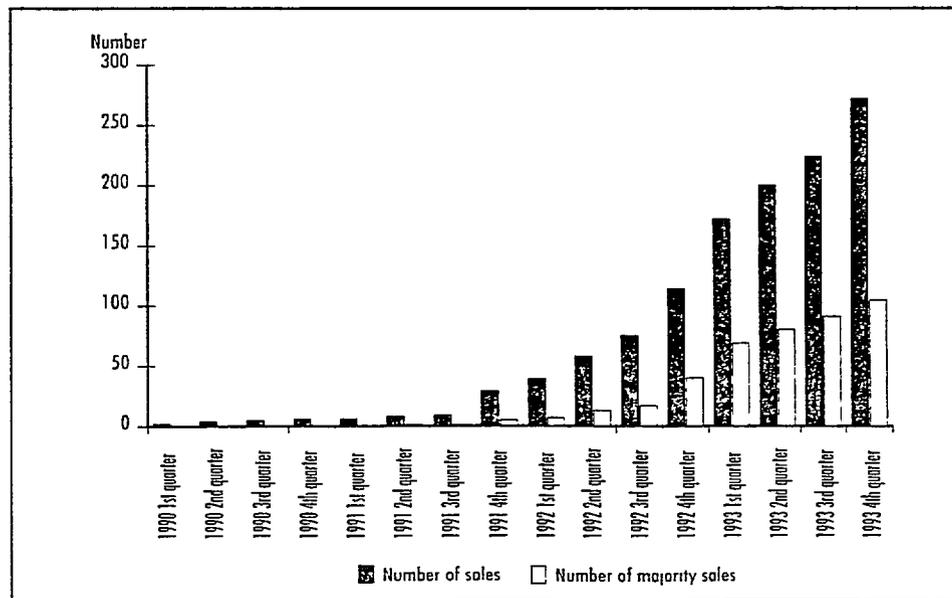
Branch	HUF million			
	SPA Loan conversion	Foreign	Empl. fee	Other
Agriculture, game management and forestry	0.00	0.00	0.00	109.8
Mining	65.00	0.00	203.00	0.00
Processing industry	842.14	1074.89	17834.24	596.92
Building industry	0.00	0.00	0.00	199.15
Trade, vehicle and consumer services	1188.41	0.00	217.14	1089.71
Accommodation and catering	114.60	0.00	459.78	70.00
Transport, storage, post and telecommunications	400.00	0.00	120.50	0.00
Financial activities and supplementary services	115.95	0.00	0.00	5273.63
Real estate deals, leasing and services assisting in business activity	2441.00	0.00	0.00	24.08



In the past years significant changes took place in the process of privatization in many other respects. Although the government was consistent in selling state property on a market basis several preferential procedures were launched in order to accelerate the dismantling of state property. One of them is that the process of buying property was greatly eased for employees working at the company involved. The effect of these easier terms have been felt since 1990. Employee ownership has been increasing in every respect since 1992. Employees acquired primarily share ownership at the companies. However in 1993 the number of companies increased where employees secured majority ownership.

DEVELOPMENT OF THE NUMBER OF SALES TO EMPLOYEES AT COMPANIES MANAGED BY THE SPA

Period	Number of sales	Number of majority sales	Period	Number of sales	Number of majority sales
1990 1st quarter	2	0	1992 1st quarter	39	7
1990 2nd quarter	4	0	1992 2nd quarter	58	13
1990 3rd quarter	5	0	1992 3rd quarter	75	17
1990 4th quarter	6	0	1992 4th quarter	114	40
1991 1st quarter	6	0	1993 1st quarter	172	69
1991 2nd quarter	8	1	1993 2nd quarter	200	80
1991 3rd quarter	9	1	1993 3rd quarter	224	91
1991 4th quarter	29	5	1993 4th quarter	272	105

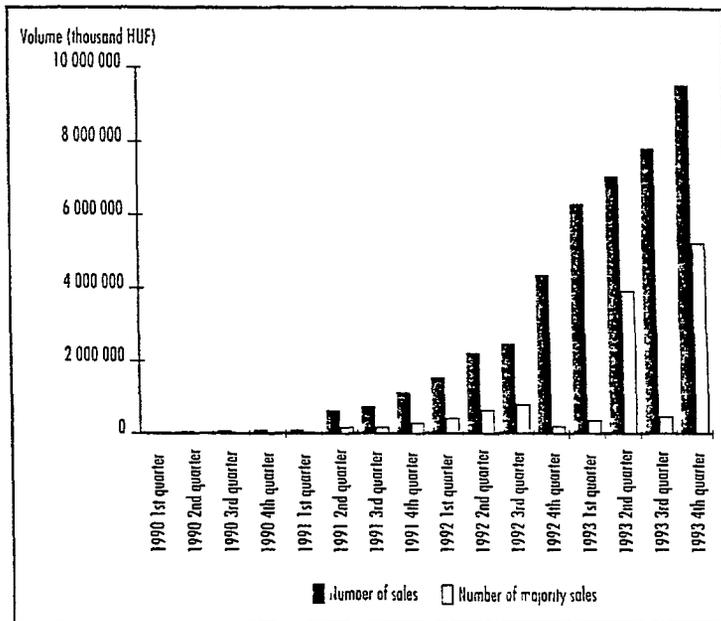


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**DEVELOPMENT OF THE VOLUME OF SALES TO EMPLOYEES
AT COMPANIES MANAGED BY THE SPA**

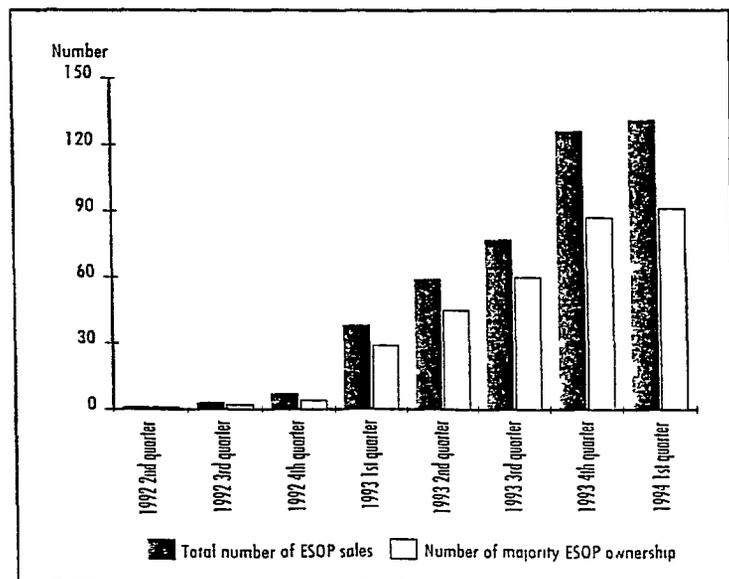
Period	Sales in thousand HUF	Majority sales (thousand HUF)	Period	Sales in thousand HUF	Majority sales (thousand HUF)
1990 1st quarter	12 480	0	1992 1st quarter	1 525 765	405 970
1990 2nd quarter	40 910	0	1992 2nd quarter	2 205 737	657 850
1990 3rd quarter	61 973	0	1992 3rd quarter	2 448 580	789 746
1990 4th quarter	85 173	0	1992 4th quarter	4 360 225	1 917 530
1991 1st quarter	85 173	0	1993 1st quarter	6 288 933	3 491 430
1991 2nd quarter	620 173	160 000	1993 2nd quarter	7 061 013	3 926 900
1991 3rd quarter	731 173	160 000	1993 3rd quarter	7 818 563	4 507 160
1991 4th quarter	1 123 343	283 620	1993 4th quarter	9 535 956	5 240 603

ESOP the Employee Share Ownership Program created a special organized form of employee ownership. Under this employees could make use of major preferences and could acquire a determining ownership share in the companies where they were employed. Naturally ESOP also bore disadvantages organizing them is rather clumsy because of the number of participants. However their spread proves that ESOP has become an important form of privatization in Hungary. The number and volume of sales under ESOP at companies managed by the SPA increased substantially in 1993. In the last quarter of that year HUF 23 billion worth of property went to ESOP ownership. Of this majority ESOP ownership arose in a property worth HUF 20 billion. According to cumulative figures ESOP organizations acquired in 1993 more than HUF 60 billion worth of state property at companies managed by the SPA.



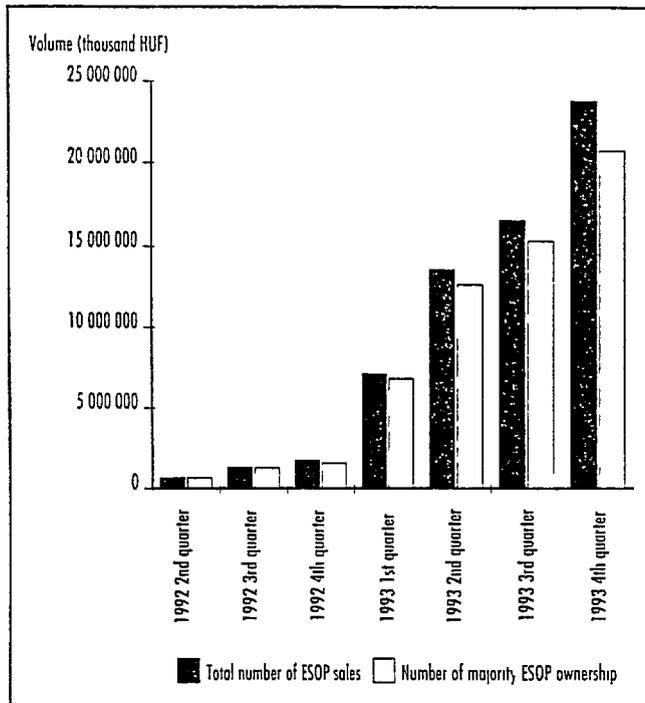
**DEVELOPMENT OF THE NUMBER
OF ESOP SALES MANAGED
BY THE SPA**

Year	Total number of ESOP	majority ESOP
1992 2nd quarter	1	1
1992 3rd quarter	3	2
1992 4th quarter	7	4
1993 1st quarter	38	29
1993 2nd quarter	59	45
1993 3rd quarter	77	60
1993 4th quarter	126	87
1994 1st quarter	131	91



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**DEVELOPMENT OF THE VOLUME OF SALES TO ESOP
AT COMPANIES MANAGED BY THE SPA**

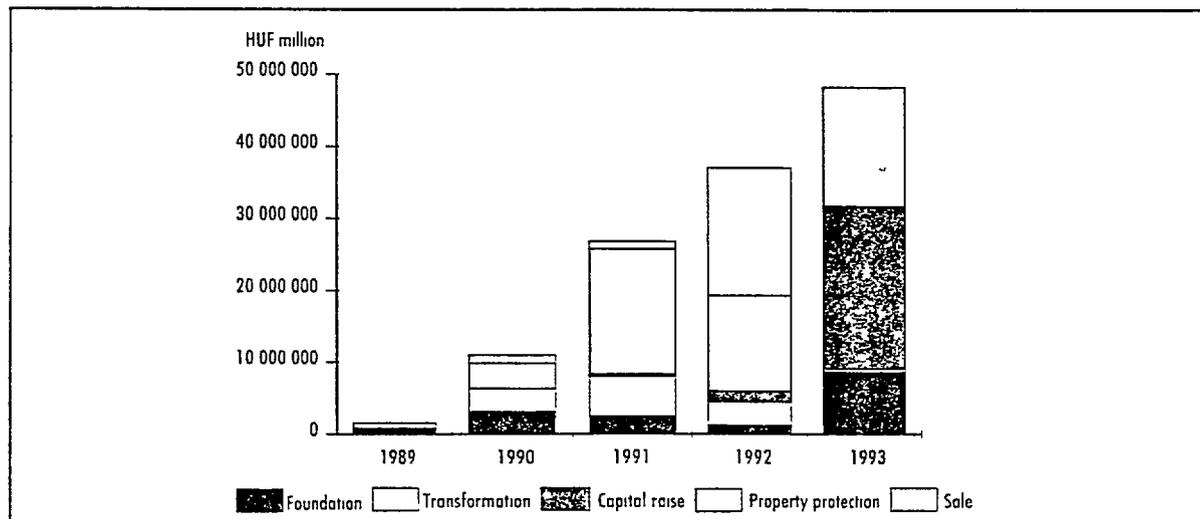


Year	ESOP total (thousand HUF)	Majority ESOP (thousand HUF)
1992 2nd quarter	655 856	655 856
1992 3rd quarter	1 290 946	1 270 946
1992 4th quarter	1 744 206	1 566 346
1993 1st quarter	7 103 098	6 811 868
1993 2nd quarter	13 566 471	12 655 981
1993 3rd quarter	16 580 948	15 352 908
1993 4th quarter	23 776 121	20 776 891

Domestic and foreign investments increased in 1992 and 1993 at companies managed by the SPA. Of course tables should be treated with care because subsequent transformations have changed the figures. For when a state enterprise is transformed into company the capital invested in companies managed by the SPA also increases. This is clearly indicated by the appropriately shaded parts in the tables. Disregarding these it can be established that by raising capital domestic and foreign investors took significant resources in the partially privatized companies managed by the SPA. This kind of taking in resources became significant in 1993.

**DOMESTIC INVESTMENTS
IN COMPANIES MANAGED BY THE SPA**

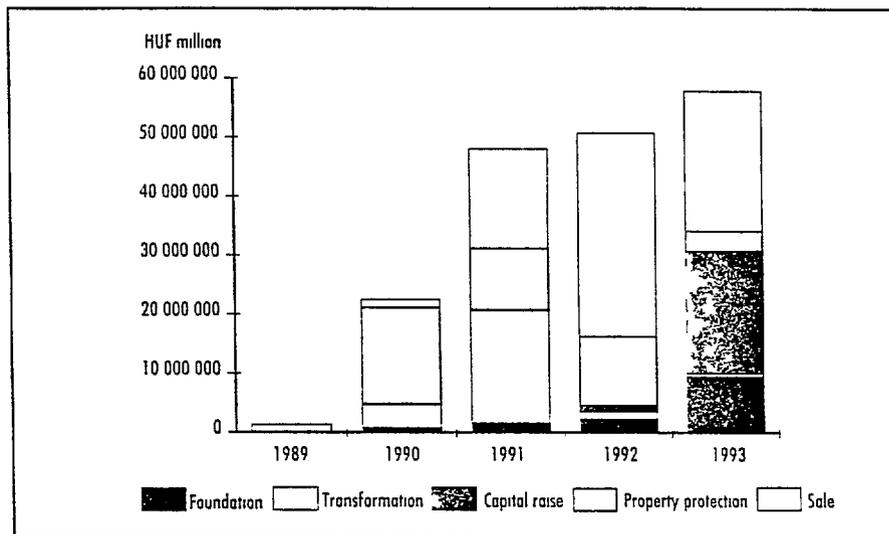
Year	Foundation	Transformation	Capital raise	Property protection	Sale
1989	732 598	80 580	11 000	720 940	0
1990	3 091 940	3 160 885	0	3 566 459	11 27 221
1991	2 435 986	5 505 270	348 152	17 467 402	1 040 681
1992	1 224 539	3 202 444	1 522 012	13 388 023	17 765 978
1993	8 630 725	439 460	22 673 062	16 533 732	56 025 227



**FOREIGN INVESTMENTS
IN COMPANIES MANAGED BY THE SPA**

Investors arriving from the German speaking countries continue to be active in Hungary. The volume of investments by Austrian and German investors greatly exceeds all others in companies managed by the State Property Agency. HUF 43 billion worth of capital arrived from Austria and HUF 34 billion from Germany. These countries are followed by the United States, the Netherlands, France and Great Britain.

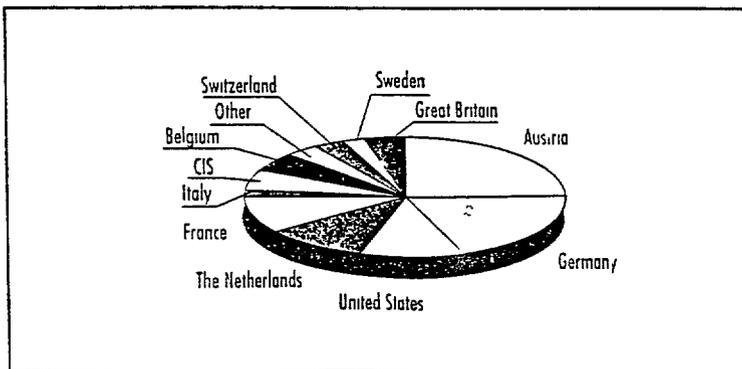
Year	Foundation	Transformation	Capital raise	Property protection	Sale
1989	52 162	0	0	12 0150	0
1990	727 010	5 908 480	1 50 000	16 529 958	1 336 755
1991	1 566 995	19 047 950	184 120	10 582 810	16 890 362
1992	2 231 520	1 297 240	1 017 725	11 75 125	34 397 605
1993	9 566 619	497 340	20 694 050	5 77 557	25 644 710



**FOREIGN INVESTMENTS
AT COMPANIES MANAGED BY THE SPA, ACCORDING TO COUNTRY**

Country	Own stake HUF billion	Country	Own stake HUF billion
Austria	43 18	Sweden	9 67
Germany	34 71	Switzerland	8 98
United States	18 73	Belgium	5 84
The Netherlands	18 29	CIS	5 24
France	17 73	Italy	3 89
Great Britain	12 88	Other	7 14

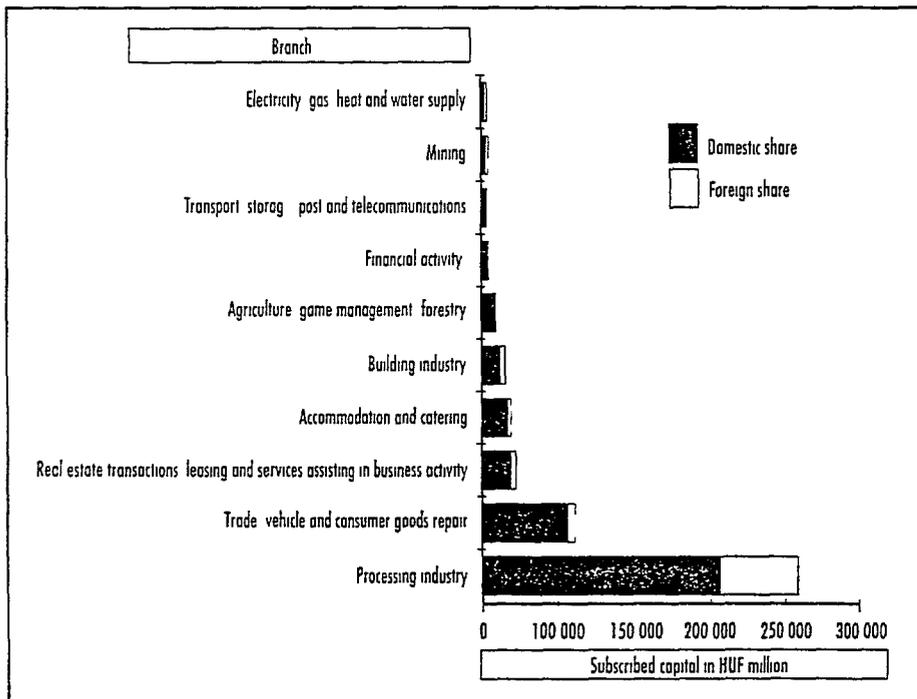
As a result of investments, the average foreign stake in companies managed by the SPA is 24.97 percent. The foreign share is the largest in electricity, gas, heat and water supply, as well as mining, where their stake is 72 and 67 percent, respectively. With 33 percent foreign ownership exceeds the average in the processing industry. Businesspeople arriving from beyond Hungary's borders have acquired significant stakes in the building industry. In other fields, however, foreign share remained under 20 percent.



**RATIO OF FOREIGN CAPITAL
AT COMPANIES MANAGED BY THE SPA, ACCORDING TO BRANCH**

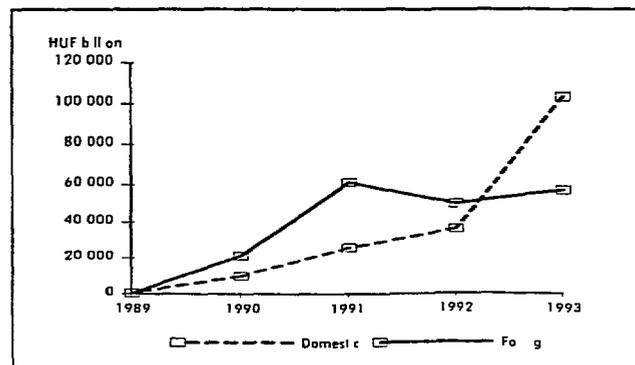
Branch	Subscribed capital		Foreign share
	HUF million	HUF million	percent
Electricity gas heat and water supply	4515 04	3279 44	72 63
Mining	5687 96	3814 74	67 07
Transport storage post and telecommunications	7273 94	400 1	5 50
Financial activities and supplementary services	9083 11	0	0 00
Agriculture game management and forestry	17 316 76	1964 99	11 35
Building industry	25 355 61	6176 04	24 36
Accommodation and catering	34 307 14	4541 47	13 24
Real estate deals leasing and services assisting in business activity	38 303 11	6614 63	17 27
Trade vehicle and consumer goods repair	113 026 51	9907 91	8 77
Processing industry	312 339 63	104 930 77	33 60
Total	567 208 81	141,630 09	24 97

Although foreign investments continue to predominate in Hungarian privatization in 1993 domestic investments substantially increased concerning the property managed by the SPA. This is primarily the result of the fact that a number of new privatization methods were introduced (employee ownership acquisition ESOP leasing payment in installments sales for compensation vouchers) which enabled domestic entrepreneurs with little capital to gain ground in privatization. Thus 1993 turned out to be the first year when the volume of domestic investments exceeded the volume of foreign investments in enterprises and companies managed by the SPA. Naturally the form of investments differs greatly. For foreigners bring primarily cash while the cash ratio of domestic purchase transactions is at a minimum sales take place primarily through loans and compensation vouchers.



**RELATION
OF INVESTMENTS IN ENTERPRISES AND COMPANIES
MANAGED BY THE SPA**

Year	Investments (HUF billion)	
	Domestic	Foreign
1989	1 545	1 282
1990	10 946	22 245
1991	26 797	62 341
1992	37 102	50 679
1993	104 302	57 781



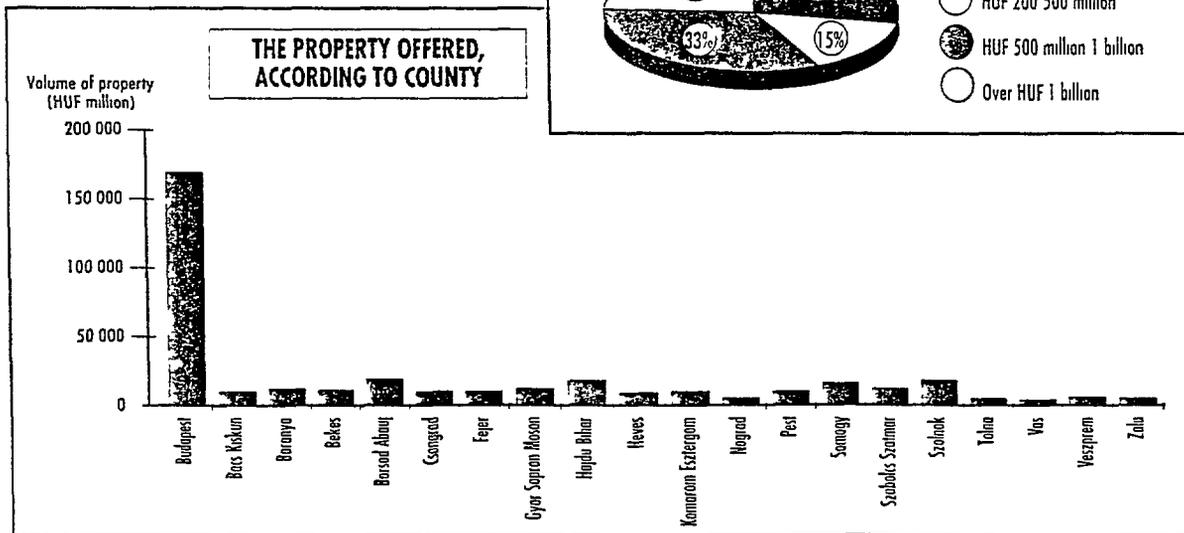
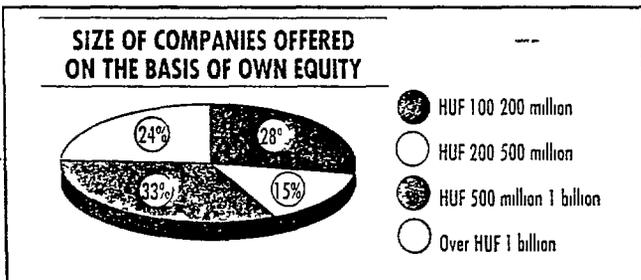
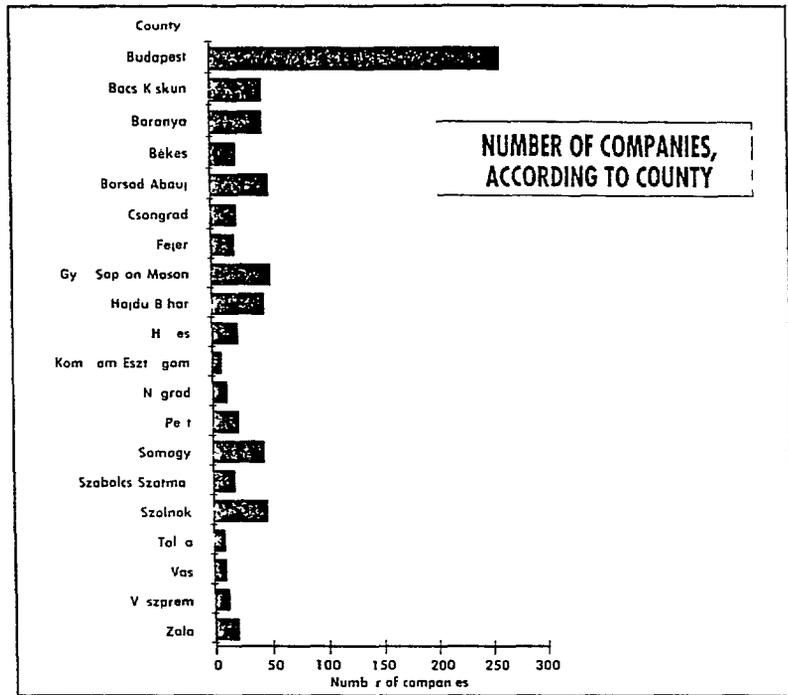
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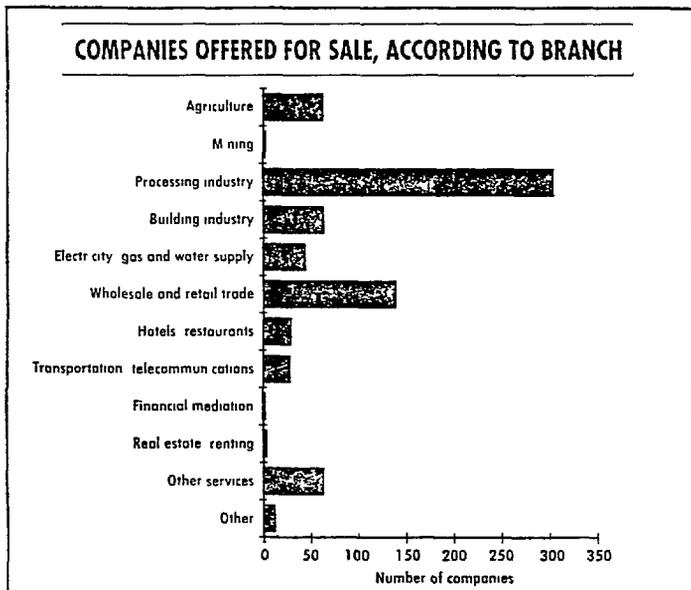
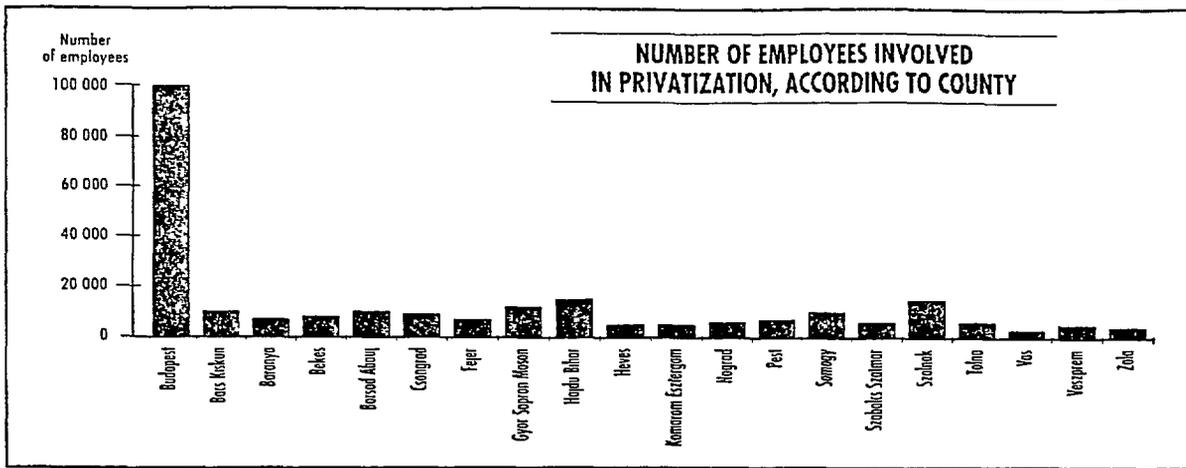
Last December the government decided on the acceleration of the privatization process the introduction of new preferential payment methods and a comprehensive survey of the privatization assortment. Accordingly the number of sales to ESOP organizations and sales by using Existence Credit increased significantly in 1993. A new privatization technique privatization leasing was also launched in that year in a considerably smaller volume than the other sales techniques. The spread of preferential payment techniques is also shown by the great increase in the ratio of domestic investors in sales.

Putting compensation vouchers on the market gave an especially large impetus to the process of privatization. In part these increase the pace of the sale of state property in the form of compensation voucher/share exchange transactions preferring those originally compensated. A special advantage of this form is that a number of successful securities are to be found among shares offered for compensation vouchers. Thus many of those entitled to compensation who thus became shareowners will remain in contact with the share market in the future. Share ownership is beginning to become a mass phenomenon and a proprietary class keeping a part of its savings in corporate shares is to be gradually established.

It is a similarly important advantage that the SPA is increasingly approving payment for the offered companies in compensation vouchers. Obviously this does not involve those originally com

THE SPA'S BIGGEST OFFER SO FAR

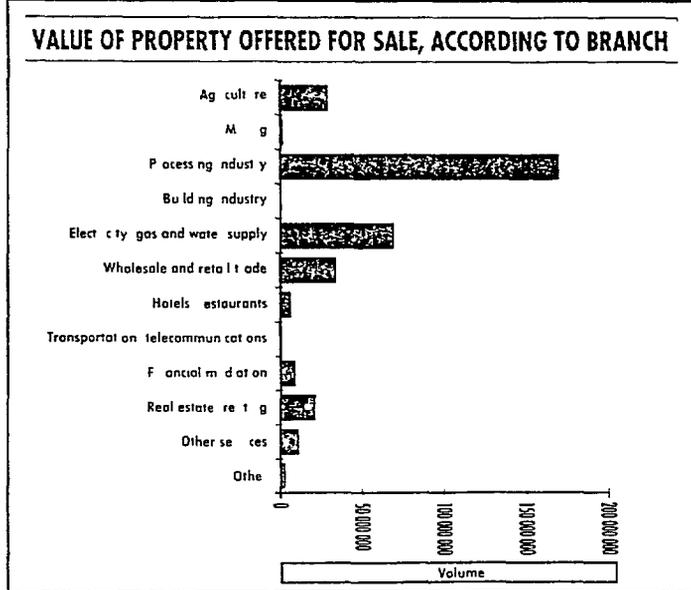




compensated as in most cases a tremendous amount is involved far exceeding the average proportion of compensation. However the solution was that the adequate secondary market of compensation vouchers evolved creating an opportunity for those compensated who are unable to participate in share exchanges or land auctions to sell their compensation vouchers even if not at face value.

Pursuant to the government's resolution surveying the privatization assortment and the establishment of a unified data base enabled the SPA to offer for sale HUF 345 billion book value worth of property in 713 of its companies exceeding the total number and volume of sales so far.

It is expected that the actual purchase price paid for the offered property will substantially lag behind the book value owing to the price allowances that can be drawn and the losses made by the companies involved last year. Most of the companies are active in the processing industry approximately 20 percent of them in trade and nine percent in agriculture.



Sixty percent of the companies in the list are valued at between HUF 100 million and 1 billion. The ratio of companies with a book value of less than HUF 100 million and those with a book value exceeding 1 billion is 20 percent each.

The SPA sells a majority stake at three quarters of the companies and 100 percent ownership appears on the offer list at more than half of the companies. Eighty big companies represent half of the mass of property offered for sale active primarily in the hotel industry, processing and trade.

The unified offer structure does not mean that the sale of every company in the list can be completed in 1994. At the same time it provides a realistic chance that this year's sales in terms of the number of companies and the volume of sales will exceed previous sales.

FACTS ON THE PRIVATIZATION OF PROPERTY ASSIGNED TO THE SPA

Current situation

NUMBER OF COMPANIES

Assigned to the SPA in 1989 ¹	2000
Companies assigned to the SPA	1848
Transferred to other state holding organization	189
Liquidation final accounting	432
Transformed by the SPA	1197
• State enterprise	30

*Approximate figure
Of this 20 are pharmacy centers and 10 liquidations and final accountings are expected*

NUMBER OF BUSINESS ORGANIZATIONS

Assigned to the SPA	1312
- Companies established through transformation	1197
- Companies established by foundation withdrawal of funds or founded before the establishment of the SPA	115
• Transferred to other holding organization	62
• Liquidation final accounting procedure	38
• 100 percent sold	492
• Up for sale	720
<i>(Unsold or partially sold companies)</i>	

VALUE OF THE PROPERTY ASSIGNED TO THE SPA (HUF BILLION)

In enterprises	15 36
SPA property in business organizations <i>(equity proportionate value)</i>	358 17
Withdrawn property up for sale	4 30
• Total	377 83

Privatization of companies

SALES

	Number of companies	Size of property sold ³ (HUF billion)
<i>According to the size of ownership right sold</i>		
100 percent	492	175 84
Above 50 percent	163	173 50
Below 50 percent	35	5 47
		254 81

According to the provisions of the World Bank the whole property of the business organization can be regarded as property involved in privatization at sales above 50 percent whereas for sales below 50 percent the corresponding size is the property value of the business part sold

OWNERSHIP STRUCTURE OF BUSINESS ORGANIZATIONS WITH SPA HOLDING (%)

	At foundation	At present
• SPA	84 62	62 08
• Local government	4 63	4 94
• Hungarian investors	5 52	21 54
<i>Of this employees</i>	0 37	5 89
• Foreign investors	5 17	11 45

SALES FOLLOWING THE REORGANIZATION OF COMPANIES (DUE TO PROPERTY PROTECTION)

	1990	1991	1992	1993	Total
Number	37	180	329	650	1 196
Value (HUF billion)	7 22	21 73	21 33	67 19	117 53

AMOUNT APPROPRIATED FOR REORGANIZATION FROM PRIVATIZATION REVENUES

	1990	1991	1992	1993	1994 March	Total
Value (HUF billion)	-	-	5 8	5 9	0 644	12 34

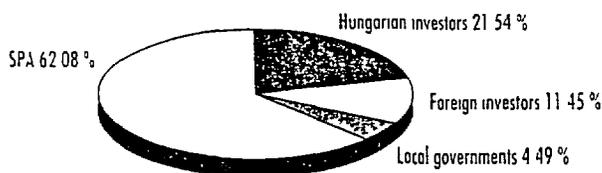
SALES ACCORDING TO TECHNIQUES SUPPORTING DOMESTIC INVESTORS

	1991	1992	1993	1994 March	Total
ESOP					
<i>number</i>	-	7	118	22	147
<i>face value (HUF billion)</i>	-	1 80	21 79	5 46	29 05
Leasing					
<i>number</i>	-	-	9	7	16
<i>face value (HUF billion)</i>	-	-	3 02	2 16	5 18
E Credit					
<i>value (HUF billion)</i>	1 01	9 07	21 70	8 06	39 84
Compensation vouchers					
<i>face value (HUF billion)</i>	-	2 2	16 42	4 97	23 59

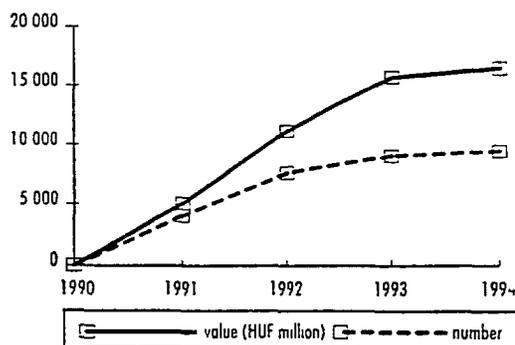
SALE OF SHOPS (PRE PRIVATIZATION)

	1991	1992	1993	1994 March	Total
Number	4 066	3 571	1 428	416	9 481
Value (HUF billion)	5 09	6 10	4 55	0 76	16 50

OWNERSHIP STRUCTURE OF BUSINESS ORGANIZATIONS



SALES OF SHOPS



Foreign investments

BREAKDOWN OF INVESTMENTS ACCORDING TO COUNTRY

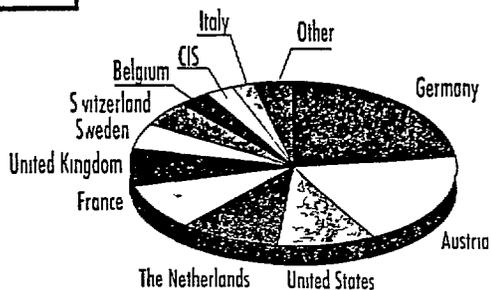
Country	Number of companies	Number of investments	Foreign share ¹ (equity, HUF billion)	Foreign share ¹ (%)
Germany	73	88	39.68	21.09 %
Austria	99	124	39.43	20.96 %
United States	24	29	20.09	10.68 %
The Netherlands	13	15	18.29	9.72 %
France	33	33	16.98	9.02 %
United Kingdom	28	32	12.88	6.85 %
Sweden	8	12	9.67	5.14 %
Switzerland	12	14	9.33	4.96 %
Belgium	7	10	5.84	3.10 %
CIS	13	14	5.24	2.79 %
Italy	20	21	3.89	2.07 %
Other	27	31	6.83	3.63 %
Total	357	423	188.15	100.00 %

¹ Includes sale for property protection and in-kind property investments at foundation sales of withdrawn property, raise of capital sales of shares and business parts (does not include greenfield investments)

ACCORDING TO THE SIZE OF INVESTMENT

PROPORTION OF FOREIGN SHARE IN THE COMPANIES ESTABLISHED

For joint ventures 65.68 %
 For the total of companies 9.09 %

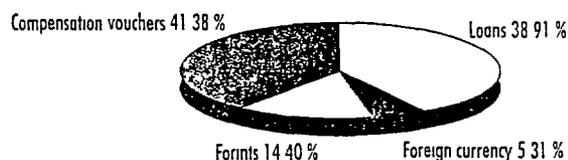


Revenues

(HUF billion)

	1990	1991	1992	1993	March 1994
Yield of property (dividend rental fee)	-	0.94	4.74	2.40	0.095
Sales					
Foreign currency	0.53	24.61	40.98	25.50	1.099
Forints (cash)	0.14	4.82	17.51	15.30	2.887
Cash revenues, total	0.67	30.37	63.23	43.20	4.081
• Loans	-	1.01	9.07	21.7	8.060
• Compensation vouchers	-	-	2.26	13.0	8.571
• Total revenues	0.67	31.38	74.56	77.9	20.712

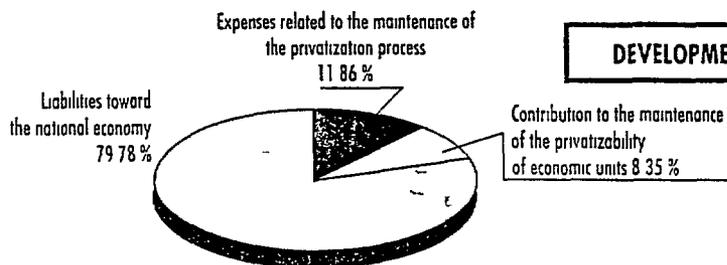
DEVELOPMENT OF REVENUES IN MARCH 1994



Expenditures

(HUF billion)

	March 1994
Expenses related to the maintenance of the privatization process	2 474 (11.86 %)
Sales related costs	1 351 (6.48 %)
Costs of running the SPA	0 581 (2.79 %)
Transferred to local governments	0 088 (0.42 %)
Refunded to business organizations (20 %)	0 288 (1.39 %)
Property management	0 166 (0.79 %)
Contribution to the maintenance of the privatizability of economic units	1 742 (8.35 %)
Reorganization	1 363 (6.53 %)
Of this of investment character	0 719
Guarantee costs (buyer banks)	0 379 (1.81 %)
Liabilities towards the national economy	16 631 (79.78 %)
State debt installment	8 060 (38.75 %)
Withdrawal of compensation vouchers	8 287 (39.75 %)
Compensation vouchers given to local governments	0 284 (1.36 %)
TOTAL	20 847 (100.00 %)



According to preliminary figures, the 169 companies belonging to the State Holding Company (AV Rt) registered profits of HUF 44.2 billion and losses of HUF 10.6 billion in 1993, resulting in a net pre tax profit of HUF 33.8 billion. The figure does not include the profit or loss of banks in the AV Rt's portfolio. The pre tax profit of AV Rt companies was HUF 22.1 billion higher than in 1992.

The AV Rt is obliged by the 1994 Property Policy Guidelines to pay HUF 8 billion in dividends to the state budget this year. The AV Rt paid HUF 28 billion to the state budget from the revenue received from the privatization of Matáv, the Hungarian Telecommunications Company, earlier this year. It must still pay HUF 28.269 billion from privatization revenue to five separate state funds.

In addition, the AV Rt has undertaken to guarantee loans or bond issues totalling HUF 20 billion for the reorganization of 15 of its companies. The AV Rt estimates that it will cost HUF 60 billion to reorganize the companies in its portfolio.

TENDERING REGULATIONS OF THE STATE HOLDING COMPANY

SECTION I GENERAL REGULATIONS

Title 1 The objective and effect of the regulations

(1) The objective of these regulations is pursuant to Act LIII of 1992 on the management and utilization of business property remaining in long term state ownership as well as on the basis of the provision in clause (1) of paragraph 30 of this act and pursuant to Act LIV of 1992 on the sale, utilization and protection of property in temporary state ownership.

1.1 to set the general rules of tendering and ensure the conclusion of well founded contracts serving the most efficient utilization of state property assigned to the State Holding Company (hereinafter AV Rt) as well as to protect the integrity of bidding competitions by guaranteeing equal conditions for bidders.

1.2 to regulate the rules of selecting and tendering consultants (proxies) necessary to fulfill the tasks of the AV Rt efficiently while taking into account economic efficiency and utilizing every advantage of selection through tendering.

1.3 to promote the implementation of the objectives of the AV Rt by concluding well founded and enforceable contracts and by guaranteeing the integrity of the bidding competition.

(2) The effect of these regulations extends to every agreement and contract to be concluded with any natural or legal person, external standing or occasional consultants irrespective of value limit.

2.1 The AV Rt decides on the sale, transfer to management or leasehold of the state property assigned to it, as well as on assignments related to these tasks through tendering/bidding procedure (competitive bidding).

2.2 When defining the conditions of transformation of business organizations assigned to it or even afterwards if necessary, the AV Rt can require a bidding competition for the acquisition of a stake by an external entrepreneur as defined in clause (1) of paragraph 40 of Act LIV of 1992 if it is justified by the size and economic significance of the company or if the AV Rt is aware of several bidders acceptable as partners.

(3) Tendering can be realized by bidding competition or invitation of competitive bidding (competitive bids).

3.1 Regulation under point 2.1 shall not be applicable.

(a) in the event of public bid for the sale of shares pursuant to the law on securities.

(b) when converting credit (receivable) to membership right in business organization.

(c) if the AV Rt previously ensured option for external investor(s).

(d) if the second tender announced by the AV Rt is also unsuccessful in the absence of a suitable bidder.

(e) if the AV Rt transfers the state property to the business organization in the form of non cash contribution.

(f) if the AV Rt utilizes the property in order to acquire other assets or as a means of exchange in order to waive membership right due to a local government in a transformed company.

(g) if the state property is sold by a property manager selected by the AV Rt during a tender and one who promised to pay an amount for the sale of the membership right previously defined in a contract with the AV Rt.

(h) for a contract to be concluded with consultants if it does not extend to an assignment related to capital mediation, portfolio management or search for investment partner.

(i) during the sale of a business part in a limited liability company.

Title 2 Fundamental principles

The principle of the equality of chances

(4) In the invitation to tender the announcer must ensure equal chances for every bidder concerning the provision of making the offer and tender conditions applied during the competitive bidding. The announcer has to define the content of the tender so that the bidders can make appropriate offers and the bids submitted regularly on time are comparable.

The principle of publicity

(5) During the tender procedure the announcer is compelled to ensure full publicity for the participants of the bidding competition.

5.1 The announcer has to ensure the demand for publicity according to these regulations for participants of the exclusive tender and those entitled to bid even if the bidding competition is exclusive or takes place through invitation for competitive bids. The announcer has to publish this fact simultaneously with publication of the tenders (invitations for competitive bids) so as not to jeopardize the exclusive character of the tendering.

5.2 Every bidder has the right to acquire all information made available by the announcer. Under this all data which does not violate business secrets and is common and necessary in business life for a bidder to make a well founded offer has to be made available to the bidder to the fullest extent possible.

Principle of disposal

(6) After publishing the tender invitation or the announcement of the exclusive tender the announcer respects the tender conditions announced and the tender regulations made public in advance. Furthermore the announcer ensures the integrity of the decision making process. These have to be applied even in the event of the invitation for competitive bids.

6.1 The announcer can exercise his right of disposal related to the tender with special regard to the subsequent modification of the tender conditions, the withdrawal of the tender and the modification of the rules of the procedural regulations published only under the framework of legal regulations related to tendering and these tender regulations so that it does not violate the essential rightful interests of persons involved in the tender.

6.2 By submitting an application to the tender or making a bid the bidder acknowledges the rules of the announcement as binding on him.

6.3 Rights ensured by these regulations should be exercised in harmony with their objectives and according to the requirement of good faith.

Title 3 Notions

(7) When applying these procedural regulations the following notions have to be applied according to the following interpretation:

(a) Announcer (inviter for bid) The AV Rt or any other person acting on commission by the AV Rt (e.g. property manager authorized with sales right) as well as a consultant acting in his own capacity during a company initiated simplified privatization procedure and the related business organization in the case of property protection transactions.

(b) Bidder (applicant) Any domestic or foreign natural and legal person, business organization without legal entity or the bidding (competing) community (consortium) of the former. The responsibility of the bidding (competing) community (consortium) is joint and several.

(c) State property The property, property part of the state in business organizations as well as every other right of property value which has value in economic and business life and trade.

(d) Public invitation for bids Invitation for the purchase, subscription, renting (leasehold) of state property (property part) through the publication of a tender announcement carried by the print media or any other means of information for buyers not defined in advance.

(e) Exclusive tender invitation for competitive bids Invitation to purchase (subscribe), manage, rent (leasehold) state property (property part) so that only those invited by the AV Rt can submit tenders.

(f) Pre qualification procedure A two or several round tender in the first round of which the announcer tests especially the ability, expertise, suitability and financial reliability of the bidders. On the basis of the first round the announcer compiles a list according to which actual tendering takes place through an exclusive tender or invitation for competitive bids. No price offer can be requested in the first round of the pre qualification round.

(g) Single round tender A tender during the announcement of which every tender condition is published in the invitation for tender. The content of the winning tender forms part of the contract to be concluded.

(h) Alternative bid A bid which is made during the period open for submitting a tender by a bidder so that in addition to a bid suitable for the tender conditions he also submits another bid deferring from the arrangement or structure of the tender announcement.

(i) Several round tender A tender during the first round of which the announcer selects the participants of the next round from among the bidders making valid bids and invites them to supplement or modify their bids.

(j) Unification of bids If the announcer of the tender or the announcer permits bidders who have made a valid offer in the first round and qualified for participation in the second round can make a joint bid.

(k) Notification (information) Information relevant to the tender must be disclosed to those involved by mail, telefax, telex or telegram.

SECTION II SPECIAL RULES OF INVITATION FOR COMPETITIVE BIDS

(8) There is no tender invitation (announcement, advertisement) in the event of invitation for competitive bids.

TENDERING REGULATIONS

8.1 The fact of the invitation for competitive bids has to be published

8.2 In the case of an invitation for competitive bids, at least three bids have to be invited while ensuring equal conditions. The period open for submitting a tender is a minimum of five days.

8.3 The inviter for bid notifies the bidder on his decision related to the judgment of the bids according to conditions set in the invitation for bid.

8.4 Otherwise, rules related to exclusive tenders should be adequately applied for invitations for bid with differences described in these regulations.

SECTION III ANNOUNCEMENT OF THE TENDER

Title 1 Types of the tender

(9) The tender can be public or exclusive.

9.1 Tenders are public unless the general manager or the deputy general manager entitled for announcing a tender decides in favor of announcing an exclusive tender. During a public tender, the group of eligible bidders can be restricted if justified for special professional interest or competition considerations.

9.2 An exclusive tender can be invited if the character and importance of the state property subject to the tender or the solution of tasks related to its most efficient utilization justifies the participation of previously defined investors or business partners or other competition policy reasons prevail (for example, to avoid hostile buyouts). For the purpose of selecting a consultant, an exclusive tender can be announced even in the absence of the above conditions.

9.3 The mode of the tender has to be disclosed on an announcement (secret knowledge of the data of the bidder, etc.).

The announcement and publication of the tender

(10) The tender is announced by the AV Rt or a person assigned by the AV Rt or the company or business organization.

10.1 The public tender has to be published in at least two national daily newspapers and the city, county or regional daily according to the property to be privatized, 30 days before the first day of the deadline set for the submission of the tenders. The announcer can decide to publish the tender in foreign financial, economic periodical(s) as well.

10.2 The announcer notifies the bidders involved about the exclusive tender simultaneously and directly.

For an exclusive tender, the tender announcement has to be sent to at least three bidders. The fact that an exclusive tender has been invited must be published by the announcer in two national daily newspapers.

If a pre-qualification list exists in connection with the tender, the participants of the tender have to be selected primarily from this list.

In harmony with the Organizational and Operational Regulations and the related decision by the board, the Board of Directors, the general manager and the deputy general manager is entitled to announce the tender. A legal adviser has to provide an opinion from a legal point of view on the announcement of the tender.

The announcer of the tender is entitled to define the tender period.

(11) A tender can be announced for the whole or certain parts (parts) of the state property (property part).

(12) The tender can also be announced in two or more rounds. In this case, bidders selected as a result of the first round can participate in the second or following rounds according to considerations set in advance and published by the announcer. In the second round, only bidding conditions previously disclosed by the announcer can be modified; in other parts, bids made in the first round remain in force.

(13) In the course of the tender procedure, with the exception of those in point 13.1, the announcer must not change the conditions of the tender and the mode of procedure and judgment.

13.1 The announcer can change the conditions disclosed to the bidder(s) as described in clause (13) or rules (regulations) or any of them during the tender only once according to the following:

(a) if he maintained this right in the tender announcement by marking the conditions that can be changed, or

(b) if he extends the deadline for submitting bids.

13.2 Changes according to clause (13) and point 13.1 have to be published according to rules pertaining to the announcement of the tender and the invitation for bids and have to be sent to every party concerned. The fact that the bids submitted previously have been taken into account with respect to the change has to be disclosed in the notification.

The tender can be modified only so that the bidder should have at least 15 days upon modification to submit a tender.

13.3 The deadline open for submitting the tenders can be extended by a maximum of 30 days on one occasion in justified cases. The announcer notifies the bidders of the deadline thus extended similarly to the announcement of the tender at least 15 days before the expiration of the original deadline and in the case of exclusive tender, notifies the participants.

13.4 The announcer must not change the tender announcement 15 days before the expiration of the final deadline.

(14) The tender announcement (advertisement, invitation for bid) shall contain:

(a) the name and location of the organization announcing the tender, furthermore, if the tender was announced on assignment of the AV Rt, a related reference;

(b) the objective and character of the tender (open or exclusive), for a multi-round tender, the number of rounds, furthermore, an indication as to whether the bidder can bid in secret (the name of the bidder is disclosed in a separate, closed envelope) or with signing his bid;

(c) the name of the property, property part (business part share) to be put to property management (leasehold) or on sale as the subject of the tender;

(d) the place, mode and deadline of submitting the tenders.

For a public tender at least 30 days have to be ensured for making the bids at least 15 days for an exclusive tender and five days for an invitation for competitive bids

(e) the duration of the tender obligation

(f) disclosing the place to ask questions concerning the tender and the source of eventual further information

(g) in the case of the availability of a detailed tender announcement or prospectus or information documents the place method time and cost of viewing them

(15) In addition to data included in the tender announcement the detailed tender announcement has to contain

(a) the contents of the tender announcement and its appendices

(b) the procedural regulations

(c) the mode and considerations of the judgment of the bids

(d) the place and time of the announcement of the result (if the judgment of the bids takes place without publicity it should be referred to separately)

(e) when approving alternative bids a related reference

(f) if the bids are approved also in another language than Hungarian a reference to this

(g) any right encumbering the subject of the tender

(h) the obligatory official provisions

(i) the obligation of personal participation in the course of performing the tender

(j) any other data deemed necessary by the announcer

15.1 In the tender invitation the announcer can specify that when submitting the bids the bidder shall enclose a bid guarantee and draft contract or make a statement on the approval of the draft contract sent by the announcer

15.2 The bidders have to submit their bids in five copies one copy of which is duly signed and stamped (original signature in the case of private individuals) the others initialized with a mark referring to the tender by the deadline and at the place of submitting the bid personally or through a proxy in the presence of a public notary who takes minutes on the event. This provision is not valid for the invitation of competitive bids

15.3 If the tender is aimed at the full or partial sale of an economic organization the tender announcement has to carry relevant balance figures

15.4 At the sale of securities corresponding regulations also have to be taken into account

15.5 Prior to the announcement the announcer is entitled to have the value of the property (property share) assessed by an auditor

(16) If the announcer is an enterprise or a business organization the invitation to tender and its appendixes have to be presented to the AV Rt before their publication for counter signature

16.1 A tender issued by an enterprise or business organization can be published only after being countersigned by the AV Rt

(17) If the tender announcement involves a property or activity for which the law provides right to local governments the opinion of the local government involved has to be asked for prior to the publication of the invitation to tender and this fact has to be included in the tender announcement

The provisions of this clause must also be applied for other state organizations (e.g. National Historic Monument Protection Supervision)

(18) If on the basis of property management (sale) contract to be concluded as the result of the tender the announcer wants to convey a part of the yield (dividend share) to the party obliged to render the service upon contractual performance this fact has to be disclosed in the conditions of the tender announcement

(19) In property protection cases if necessary figures related to the desired direction mode and other conditions of the utilization of state property that are necessary for preparing a well founded bid have to be carried in the invitation to tender

(20) If the tender invitation does not rule otherwise the bidder has to keep secret the fact of his participation at the tender or the fact of the withdrawal of his bid as well as the content of his bid until the publication of the result of the tender. This does not extend to facts disclosed to the financing bank

20.1 In the invitation to tender the announcer can grant exemption from under the obligation of confidentiality according to clause (20)

20.2 The announcer handles the content of the bids confidentially until the closing of the tender and does not provide information on their contents either to outsiders or to the participants of the tender. The bidder can exempt the announcer from this obligation but he can prohibit the publication of individual figures even then

20.3 The announcer can disclose the name of a bidder participating at the exclusive tender to the other bidders only if the bidder gave a written approval of publication

20.4 Information can be provided to the bidder in order to clarify tender conditions beyond the provisions of the tender invitation. On site visits can be ensured but only if it does not hurt the equality of chances of the rest of the bidders and provisions related to handling the bids until their judgment. Such information must not result in the modification of the original tender condition(s). If the bidder is provided with information or figures during the information or on site visits which can affect the tendering of rest of the bidders this fact or information has to be disclosed to the rest of the bidders

(21) For projects financed by international financial aid programs (e.g. PHARE USAID) the tender conditions of the announcer have to be taken into account when employing external consultants

Title 3 Tender collateral

(22) Participation in the tender can require providing collateral (e.g. earnest money in the case of a tender with investment purpose) which has to be presented to the announcer simultaneously with submission of the bid or by the date and in the way defined in the tender invitation by the announcer

22.1 The collateral has to be returned in the case of the withdrawal of the invitation to tender the establishment of the invalidity of the bids and after the judgment of the bids with

TENDERING REGULATIONS

the following exceptions. Under the period of deposit the ear- nest money does not bear any interest.

The collateral is not returned if it is transformed into a supplementary liability ensuring the contract concluded fur- thermore if the bidder withdrew his bid during the tender ob- ligation or the conclusion of the contract failed for reasons due to him or for any other reason that emerged in his sphere of interest.

22.2 At the request of the announcer the bidder has to cer- tify the content of his bid. If the bidder does not fulfill his ob- ligation to certification within the deadline ensured for this he loses the collateral.

Title 4 Tender obligation the right of divergence

(23) The tender obligation of the bidder if the invitation to tender does not declare otherwise begins when the dead- line open for submitting the bids expires.

23.1 The bidder has to guarantee his bid until the date de- fined in the tender announcement but for at least 30 days upon the expiration of the submission deadline except if the an- nouncer concludes a contract with a bidder who has won the tender within this period or notifies the bidders in writing that he has declared the tender unsuccessful.

(24) The bidder can modify his bid only

(a) if the tender announcement provides the opportunity and the announcer invites the bidder by setting a deadline to modify his bid.

(b) if as a result of the first round of a several round ten- der he qualified for participation in the second round and can modify his bid submitted in the second round according to lim- its set in point (a).

In any other case divergence from the original bid is null and void.

24.1 In the tender announcement governing the case de- fined in 24 (b) the proportion and mode of the divergence has to be determined and also the parts that can be changed. In the absence of such a provision the bidder can change only the financial part of the bid including the purchase price, pay- ment schedule and collateral. The modification of any other condition of the bid is invalid in such a case the bid is par- tially null and void in relation to the part involved in the modi- fication and it is replaced by the condition of the bid made in the first round.

24.2 Until the expiration of the deadline for submitting the bid the bidder has disposal over his bid according to the con- ditions of these regulations or the announcement.

Title 5 Withdrawal of the bid exclusion from the tender

(25) The announcer can withdraw the tender until the dead- line set for submitting the bids. Rules applied at publication must be applied in case of withdrawal.

25.1 In the event of the withdrawal of the tender if the tender documentation or prospectus was made available for a fee the announcer has to refund the fee in exchange for the documents.

(26) If the bidder or any other person in his sphere of in- terest violated the confidentiality of the tender the bid of the bidder must be excluded.

26.1 Non performance or improper performance of condi- tions disclosed in the tender announcement or documentation (prospectus) furthermore gross violation of the obligation to provide data or any other obligation encumbering the bidder on the basis of the procedural regulations result in the exclu- sion of the bidder from the tender.

26.2 If there is no bidder who fully fulfilled the conditions included in the tender invitation the announcer after closing down the tender may regard the tender as an invitation for competitive bids. In this case the announcer as the one en- titled for judgment can conclude a contract with the bidder making the most favorable bid if the tender corresponds to the minimum requirements of an invitation for competitive bids or may decide to announce a new tender. The most favorable of the bids has to be selected after thoroughly weighing every condition. Thus special attention should be paid to financial, economic and employment policy conditions and requirements to serve the best utilization of the state property (property part) being the subject of the tender. In the case decreed in this para- graph the tender obligation of the bidder involved is main- tained according to these regulations.

(27) The bidder can withdraw his bid at any time before the expiration of the deadline open for submission under the burden of consequences defined in these procedural regula- tions.

(28) The bidder must not demand compensation from the announcer for elaborating his tender and for any other reason in connection with making a bid.

Title 6 The bid

(29) The bid submitted to the tender shall contain the par- tial and legally compulsory statement of the bidder with spe- cial regard to:

(a) the approval of conditions carried in the invitation to tender.

(b) the mode of utilizing the property or performing the service related to the subject of the tender as defined in the invitation to tender.

(c) the amount of the purchase price or fee.

29.1 If the tender prescribes an obligation to provide col- lateral the bid is valid only if the bidder certifies that he pre- sented the amount of collateral disclosed in the tender an- nouncement in the form and way described there to the an- nouncer or a person designated by the announcer certifies the depositing of the amount of the collateral.

(30) The bidder can prohibit the publication of certain fig- ures included in his bid even after the judgment of the tender. The bidder cannot forbid the publication of his name, the fee and the performance deadline.

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SECTION IV
EVALUATION OF THE BIDS, JUDGMENT
OF THE TENDER

Title I
Reception opening and presentation
of the bids

(1) During the arrival of the bids the receiver in the presence of a public notary writes the exact date of receipt onto the sealed envelope containing the bid and simultaneously certifies the receipt of the envelope. The public notary fills out a document on the circumstances of the submission and opening of the bids and after opening he closes the bids.

31.1 The opening of the bids which arrive on time can take place in the presence of the body persons conducting the evaluation in an exclusive circle or in public. (The opening is public if the bidders and his proxies can be present.)

The appointment of the persons (at least three) evaluating the bids is the task of the announcer of the tender.

31.2 When the bids are opened the presence of a public notary is necessary if the opening is exclusive or if it has been prescribed by the invitation to tender or in any other case if the announcer deems it necessary and justified.

31.3 The proxy of the bidder has to certify by a public document or a private document with full proving power his entitlement of representation and its limit. The body conducting the evaluation after hearing those involved decides on the rightfulness of representation without debate.

31.4 The task of the public notary is

(a) to witness the regular progression of opening the bids he makes out a public notary's document on its conformity with regulations containing the following

(b) reviews whether the bids correspond to requirements set by the tender invitation

(c) ensures that the evaluation identification numbers in the minutes are named furthermore the name number and date of publication of daily newspapers in which the tender announcements were published be set down

(d) ensures that protests objections and remarks announced upon the opening or presentation of the tender are set down in the minutes

(32) The public notary is not in the position to make decisions of significance in connection with the tender

(33) In the course of the public opening of the bids the name seat (place of residence) and essential content of the bids has to be presented to those present with the exception of figures the publication of which the bidder prohibited

(34) Upon the opening and presentation of the bids minutes have to be taken containing

(a) the place and date of taking the minutes the names of the persons participating in the evaluation and their capacity at the act the name of the keeper of the minutes

(b) the subject of the tender the date and place of the publication of the invitation to tender the last day of the deadline open for submitting the bids the number of bids submitted furthermore which of the bids arrived on time and which did not the evaluation serial number and number of bids

(c) the short description of the opening and presentation of the bids the contributions and remarks of those present

(d) any other information which the public notary participating in the evaluation deems necessary

In the case of exclusive tender the supplement of the minutes is the minutes of take over ensuring identification

Enclosed with the minutes shall be every bid and document in one copy each. The announcer of the tender has to ensure that the tender documents are deposited in the central archives

34.1 After the opening of the bids the announcer may request information from the bidders so that the evaluation and comparing of the bids can be duly conducted. The questions of the evaluating commission and the answers of the bidder involved shall be set down in writing. This must not result in the essential change of the financial and value related offers formulated in the bid it may serve only their interpretation

34.2 The persons and experts assigned by them participating in the evaluation (judgment) of the bids are obligated to maintain a pledge of confidentiality. Participants in the evaluation (judgment) of the bids can use the information they became aware of in this capacity only for evaluating (judging) of the tender

34.3 In the case of public tender a list shall be compiled of the persons/organizations taking over the information documentation or prospectus and it shall be enclosed to the minutes prepared on the opening of the bids

34.4 The records prepared on the receipt of the bids submitted to the tender and the data (serial number and date of receipt of bids) necessary for identification for the appendix of the minutes

(35) Following the opening of the bids the evaluation commission has to establish which of the bids are invalid. The bidders whose bid is qualified invalid must not participate in the following phase(s) of the tender procedure

35.1 If the bidder according to the establishment of the announcer submitted an invalid bid due to formal reasons not involving the essence of his bid the bidder can supplement the shortages voluntarily or at the request of the announcer within five working days. The validity of the bid is established after the expiration of the period open for supplementing the shortage

(36) The bid is invalid if

(a) it was submitted by a person who is not entitled to submit it or participate at the tender

(b) the bid was submitted after the expiration of the deadline defined in the announcement or its prolongation in a regular manner

(c) the bid does not correspond to the provisions of the tender announcement legal rules or these procedural regulations

(d) in the event of an obligation to provide collateral the bidder failed to present the collateral to the announcer or presented it not according to the provisions

(37) The invalid bid has to be regarded so as if the bidder involved would not have submitted a bid under the given tender procedure. The invalidity of the bid does not involve the validity of the tender

(38) Valid is the bid which corresponds in every respect (in form and content alike) to the provisions of the invitation to tender

THIS IS HOW WE PRIVATIZE

CONFERENCE ON THE CHANGE OF OWNERSHIP

With the participation of the minister in charge of privatization, the heads of the State Property Agency and the State Holding Company, and representatives of larger companies successfully privatized, a conference was held on the four year experience of the change of ownership

THE ACHIEVEMENTS OF PRIVATIZATION

Tamas Szabo minister in charge of privatization stressed in his speech that the privatization of state assets is at the halfway point so continuation is an absolute necessity in order to increase the economy's competitiveness to create new jobs and to provide the capital needed for the economy to function. To day all commercial units have been privatized all companies have been converted into joint stock companies and about half of the companies have private owners. During the past three years the number of private entrepreneurs has more than tripled rising to 800 000 while the number of companies has risen to 170 000 more than a 20 fold increase.

Laws have been made on compensation and on the quantification of co operatives assets. Consequently the compensation vouchers appearing in the economy have entered the Hungarian capital market and through the land privatization 90 percent of the agricultural land can go into the hands of about 500 000 new owners by the end of the year. Enabling foreigners to invest here did not bar local investors from the privatization process. Forty thousand people participated in the Employee Share Ownership Program and more than 10 000 Hungarian small investors used E Credit. Another outstanding result of the privatization process was that last year foreign capital of about USD 7 billion flowed into the country equivalent

to about half of Hungary's net debts. The achievements prove that privatization was not serving political purposes but was primarily carried out on the basis of rational economic interests. That is exactly the reason why the minister considers it a mistake that it is mainly politicians rather than economic experts who criticize the privatization process. While public figures speak about privatization scandals week after week the companies with new owners talk about the good results of the privatization also supported by the profits these companies make.

THE DEVELOPMENT OF THE PRIVATIZATION PROCESS

At the initial spontaneous phase of the privatization process mistakes and abuses of authority did indeed occur. This however is not caused by a lack of expertise since the two holding organizations did not even exist in 1989 and 1990. The collapse of the former markets and the insolvency of our former business partners did not exactly help create a private economy either. Neither competing nor competition had any tradition nor was a model readily at hand which we could have copied at the beginning of the ownership change. This accounts for the fact that most of the criticism regarding the privatization concerns transactions done in this period.

The government completed its privatization strategy at the end of 1991. The necessity of creating new regula-

tions of transferring the right of disposal to the ownership bodies and of taking steps to strengthen the supply and to boost demand were laid down in this study. On the basis of the strategy Parliament created the decrees needed for the operation of the two holding organizations. Following these the officials began to work out the favorable privatization techniques such as the ESOP E Credit leasing and payment in installments whose positive effects began to show at the end of 1993.

TYPICAL CONFLICTS AT PRIVATIZATION DECISIONS

Tibor Pongracz president of the SPA's Board of Directors explained the decision making mechanism of cases presented to the Board of Directors. For Hungarian owners the body did not regard price as the decisive factor which was not entirely the case when it came to evaluating the bids of foreign investors although the amount of revenues achievable was not the only point of consideration in such cases either. Before making a decision the board considered several important factors such as maintenance of the present employment level and the size of equity increase expected. The president of the board stated that most of the decisions had been right although mistakes were made due to the large number of decisions. However the fact that the press criticizes the privatization process virtually incessantly is accounted for by the clash of several in-

terests during the process and the fact that there are losers in every tender. He mentioned the regular arguments with the municipal offices is an example recently concerning the privatization of pharmacies. The president of the Board of Directors maintained that it is not right to give large assets to the municipal offices as they are not any better owners than the state. Therefore Pongracz is baffled by the court ruling which gave the ownership rights of the pharmacies in Bekes County to the local municipal office especially considering the fact that the Parliament had already made a clear decision on the matter in the SPA's favor.

THE STATE AS AN OWNER

In his speech *Lajos Csepi*, CEO of the State Holding Company (AV Rt) argued against entrusting to ministries the management of companies which are to remain in long term state ownership. He believes that the ministries would only be interested in increasing quantity while ignoring efficiency. Moreover because of sociological and authority considerations none of them would dispose of a loss making company. The AV Rt however also performs supervisory tasks apart from those stemming from ownership. Consequently the AV Rt is primarily interested in efficient management and in growing the value of state assets rather than in sheer possession. He mentioned the change in the rights and opportunities of the general managers of the companies owned by the AV Rt. It is no longer the board of directors but the annual meeting who decides about their legal conditions so the state can really use its ownership rights. From now on the salaries of general managers will depend on the profits of their company so the head of a company which owes debts to the state cannot get a pay raise. The bonus system is arranged in a way that only a profitable company can pay under such title. They have abolished the practice of no top limit and stipulated that a maximum of 50 percent bonus can be released. Even this is attached to the condition that the company is making a profit and takes actions towards privatization.

Csepi also analyzed the AV Rt's business result. The companies belong

ing to their portfolio made a total profit of HUF 23 billion in 1999. The AV Rt is not satisfied with this result however the profit was not a reward of a dynamic development but an effect of covering the companies' debts. And this is not enough as they failed to fuel the Hungarian economy, the CEO concluded.

There is no known formula for the Eastern Europe in transformation said *Horst Fohr*, PR manager of the German Treuhandanstalt in a lecture entitled *Solution to Hungarian Privatization from a German Perspective*. Hungary should not count on external help, he said. Hungary has to solve its problems alone just like the Germans did. He stressed that the transformation cannot happen from one day to the next saying: "Those who believe that in one or two years we will reach Canaan will be disappointed." In spite of this he recommended completing the change of ownership as fast as possible. Hastiness of course has consequences. In Germany the costs of the transformation process are a lot higher than the revenues generated by the privatization. One reason for this is that modernization and retaining the production capacity (and as such keeping the jobs) were the prime goals. Even so they could not avoid liquidating over 3000 companies.

FIRSTHAND EXPERIENCE

Istvan Bruckner, general manager of Centrum Aruhazak Rt spoke in the name of a happy, successful and content community. He explained and praised the opportunities an ESOP or organization has in the name of Europe's largest such organization. He compared the four year process of transformation to a play with a happy ending where the audience does not know whether it will turn out to be a tragedy or a comedy. It all turned out well in the end and they look to the future with confidence since they have remained profitable during the past four years. They prepared themselves for the privatization. Getting the capital was not really a problem either. Besides using the usual E Credit construction they managed to get a HUF 5 billion loan indispensable for further developments. It should also be noted that more than 6000 employees participated in the buy out by investing more than HUF 60 million.

Bruckner spoke of the possible difficulties of the future as well. He hopes that the antagonism inherent between employee and owner can be dissolved. The steady reconciliation of interests will not be easy either as a consortium of eight to 10 members also holds a strike in the company apart from the ESOP organization.

Tobacco growers however did not want this kind of privatization. *Andras Semsey*, president of the Association of Tobacco Growers stressed that only serious capital investors were considered. No one else could have provided long term production security. Therefore they lobbied strongly for the United Lea Tobacco when the privatization of Nyirdofer occurred. Now it seems that besides of the technological change the 10 000 tobacco growers in Nyirseg can keep their jobs. They received credit and support.

Cerbona Rt chose a rather complicated privatization method. A limited company formed by the management, the ESOP organization, some of the growers and some private investors as well were all part of the consortium which was created for the privatization. *Tibor Csodo* maintained that the enterprise was viable in its present form. However trust and knowing one another are of utmost importance in this company structure.

Of the foreign investors the most attention was paid to the speech of the of MagvarCom representative. MagvarCom played a major role in the privatization of MATAV Rt. *Paul B Gross*, an official of the German American consortium pointed out that competition was extremely fierce. On top of that the money at stake was USD 875 million. He found it important to stress that in the management of the company the AV Rt and the MagvarCom are involved to an equal degree. He said that buying MATAV was important to them because they look further planning to establish a network covering the whole region. Finally he added: "We shall spend about USD 4 billion on development in your country by the year 2000."

Szabo spoke in favor of diversity in privatization in his concluding words. He placed special emphasis on the importance of foreign investors and finally stated: "the private economy has taken control in Hungary."

250 and has registered capital of USD 210 million operates 80 shops and shopping centers with an annual turnover exceeding USD 300 million

The tender invitation allowed payment in cash or E Credit as well as compensation vouchers. Rules of law and the SPA's tender rules regulate payment with compensation vouchers of foreigners and Hungarian companies with foreign interest. The terms of payment and terms of reference are stipulated by the Law on Associations, the Foreign Exchange Regulations and the Law on Compensation. Foreigners can only pay with compensation vouchers if they have a per-

mit from the foreign exchange authorities or if they are holders of compensation vouchers in their own right. But if a foreigner establishes a firm in Hungary or if he is owner of an association in Hungary, then he is regarded as a resident and as such he receives the same treatment as any other domestic investor.

In the process of the privatization of Budapesti Kozert Rt, both the Austrian Huma and the Israeli Super Sol set up limited companies whose registration was underway during the tender procedure. Under Hungarian laws, firms which have submitted their registration application but have not yet been

registered can conclude contracts since the date on which the application is submitted to the Registry Court is regarded as the date of registration. Since the Hungarian Registry Courts are overburdened and the wait to get registered is long, it was logical to apply this practice. Thus the tenders for the privatization of Budapest Kozert Rt submitted by the limited companies with foreign stake whose registration was underway was quite legal and they are entitled to pay in compensation vouchers. The bidders have agreed to buy the compensation vouchers at the Budapest Stock Exchange.

magos

EUROPE'S LARGEST ESOP ORGANIZATION

Department store chain Centrum Rt has registered capital of HUF 5 billion and shareholders' equity of HUF 8.7 billion. The company has a chain of 26 stores, whose turnover totalled 300 million in 1993. Turnover is expected to amount to HUF 19.5 billion this year, with pre-tax profit of HUF 450 million. Centrum's ESOP organization and a limited company set up by the management purchased a 51.5 percent stake at face value. The consortium established by the two groups paid HUF 420 million in cash, HUF 754 million with compensation vouchers, and HUF 1.374 billion using E Credit.

GENTRUM IN EMPLOYEE OWNERSHIP

With the signing of the privatization contract after four years of wrangling, the case of the Centrum Aruhazak Rt (Centrum Stores Rt) has come to an end. The SPA sold 51 percent of the Centrum shares to the ESOP organization and to the consortium established by the management called Strategia Kft (Strategy Kft).

The assets of the Centrum are HUF 8.7 billion and its capital stock is HUF 5 billion. Twenty-six percent of the assets of the chain store was acquired by the 3500 member strong ESOP organization and 25 percent was acquired by the Strategia Kft. Local governments hold a 13.5 percent stake in the Rt, which employs 4000 people and has 26 stores. The SPA will sell a further 10 percent stake to the employees on favorable conditions and will keep 25 percent. These data show that the employees and the majority owners of the chain store are the same. Thus one of Europe's largest ESOP organizations was created at the Centrum.

Employees can buy the 51 percent block of shares at face value. Of this they will pay HUF 420 million in cash, HUF 754 million

in compensation vouchers and HUF 1.374 billion with E Credit.

Out of the 25 percent stake bought by the management, they will keep only two percent; the remaining 23 percent will be handed over to producers and consortium partners. The chain store can immediately receive a capital injection since under the privatization contract the associations forming the consortium were only able to buy shares at face value on the condition that they undertook capital increases in the range of HUF 40-250 million, totalling HUF 900 million in two years' time.

Among the members of the consortium is the investors' group of Andrew Sarlos, the Hungarian born Canadian businessman. This group has agreed to perform a capital increase of HUF 1 billion within a year and they have also bought the block of shares worth HUF 250 million of Gellert Co, which because of changes in conditions withdrew.

The Gellert Co was an interesting player in the transaction. From the block of shares worth HUF 250 million it wanted to

buy - under a background agreement concluded with Centrum, which the parties are otherwise entitled to prior to the decision of the board - it would have resold a block of shares worth HUF 150 million with considerable profit to the MBO or, if the management proved insolvent, the company should have paid for the shares regained this way.

But the background agreement got around prior to the conclusion of the privatization contract. Therefore the SPA decided that it would postpone the conclusion of the contract in order to thoroughly examine the conditions of the background agreement. But the withdrawal of the Gellert Co cleared the last obstacle in the way of privatization.

With this form of privatization the parties involved think that the future of the chain store, which has operated profitably so far, is guaranteed. Three new units have been added to the Centrum in recent years and half of the stores have been renovated.

(kovacs)

MataV the Hungarian Telecommunications Company had an after tax profit of HUF 1.6 billion on a turnover of HUF 67.5 billion in 1993. HUF 400 million of the after tax profit was spent on payment obligations to be covered from the after tax profit. The remaining HUF 1.2 billion was set aside as dividend fund. In line with the privatization deal, HUF 500 million in dividends was paid to the State Holding Company (AV Rt.) MagyarCom Consortium (Deutsche Bundespost Telecom – Amertech) which holds a 30.2 percent stake, EBRD with a stake of 1.98 percent and IFC (0.98 percent) transferred their dividends into the profit reserve together with the HUF 300.88 million contribution to the reserves from the AV Rt. which holds a 66.74 percent stake in MataV. MataV Rt. has registered capital of HUF 104.228 billion and its profit and capital reserves previously stood at HUF 77 billion. MataV Rt. plans to establish 250,000 new telephone lines (including 75,600 in Budapest) this year, which represents an increase of 19.3 percent. MataV plans to spend a total of HUF 34 billion on regions covered by its national concession and HUF 9 billion on areas which it gained through local tenders while HUF 21.5 billion will be spent on additional investment. Twenty nine of Hungary's 54 regions are included in its national concession while 10 further primary areas were awarded to MataV following 25 local concession tenders. MataV Rt. has installed some 500,000 new lines since 1990 bringing the total number of phone lines in Hungary up to around 1.5 million.

MATAV EMPLOYEES AS OWNERS

A long held wish of the employees of the Hungarian Telecommunications Company, MataV Rt., came true when the AV Rt. decided at the beginning of May to sell shares to the company's employees. The employees of the country's largest telecommunications company will be able to purchase shares at a 50 percent price reduction.

The AV Rt. offered 278,833 of its MataV shares to a face value of HUF 10,000 each which represents 2.7 percent of the total stock of MataV shares, said *Jozsef Baranyai*, head of MataV's Human Resources Development Department. The purchase price which was set down by the AV Rt. was the same as MagyarCom paid during the privatization of the company that is 236.1 percent of the face value. Of this the AV Rt. gives a 50 percent discount and also grants further preferences for the remaining part. Employees will have to pay 10 percent of the reduced purchase price in cash or with compensation vouchers and the rest in installments over three years with interest the same as that of an E Credit.

The average number of shares an employee is expected to purchase is 10 and no plans have yet been approved for a possible oversubscription. The maximum number of shares an employee will be allowed to purchase will be specified under the allocation regulations of the asset management organizations. Since not only the employees but other groups as well are interested in MataV shares, these groups' possible pre-emption rights may limit the number of shares employees will be able to purchase. The AV Rt. has approved regulations for employees selling their stake in the company to a third person.

These regulations stipulate that MataV has the right to repurchase this stake within five years. If an employee leaves the company within three years of the subscription of the shares, the shares will have to be offered to the company at the purchase price the employee paid for them. The AV Rt. considers the rights for repurchase and pre-emption important because it wants to avoid creating a profit incentive for employees to purchase shares. The AV Rt. wants the employees to purchase company shares to strengthen their ties to the company. The subscription period is expected to begin in September after all the details of the subscription are cleared up.

Employee ownership is not new at MataV since it was already included in the reorganization plan. Employees have also been interested in the share purchase and their interest has grown stronger after the enactment of the Employee Share Ownership Program (ESOP), the Property Policy Guidelines and the launch of the Preferential Share purchase Program (PSP). The employees' interest representation organizations put pressure on the company when the privatization process approached the end. (MataV employees are represented by one large and several smaller trade unions.) Magyar Takozlesi Szakszervezet (Hungarian Telecommunications Trade Union) to which most employees belong and the Central Workplace Council unanimously wanted the employee share offer before the privatization. Their survey of the company's employees proved a keen interest and intention to purchase shares. However, the AV Rt. refused the proposal saying the shares would have a real

price and value only after the privatization.

MataV's management has always agreed with the employees' organizations on the importance of the employees' ownership. Smaller disputes occurred only on the specific date for it and the amount of shares to be offered for the employees. The management considered employee ownership important because it is a method proven in worldwide practice. Employees' behavior and attitude toward work are strongly influenced by being able to receive dividends and to influence price rates. For example, they understand the management's view extremely well in crisis situations hence they are willing to make temporary sacrifices. In addition, they closely monitor the company's activities and business performance. At MataV the employees are fully aware of the new opportunities which have opened up as a result of the privatization and the equity raise; they know the company's management well and trust their skills. In view of all this, they consider the share purchase a profitable investment since they all count on the increase of the share prices.

The promotion of MataV's ESOP program is in harmony with the programs – compensation, PSP, ESOP, E Credit and so on – which have been designed to promote share purchases of many people in the past few years. These programs are regulated by the Property Policy Guidelines and MataV's ESOP program is carried out according to the AV Rt.'s concept. In the future, MataV wants to offer more shares to the employees every time the equity is raised, but the conditions will not always be so preferential.

T. L.

RESULTS OF PRIVATIZATION

1990-1994

OBJECTIVES AND RESULTS OF PRIVATIZATION

Objectives of and expectations from Hungarian privatization

Privatization is a process of social adaptation involving the privatization of the business property of the state (valued at more than HUF 2 billion) the transfer of local government property (valued at HUF 2 trillion) the registration of cooperative property (valued at HUF 200 billion and involving 1.2 million persons) and compensation (valued at HUF 220 billion and involving 1.3 million persons)

The primary objective of Hungarian privatization has been the establishment of an efficient market economy controlled by owners and competitive internationally contributing to the modernization of companies by additional drawing in of capital and to the restoration of the economic equilibrium through privatization proceeds Privatization at the same time fuels economic restructuring and helps ensure the country's integration into the world economy In addition an important objective is to maintain jobs None of the political forces questioned the strategic objectives of economic transformation and privatization

At the same time the implementation of these objectives faced difficult international and domestic conditions

The initial objectives of privatization and expectations had to be confronted with the conditions of the economic transformation process First among them is the Hungarian state debt which in comparison with GDP is the fifth largest in Europe Major problems include the increase of the budget deficit inflation bankruptcies and liquidations involving a great proportion of the corporate sphere In the wake of the collapse of the former Comecon markets and the shrinkage of the internal market sales opportunities decreased causing the profitability of companies to decrease substantially in the years after 1990

Phases of the privatization process

In Hungary the first phase was the period of spontaneous privatization between 1987 and 1990 The spontaneous process was made possible by the corporate and transformation laws The process of the transformation of enterprises appeared as rearrangement into corporate forms as the first step of privatization at a time when state ownership still dominated The extent of privatization was smaller then but the inflow of foreign capital however slowly began At the same time society has been irritated by the phenomenon of those in power maintaining their positions through spontaneous privatization

The second phase of privatization set in motion with the establishment of the State Property Agency (SPA) resulted in the strengthening of the state control of the privatization process and the launching of centrally planned programs A preliminary privatization process started which assisted in the massive establishment of small ventures by sales through bidding As a result more than 10 000 new

ventures were established primarily in the sphere of services In addition the centrally initiated first and second privatization programs were launched the first was the privatization of 20 selected big companies with the assistance of foreign consultants and the second was the privatization of the corporate property management centers Also the privatization of building enterprises valuable office buildings old chateaus and historic wine districts was organized into a program Centrally initiated privatization programs failed to meet expectations no massive sales took place At the same time investor initiated privatization started quickly primarily thanks to the sizable investments of foreigners

The third phase of privatization began in August 1992 At this point the new privatization regulations took effect on the sale utilization and protection of property in temporary state ownership and on the management and utilization of business property in permanent state ownership

The new regulations provided for the transformation of every Hungarian state enterprise into a business organization listing those which will remain in state ownership (in 100 or 50 percent or to a smaller extent) The ownership rights over these are exercised by the State Holding Company (AV Rt) The remaining (much larger) part of state enterprises however need to be fully privatized which is the task of the SPA The method of selecting the buyer or the property manager is the invitation of tenders and competitive bids

Actually the financial set of institutions that operates privatization and assists in solving structural problems is evolving in the third phase By then the mass of compensation vouchers in circulation suitable for privatization will represent a substantial value and the Existence Credit granted will reach tens of billions of forints The Loan Guarantee Rt is established along with development companies risk capital companies and the institute of loan consolidation

CHARACTERISTICS OF THE PRIVATIZATION PROCESS

General features

Right from the beginning privatization has been caught in the middle of conflicting interests between employees and investors and competing investment groups of different strategies However Hungarian privatization was relatively successful in balancing conflicting interests and often contradicting privatization considerations and needs This is due to the flexible and pragmatic practice of privatization which distinguishes Hungarian privatization from the centralized and less diverse methods of other countries

Hungarian privatization practice implements a market type privatization The most important privatization objective is to create efficient owners control with genuine owners In the course of tendering in addition to price offers the professional abilities of the investor are also taken into account The principle of competition is to ensure the equality of chances and the openness of the privatization process

The main feature of Hungarian privatization is its diversity. No privatization technique predominates: the transformation of ownership is underway in several channels simultaneously. The majority of the buyers of state property are trade investors. Until the end of 1992 the ratio of foreign capital in the acquisition of property was very high (70 to 80 percent). But as of 1993, primarily as an effect of preferential techniques, the participation of Hungarian investors has become dominant.

Privatization techniques and methods

The Existence (E) Credit

The E Credit has been available to Hungarian investors since 1991. The amount of state property purchased with this credit has increased every year. The utilization of the E Credit got new impetus at the beginning of 1993 when the government introduced easier terms: the base interest rate was decreased to three percent, onto which creditor banks were allowed to charge a maximum four percent interest differential. By the establishment of the Loan Guarantee Rt, it became possible for beneficiaries, provided they did not have adequate funds, to ask the Rt to act as paying guarantor.

After the modifications, the own fund expiration period and grace period changed as follows:

Total amount of loan and installments	Own fund	Expiration period	Grace period
Up to HUF 5 million	2 percent	15 years	3 years
Above HUF 5 million	15 percent	15 years	3 years

Supplementing their own funds with E Credit, many Hungarian citizens have become the main participants of innumerable successful privatization transactions. The ratio of privatization purchase transactions settled by E Credits rose to 21 percent in 1993. The growth was enabled primarily by the easier terms for drawing loans. The total amount of E Credit drawn by the beginning of 1994 reached HUF 32 billion.

ESOP

The Employee Share Ownership Program is an important instrument of preferential property acquisition, in many cases saving jobs from liquidation. Also, through the ownership conscience of employees, it can promote more efficient economizing. The spectacular upswing of sales through ESOP was an ample response to those who doubted this form of share acquisition by employees. While employee share ownership took place in seven cases in 1992, the number of ESOP sales reached 126 by the end of 1993, with a total value of over HUF 23 billion. Under the ESOP program, 45,000 persons acquired property by the end of 1993.

One guarantee of the stability of ESOP companies might be that, contrary to often heard criticisms, a large number of the sales took place not against the managers' will but with their active participation or even at their initiative.

In many cases, an ESOP offer is accepted because external investors would offer only a lower price and its approval would probably result in the appearance of owners short of sufficient capital. Even in such cases, ESOP enables privatization after which the company's management (in many cases becoming part owners) can concentrate on stabilizing the company. In a number of cases, they acquire property together with external investors who contribute to the acquisition of funds necessary for later development. Repayment of ESOP loans is due in three years, that is, from 1996-97. By then, the stabilization of the market positions (evident since 1993) will

hopefully allow the accumulation of revenues, and thus repayment will not be impeded.

PSP

This program is meant to accelerate the privatization of state property. Through the Preferential Share purchase Program (PSP), several hundred thousand new owners will appear on the market who will be able to subscribe the shares of 70 well-known Hungarian companies at a value of HUF 120 billion. As of the launching of the first phase of the program in April 1994, tens of thousands of citizens are able to subscribe share property in profitable companies, mostly in the commercial hotel industries. Companies put in the PSP program were those in which the property is owned at 51 percent by trade investors. This might be an adequate guarantee for the profitability of the companies and their future stability. Therefore, in addition to the concern of small shareholders for a dividend, there is also interest from trade investors concerned about the sufficient development of the company. The successful cooperation of small investors and trade partners is well illustrated by the cases of Danubius and Pick.

The following companies are to be involved in the initial phase of PSP:

- In 1991, the **Sopron Brewery** went to the 51 percent ownership of Brau Union AG, the largest Austrian brewery company. The Austrian partner raised the originally HUF 1 billion equity by HUF 500 million, thus the previous 40 percent share of the SPA decreased to 28 percent. In spite of the 15 percent decline of domestic beer consumption last year, the Sopron Brewery's sales fell by only five percent, climbing from fifth to third place in the business on the domestic market. With HUF 2.7 billion in sales revenues, the company produced a HUF 500 million profit.

- The equity of **Pannonia Hotels** is HUF 6.7 billion, on which the Accor hotel holding of France shares 51 percent. Also, the London-based EBRD holds a few percent share package. Originally, the introduction of the company on the stock exchange was planned later, but even so, there is no obstacle to the public share issue taking place in autumn 1994. The SPA shares HUF 1.4 billion of the equity, one third of which will be put in the PSP program.

- **Pannonplast Rt.**, mostly known for its Curver brand household articles, was organized into a holding of more than a dozen limited liability companies last year. Fifty-one percent of the ownership proportion of the holding center was taken over by a foreign financial investment group in 1993. In the individual companies, several Japanese, Austrian, Korean, and British plastic industry companies have shares. The turnover of Pannonplast, producing primarily for the domestic market, fluctuated around HUF 4.5 billion in the past years and produced HUF 500 million in profit. At the general meeting in March 1994, the raise of the equity was decided. By this, the SPA's share, which can go to the ownership of citizens under the PSP, declined to 10 percent.

- The public share issue of **Global TH Rt.** will be implemented despite technical difficulties which have since emerged. Results of the company, which has had a HUF 1.2 billion equity since mid-1991, demonstrate the solidity of the business. The turnover of the company, which has 44 department stores, was HUF 2.2 billion in 1992 and HUF 2.7 billion in 1993. Its pre-tax result was HUF 1.0 million for each of those years. It was decided at the latest general meeting that Tesco, the largest British supermarket chain, will acquire a share by a total of HUF 2.6 billion raise of the equity in Global TH. Thus, the SPA's share in Global declined to 14 percent.

Compensation

Compensation, the legal remedy for offenses committed against property and people, strengthened the principle of a market economy based on private ownership and the inviolability of property based

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PRIVATIZATION

on legal guarantees. The 13 million citizens entitled for compensation vouchers at a nominal value of HUF 240 billion beyond partial financial compensation were able to become active participants in privatization. The introduction of compensation vouchers in the stock exchange was a major step which, in addition to stabilizing the rate of the compensation vouchers, acquainted those compensated with the operation of the capital market and helped expand participation in privatization. The wide ranging utilization of compensation vouchers in privatization at the same time enables the participation of domestic investors in privatization amid preferential conditions. Also from an instrument expanding privatization demand, compensation increasingly grew into an institution encouraging the acceleration of privatization.

Fundamentally, the balance of the compensation market is determined by the volume and time span of the issue and final utilization of the vouchers. Therefore, the presentation of an adequate privatization supply is especially important.

As of the end of 1993, HUF 90 billion worth of compensation vouchers of the total HUF 230 billion due were put into circulation and HUF 20 billion nominal value worth of compensation vouchers have been utilized up to the beginning of 1994. The government is continuously expanding the opportunities for utilizing compensation vouchers in privatization and increasingly relies on compensation voucher/share swap deals in which those originally compensated can directly participate and enjoy a clear advantage.

Criticisms that compensation would trigger a return of inflation have not proven correct. In fact, compensation regroups a part of privatization proceeds for those compensated. At the sale of state property through tenders, it represents preferences accelerating privatization which, however, does not necessarily result in loss of revenues, as the purchase price is primarily determined by the development of privatization demand and supply. From the sale of compensation vouchers, almost as much cash is flowing in consumption as the buyers of compensation vouchers spend on it from their own saving.

The achievement of compensation is that, in contrast with other Eastern Central European countries, Hungary was able to avoid unclarified ownership situations stemming from returning property in kind which would have substantially slowed down the transformation of ownership.

Preliminary privatization

As of January 1994, a total of 9259 shops were privatized in the course of preliminary privatization, which is close to 90 percent of the shops originally drawn in the program. During the sales, HUF 16 billion in privatization revenues were collected (at a 149.2 percent rate). Sales prices reached 145 percent of the bidding price. Units privatized this way make up more than 10 percent of the full shop network of retail trade in 1993. (Compared to the shop network of 1991, this value is close to 15 percent.)

Shop by shop sale in trade, catering and consumer services is almost complete. In 1993, another 1400 shops were sold.

Self privatization

The SPA announced the self privatization program in two phases aptly called the privatization of privatization. It involves a group of consultants managing privatization, including the sale itself, in the name of the SPA. By this, the SPA greatly increased its capacity for privatization, although privatization was not essentially faster than when the SPA conducted the sales itself. Up to October 1993, HUF 1.3 billion was collected from the sale of 245 companies. Businesses of major importance were the main participants in the First Privatization Program, and employees' participation was also consider-

able (sale of 211 companies with HUF 7 billion in revenues, HUF 1 billion came from employees, HUF 3.4 billion from domestic and HUF 0.5 billion from foreign investors). However, in the Second Privatization Program, consisting of medium size companies, the weight of external domestic investors was the greatest (the sale of 14 companies totalling HUF 6 billion, of which HUF 3.4 billion came from domestic investors, HUF 1.5 billion from employees and HUF 1.1 billion from foreigners).

Privatization at the stock exchange

Introduction at the stock exchange sets strict requirements on companies to be put on the stock exchange, which only a few can meet in the unfavorable economic environment. Therefore, not many companies are privatized this way. However, appearance at the stock exchange, moving a wide spectrum of investors, contributes to the success of privatization as a whole.

Therefore, primarily big, well known and successful companies were put on the stock exchange. In the summer of 1990, Ibusz became the first major security on an Eastern European stock exchange. At the end of 1992, the SPA successfully sold the shares of Pick (involving 15000 small investors) and Danubius, with substantial preferences to small investors. Another successful issue of shares, that of Zwack Rt, took place after privatization. By the introduction of the compensation voucher at the stock exchange, turnover at the stock exchange greatly increased and the market of compensation voucher trades also stabilized. The success of the compensation voucher/share trades are expected to be founded by stock exchange introduction. Good examples of this include the success of the Primagaz, Globus and Domus exchange actions in December 1993.

Foreign capital

Foreign capital is indispensable in restructuring the economy. In many cases, drawing in the necessary capital for modernization can be expected only from foreign capital. Public privatization on a market base and the fact that a major proportion of the Hungarian economy is operating in a competitive environment limits for foreign capital to acquiring markets, as it can maintain the positions it acquires only through further capital investments and modernization.

After the initial dominance of the commercial and service sphere, major foreign investments were also effected in the production sphere. In summary, some 40 percent of the USD 7 billion worth of foreign capital investment in Hungary up to the end of 1993 came through privatization. The joint ventures operating with the participation of the USD 7 billion foreign capital provide almost one quarter of the Hungarian added value.

The major capital investments amid the chronic domestic shortage of capital have so far been due fundamentally to foreign capital. The liquidity of the companies involved, and sometimes the tools for survival, improved substantially. In many cases, privatization was also accompanied by technological and organizational modernization.

Privatization of companies in permanent state ownership

The establishment of the State Holding Company (AV Rt) in August 1992 was a turning point in the privatization process in Hungary. One hundred sixty companies of every sphere of the economy, which are of nationally strategic importance, are in the portfolio of the AV Rt. Pursuant to the law, the ratio of permanent state ownership is 25 percent plus one, in a few cases 75 percent plus one vote or 100 percent. The privatization of MATAV, the Hungarian Telecom, indicates the launching of the process. It is outstanding for two rea-

sons, the price paid for one line was USD 2700 in the case of MATAV (by international comparison, the next highest price achieved per line was USD 1800 in New Zealand) and the investment will result in connecting up 8 900 000 new telephone lines in three to four years. By announcing local concessions, MATAV, in contrast with its previous national monopoly, will encourage competition to bring about high standard and acceptable services. In 1993, HUF 100 billion worth of property was sold at the AV Rt, most of which was represented by the sale of 10 percent of MATAV. One of the main objectives of the AV Rt is to sell 70 percent of the property it manages by the end of 1996.

BALANCE OF HUNGARIAN PRIVATIZATION

Facts and figures

Total privatization revenues of the SPA and the AV Rt together reached HUF 280 billion by the end of 1993 and HUF 310 billion by the beginning of 1994.

In addition to sales, HUF 120 billion worth of property was alienated during property protection transactions, and another HUF 60 6 billion worth of state property went to companies in mixed ownership as property in kind. Thus HUF 300 billion worth of state property was privatized in the three and a half years of the privatization process.

If the state property before privatization, estimated at HUF 1 8 trillion, is reduced by the value of property involved in liquidation, then 50-60 percent of the net state total property, estimated by experts at HUF 1 2 trillion, has been privatized.

Privatization at the SPA involves a HUF 400 billion property value. This exceeds the book value (HUF 399 billion) of its remaining property. Taking into account that the present SPA property is worth only HUF 260 billion at the average 65 percent sales rate valid at the end of 1993, the estimated privatization ratio is close to the two-thirds level at the SPA, which is a noteworthy result even by international comparison. The public offer of the property that remained in the portfolio of the SPA will be fully offered for public sale up to mid 1994. The activity of the SPA enjoys increasing publicity: 97 percent of the tenders are open, and wide-ranging information is available on the companies put on sale. In the past three and a half years, sales ratio was 90 percent at the SPA (in 1991 and 1992, this ratio was 110-130 percent due to the sale of companies with better profitability, however, it declined to 65 percent by the end of 1993).

Because of the rise of preferential techniques, the proportion of privatization revenues from Hungarian investors has been rapidly increasing since 1992. While revenues collected from domestic investors reached 22 percent of annual proceeds in 1991, this ratio increased to 47 percent in 1992 and 67 percent in 1993 to 84 percent by January 1994. The less substantial increase of front cash revenues indicates the dominance of preferential techniques. It is worth noting that in addition to the quick expansion of loan arrangements in 1992 and 1993, revenues realized in compensation vouchers have had an increasingly powerful role since 1993.

Of the HUF 1 3 trillion worth of state property assigned to the AV Rt, the proportion remaining in permanent state ownership is HUF 600 billion. This is represented primarily by public service companies which used to be in state ownership even in the advanced market economies. Of the HUF 700 billion worth of property to be privatized, the sale of HUF 100 billion worth of property was completed and the remaining HUF 600 billion worth of property will be offered for sale soon.

Strengthening private sector

According to statistics, the ratio of the private sector in 1990 dominated at 72 percent within the total national economic added value.

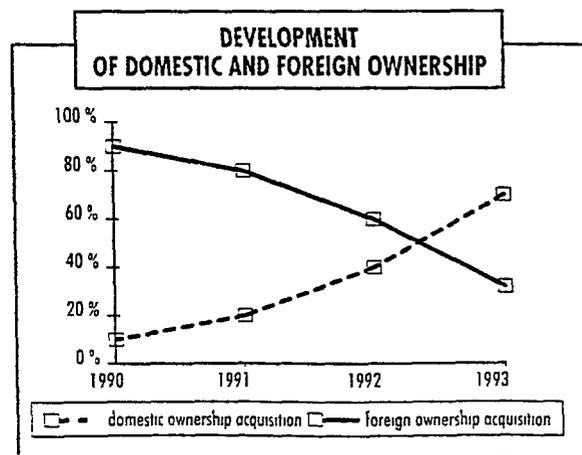
In the competitive sector, the ratio of ventures formerly in predominantly state ownership decreased to 27-30 percent within employment. By the end of 1993, the weight of the private sector reached 70-75 percent. Within added value, the ratio of private sector is lower but at least 60 percent. (Of the 750 000 employees of the state-owned business organizations, the number of employees of companies under the SPA's portfolio was 292 000 in 1993 and 284 000 at companies assigned to the AV Rt.) Privatization stabilized employment for 400 000 persons. (The number of employees in companies privatized up to 30 percent is 270 000, and the number of jobs stabilized in course of preliminary privatization sales aimed at property protection and in kind property is 275 000.) These 400 000 employees make up 17-19 percent of the employees at ventures with legal entity of the competitive sector. (Taking into account individual ventures, the ratio of labor force stabilized in the competitive sector by way of privatization is 13-14 percent.) Ventures involved in privatization provide one quarter of the added value of ventures with legal entity in the competitive sector.

In the process of privatization, the corporate property sales approved by the SPA, the utilization of SPA proceeds for reorganization and guarantees provided a total of HUF 150 billion worth of reorganization fund for the companies involved.

The number of persons who acquired employee property is 150 200 000. This figure is based on an estimate according to which employee property was distributed among the employees of three quarters of the companies sold, and of this every employee received property. Under the Employee Share Ownership Program, 45 000 persons acquired property.

The most controversial issue, the effect of privatization on an employment, concerns companies in a difficult financial situation in most cases, without privatization even more employees would have to be dismissed. According to employment figures, although staff reduction is substantial at privatized companies, privatization increased the security of employment. Staff reduction at privatized companies was of a smaller extent than the average reduction of industrial employees.

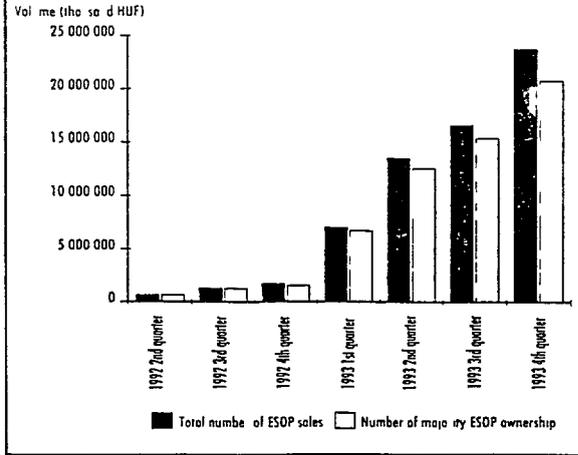
In one year (1991/1992), the reduction of employees was 22 percent on average at state-owned economic organizations assigned to the SPA (50 percent at enterprises and 12 percent at business organizations), while it was an average five percent annually during three years at privatized companies (a total of 15 percent during three years).



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PRIVATIZATION

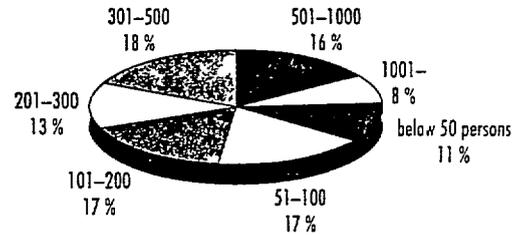
DEVELOPMENT OF THE VOLUME OF ESOP SALES AT COMPANIES MANAGED BY THE SPA



Number of employees	Number of companies
0-50	13
51-100	20
101-200	22
201-300	15
301-500	21
501-1000	19
1001-	10

Year	Total ESOP (HUF thousand)	Majority ESOP (HUF thousand)
2nd quarter 1992	655 856	655 856
3rd quarter 1992	1 290 046	1 270 946
4th quarter 1992	1 744 206	1 566 346
1st quarter 1993	7 103 098	6 811 868
2nd quarter 1993	13 566 471	12 655 981
3rd quarter 1993	16 580 948	15 352 908
4th quarter 1993	23 776 121	20 776 891

ESOP COMPANIES ACCORDING TO THE NUMBER OF EMPLOYEES



CHANGE OF THE SIZE OF BUSINESS ORGANIZATIONS WITH LEGAL ENTITY BASED ON THE NUMBER OF EMPLOYEES (CENTRAL STATISTICAL OFFICE, PKI) (percent)

Categories	1989	1990	1991	1992	1993
Under 11 persons	-	-	-	-	40.4
Under 20 persons	37.6	59.5	62.5	76.0	35.8
21-50 persons	17.6	14.9	12.2	11.0	12.4
>1-300 persons	25.5	16.2	10.65	9.6	8.9
Above 300 persons	19.3	9.4	4.7	3.4	2.5

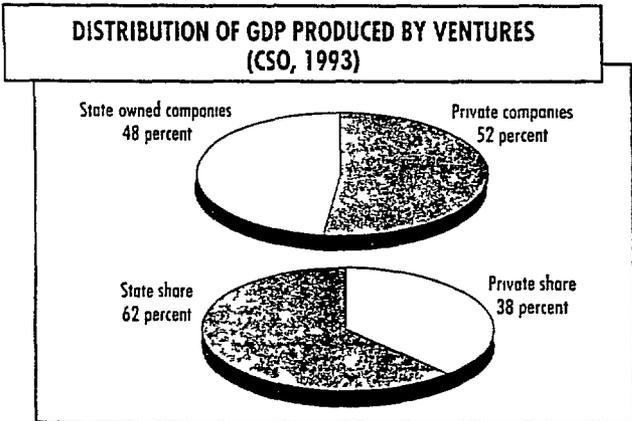
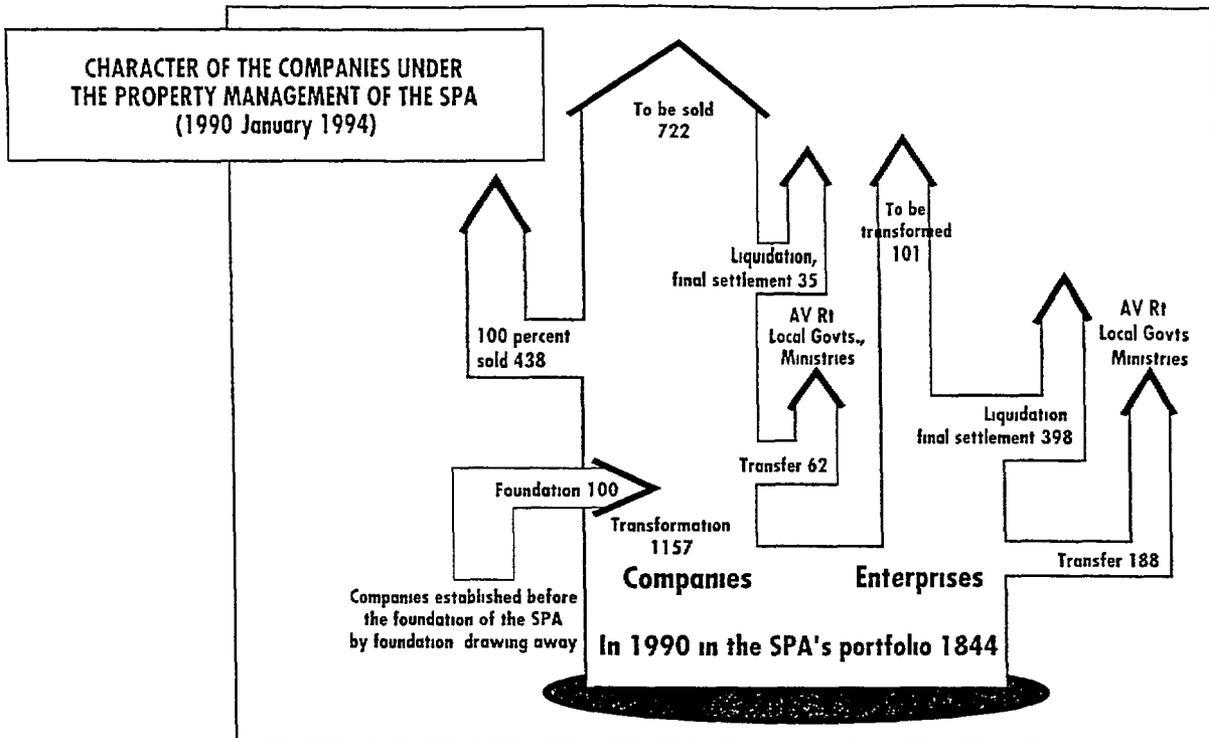
DEVELOPMENT OF THE PRIVATIZATION REVENUES OF THE SPA (HUF billion)

	1990	1991	1992	1993
Property yield	-	0.9	4.7	2.4
Sale for foreign exchange	0.53	24.6	41.0	25.5
Sale for forints	0.14	4.8	17.5	15.3
Cash revenues total	0.67	30.4	63.2	43.2
Sale for loans	-	1.0	9.1	21.7
Sale for compensation vouchers	-	-	2.3	13.0
Privatization revenues total	0.67	31.4	74.4	77.9

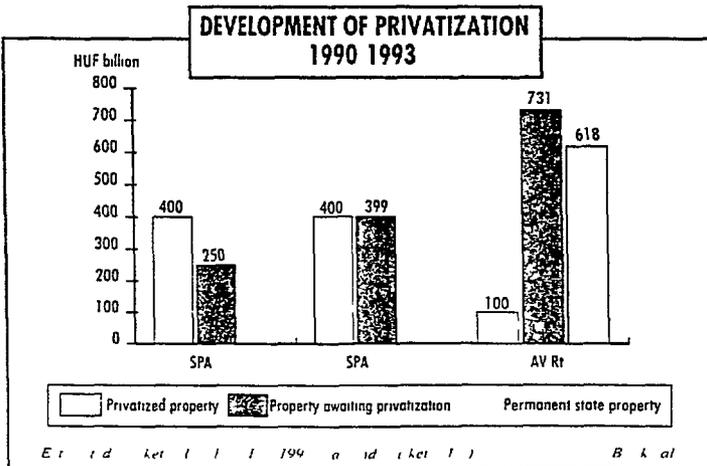
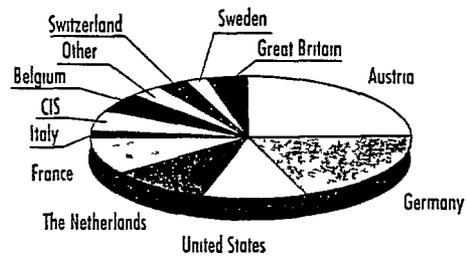
SITUATION BEFORE THE EVENTUAL MERGER OF THE TWO HOLDING ORGANIZATIONS (December 31, 1993)

Number of companies at the AV Rt	163
property value HUF billion	1 400
number of employees	290 000
equity HUF billion	289
Number of companies at the SPA	764
property value HUF billion	430
number of employees	292 000
equity HUF billion	362 30

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FOREIGN INVESTMENTS AS BROKEN DOWN ACCORDING TO COUNTRIES AT COMPANIES MANAGED BY THE SPA



Country	Equity HUF billion
Austria	43 18
Germany	34 71
United States	18 73
The Netherlands	18 29
France	17 73
England	12 88
Sweden	9 67
Switzerland	8 98
Belgium	5 84
CIS	5 24
Italy	3 89
Other	7 14

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FACTS ON PRIVATIZATION

Number of companies

CHANGE IN THE NUMBER OF COMPANIES REPRESENTING THE STATE'S BUSINESS PROPERTY

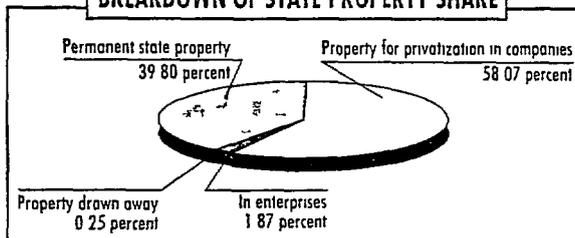
	AV Rt	SPA	Total
As of January 1 1990			
State enterprises	0	1 848	1 848
Business organizations	0	0	0
Companies total	0	1 848	1 848
Changes			
Enterprises liquidated subject to final settlement terminated	6	432	438
Companies liquidated subject to final settlement terminated	0	38	38
Companies established not by transformation	0	115	115
Companies transferred to other property manager	9	251	260
Companies taken over from other property managers	184	0	184
100 percent privatized companies	0	492	492
As of March 1994			
State enterprises	30	30	60
Business organizations	139	720	859
Companies total	169	750	919

Business property

The book value of the state's business property according to the size of state share. Breakdown of the book value of equity in HUF billion

	AV Rt	SPA	Total
In enterprises	16 1	15 36	31 46
In companies			
Permanent state property	669	0	669
Property for privatization	617 9	378 17	996 07
Property drawn away to be sold	0	4 30	4 30
Total	1 286 9	382 67	1 669 56

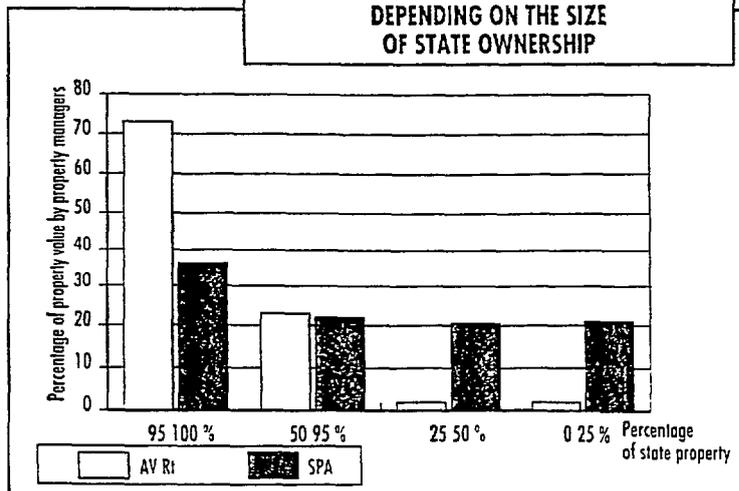
BREAKDOWN OF STATE PROPERTY SHARE



PROPORTION OF STATE PROPERTY IN COMPANIES

	AV Rt	SPA
I 95-100 percent		
Number of companies	129	38
Percentage of property value	73	36.29
II 50-95 percent		
Number of companies	24	149
Percentage of property value	23	22.09
III 25-50 percent		
Number of companies	9	85
Percentage of property value	2	20.59
IV 0-25 percent		
Number of companies	7	132
Percentage of property value	2	21.07

PERCENTAGE OF PROPERTY VALUE DEPENDING ON THE SIZE OF STATE OWNERSHIP



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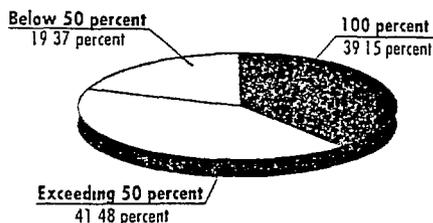
Privatization

SALES

Review of the number of companies with sale as well as the corporate property involved in privatization according to the magnitude of the ownership right sold

Pursuant to a World Bank provision the whole property of a company at sales exceeding 50 percent and the property value of the business part sold at sales below 50 percent are regarded as property involved in privatization

BREAKDOWN OF THE COMPANIES SOLD ACCORDING TO THE MAGNITUDE OF THE OWNERSHIP RIGHT SOLD



According to ownership right	AV Rt		SPA		Total	
	Number	HUF billion	Number	HUF billion	Number	HUF billion
100 percent	-	-	492	178.84	492	178.84
Exceeding 50 percent	2	16.00	163	173.50	165	189.50
Below 50 percent	7	83.00	35	5.47	42	88.47
Total	9	99	690	357.81	699	456.81

OWNERSHIP STRUCTURES

Ownership structure of companies with state property share upon establishment and at present

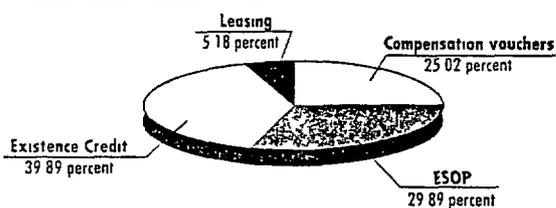
	Upon transformation		At present	
	AV Rt	SPA	AV Rt	SPA
State ownership	91.80	84.62	82.40	62.08
- of this permanent	45.20	-	42.90	-
• Local government	2.00	4.65	4.00	4.94
Domestic	6.00	5.52	7.90	21.54
- Of this employees	-	0.57	-	5.89
Foreign investors	0.20	5.17	7.70	11.45

Sales supporting domestic investors

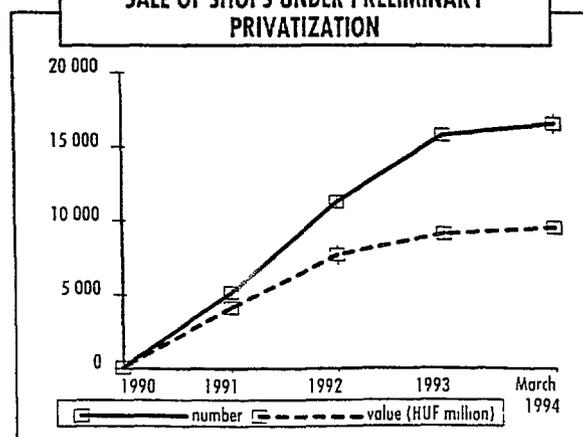
	AV Rt	SPA	Total
ESOP			
Number	2	147	148
Face value (HUF billion)	0.8	29.05	29.85
Leasing			
Number	-	16	16
Face value (HUF billion)	-	5.18	5.18
E Credit			
Value (HUF billion)	-	39.84	39.84
Compensation vouchers			
Face value (HUF billion)	1.40	23.59	24.99

Shops (preliminary privatization) SPA	1991	1992	1993	March 1994	Total
number	4066	3571	1428	416	9481
value (HUF billion)	5.09	6.10	4.55	0.76	16.50

BREAKDOWN OF SALES SUPPORTING DOMESTIC INVESTORS



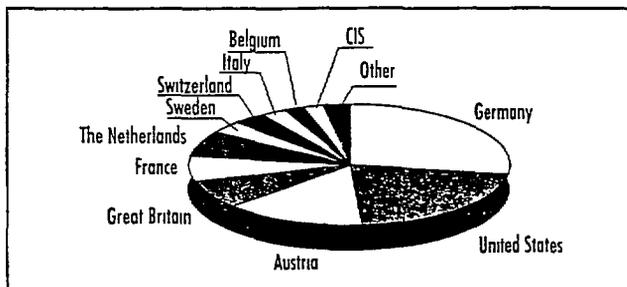
SALE OF SHOPS UNDER PRELIMINARY PRIVATIZATION



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Foreign investments

	AV Rt			SPA			Total		
	companies #	HUF billion	share percent	companies #	HUF billion	share percent	companies #	HUF billion	share percent
Germany	1	37.5	41.57	73	39.68	21.09	74	77.18	27.73
United States	1	39.3	43.57	24	20.09	10.68	25	59.39	21.34
Austria	-	-	-	99	39.43	20.96	99	39.43	14.17
Great Britain	2	7.9	8.76	28	12.88	6.85	30	20.78	7.47
France	1	2.4	2.66	33	16.98	9.02	34	19.38	6.96
The Netherlands	-	-	-	13	18.29	9.72	13	18.29	6.57
Sweden	-	-	-	8	9.67	5.14	8	9.67	3.47
Switzerland	-	-	-	12	9.33	4.96	12	9.33	3.35
Italy	1	2.6	2.88	20	3.89	2.07	21	6.49	2.33
Belgium	-	-	-	7	5.84	3.10	7	5.84	2.10
CIS	-	-	-	13	5.24	2.79	13	5.24	1.88
Other	1	0.5	0.55	27	6.83	3.63	28	7.33	2.63
Total	7	90.2	100.00	357	188.15	100.00	364	278.35	100.00



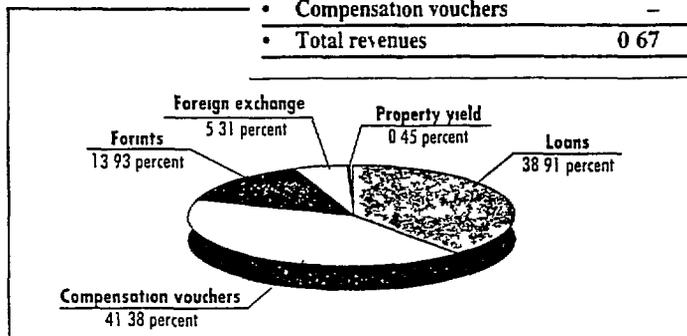
The table shows the number of companies involved in foreign capital, the contract value of investments, the extent of share of the equity and the breakdown of investors by relations by holding organizations and in aggregate.

Investments include sales aimed at property protection, property in kind, investments upon foundation, sale of property drawn away, raise of equity as well as share and business part sales.

(Greenfield investments are not included.)

Revenues – SPA (HUF billion)

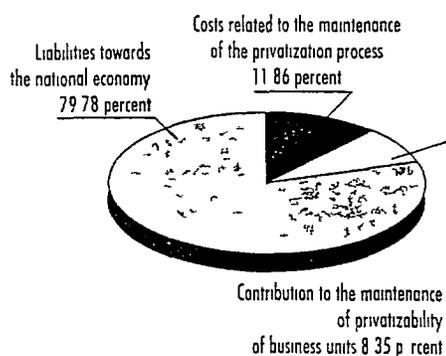
	1990	1991	1992	1993	March 1994
• Property yield (dividend, rental fee)	-	0.94	4.74	2.40	0.095
• Sales					
Foreign exchange	0.53	24.61	40.98	25.50	1.099
Forints (cash)	0.14	4.82	17.51	15.30	2.887
Cash revenues, total	0.67	30.37	63.23	43.20	4.081
• Loans	-	1.01	9.07	21.7	8.060
• Compensation vouchers	-	-	2.26	13.0	8.571
• Total revenues	0.67	31.38	74.56	77.9	20.712



Expenditures – SPA

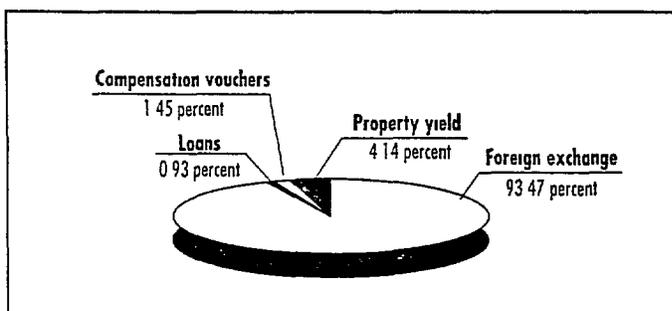
(HUF billion)

March 1994	
Costs related to the maintenance of the privatization process	2 474 (11 86 percent)
Sales related costs	1 351 (6 48 percent)
Costs of running the SPA	0 581 (2 79 percent)
Transferred to local governments	0 088 (0 42 percent)
Refunded to companies (20 percent)	0 288 (1 39 percent)
Property management	0 166 (0 79 percent)
Contribution to the maintenance of privatizability of business units	1 742 (8 35 percent)
Reorganization	1 363 (6 53 percent)
Of this of investment nature	0 719
Guarantee costs (buyer banks)	0 379 (1 81 percent)
Liabilities towards the national economy	16 631 (79 78 percent)
Repayment of state debt	8 060 (38 75 percent)
Withdrawal of compensation vouchers	8 287 (39 75 percent)
Compensation vouchers to local governments	0 284 (1 36 percent)
TOTAL	20 847 (100 00 percent)



Revenues – ÁV Rt

(HUF billion)



	1992	1993
• Property yield (dividend rental fee)	3 5	4
• Sales		
Foreign exchange	–	90 2
Forints (cash)	–	–
Cash revenues, total	3 5	94 2
• Loans	0 9	–
• Compensation vouchers	–	1 4
• Total revenues	3 5	96 5

Expenditures – ÁV Rt

(HUF billion)

	1993	1994 estimate
Privatization revenues	92 509	120 826
Privatization costs and expenses (without payment to the budget)	34 425	86 894
Privatization proceeds	58 084	33 392
Liabilities toward central budget from privatization revenues	28 000	28 269
Part remaining at property manager from privatization proceeds	11 000	3 000
Further utilization		
Privatization in exchange for withdrawal of compensation vouchers	1 373	71 809
Transfer of property to local governments	–	–
Other liabilities (concession fee) from privatization proceeds	13 262	–
Amount spent on reorganization from privatization revenues	31 268	–
Costs related to privatization consulting	0 658	1 048
Contribution to preparing strategic reorganization plans of companies	0 038	0 115