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UNIDO CASE STUDIES OF INDUSTRIAL RESTRUCTURING IN THE CENTRAL AND EASTERN EUROPEAN (CEE) AND FORMER SOVIET UNION (FSU) REGION: POLAND AS A PILOT STUDY

prepared by

Europe Programme
Country Strategy and Programme Development Division
in co-operation with the
Enterprise Development and Restructuring Branch,
Human Resource and Enterprise Development Division

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Preface

It has been over four years since the countries of Central and Eastern Europe (CEE) began the unique and historic process of transformation from a command to a predominantly competitive market-based economic system. Three years ago the former Soviet Union (FSU) made initial steps in the same direction. While real achievements have been made by most of the countries in terms of macro-economic stabilization, the process has not yet delivered a significant re-orientation and restructuring of industrial structures and major improvements in economic performance and growth, particularly at the industry level. It is against this background that the issue of industrial restructuring in the context of overall private sector development and privatization becomes critical. It is now clear that the success of the transformation process in the CEE/FSU region will depend more than on macro-economic reforms. The regeneration of the industrial base, an essential element of a country's development and UNIDO's particular concern, will require the development of an integrated macro-micro economic policy framework with concerted, enterprise-targeted policy measures and institutional and other support. Too much was expected too soon of macro-economic reforms. They constitute the first essential phase of the transformation process. But, there must now be a second phase in which the focus has to be on the removal of rigidities and bottlenecks at the enterprise level. This requires greater integration of the macro-economic framework with measures designed to induce the proper supply response at the enterprise level. An analysis in terms of case studies of the major impediments to an adequate enterprise supply response may hold major lessons for national decisions within the CEE/FSU region and for their supporting international technical co-operation partners.

In this regard, Poland has been chosen as a pilot case study. It was the first of the CEE/FSU countries to embark on a programme of fundamental economic reforms in the transition to a market economy. It is also a country whose industrial restructuring has been assisted by a major Western donor - the British Government in the form of support from its Know-How Fund through UNIDO to Polish industry. It is also a country with which UNIDO has long been associated and in which it has built up the most first-hand experience of restructuring industrial enterprises since the transformation process began in the region.

Though this report presents case studies of Polish industries, other studies of the region by UNIDO and other international organizations report similar findings. UNIDO, therefore, firmly believe that these Polish case studies provide useful experience and guidance for other countries embarking on similar restructuring exercises. The case studies are based on an on-going UNIDO restructuring project in Poland. Beginning in 1991, USD 2.3 million were made available by the British Government through its Know-How Fund for Central and Eastern European (CEE) countries to enable UNIDO to assist in the restructuring of 15 Polish industrial enterprises.

The primary objective of the UNIDO restructuring project was to facilitate the restructuring process and eventual commercialization of the ten enterprises selected. The programme also had a series of secondary objectives:

(a) To keep the enterprises operational and maintain their financial liquidity in the short term, until a firm restructuring plan could be drawn up. Priority was thus to be given to conducting an immediate assessment of assets and liabilities, defining urgent short-term measures to improve the liquidity of the enterprises and undertaking negotiations with creditors, as well as to addressing short-term technical, marketing and financial problems.

(b) To carry out a comprehensive techno-economic evaluation of the enterprises' operations in terms of the types of plant, machinery and equipment used, skills available, the types and volumes of products currently manufactured, scope for reducing costs and rationalizing assets and any technical problems.

(c) Based on the foregoing evaluation, to provide advice to the enterprises on an ideal product mix and to recommend new or diversified product lines and markets, due consideration being given to the changing economic environment and comparative advantages, and to necessary improvements in the enterprises' managerial/technical capabilities.

(d) To help enterprise management develop a better, more coherent organizational and strategic view of their future, thus enabling the enterprises to elaborate and

(d) To help enterprise management develop a better, more coherent organizational and strategic view of their future, thus enabling the enterprises to elaborate and implement an effective restructuring plan and strengthen their position during discussions/negotiations with potential technical and/or commercial partners.

Preparatory work was needed on all these objectives in order to define a preliminary work plan for restructuring the enterprises.

It was assumed that UNIDO together with the external consultants working with UNIDO Headquarters staff could provide ad hoc advice on various specific problems. This advice as well as the involvement and support provided by UNIDO, the Polish Industrial Development Agency (IDA) and the consultants were also seen as a confidence-building measure bolstering the efforts of the enterprise managers.

The project was also seen as an opportunity for the professional staff of the newly established IDA to gain first-hand experience in the formulation, execution, monitoring and evaluation of industrial restructuring projects. IDA staff were also afforded the opportunity to visit UNIDO Headquarters as well as to acquire some brief pertinent training in the United Kingdom.

On the basis of rigorous selection criteria, 15 large and medium-scale enterprises out of around 40 candidates were selected for in-depth examination. Basically, these were potentially viable enterprises which were willing to undertake major restructuring efforts themselves but still required external assistance. The enterprises selected employed between 1,000 and 20,000 employees and produced a wide variety of products ranging from linen fibre and fabric, colour and black and white television sets, screen monitors, work stations through to military tracking equipment, gear transmissions, construction cranes, locomotives and mobile cranes. Full details of the project and major findings are given in the UNIDO Europe Programme forthcoming report - **Economies in transition: restructuring of large-scale industries**.

The case studies were prepared by George Assaf and Lalith Goonatilake of UNIDO's Europe programme, Country Strategy and Programme Development Division, and Enterprise Development and Restructuring Branch, Human Resource and Enterprise Development Division, respectively in co-operation with UNIDO consultants Peter Chudy and John Henley. To illustrate the major findings and recommendations of UNIDO's restructuring project, three representative case studies are presented in this report.

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INTRODUCTION TO THE CASE STUDIES

The Polish enterprises selected as case studies reflect the difficult transformation process undertaken by the former socialist states in 1989. The successes and failures of the restructuring programme are an amalgamation of macroeconomic and microeconomic decisions taken by the enterprise management and various policy making institutions. Although certain problems were unique to a given enterprise, many more were commonly shared. All of the enterprises discussed in the case studies had considerable problems adjusting their product-oriented structures into competitive market oriented operations. Besides being able to produce what the market demands, the enterprises examined encountered difficulties when faced with such strategic issues as pricing, budgeting, cost monitoring, distribution, quality control, product design, marketing, and sales. In short, the enterprises were not hitherto prepared to perform those functions necessary to create value added operations.

To compound the problem, the enterprises lacked support systems available to their Western counterparts. Without a strong banking sector well versed in risk assessment and credit and project analysis, many of the enterprises could not rely on their banks to be an active partner during the restructuring process. Lacking well developed financial skills and support, the enterprises faced a multitude of problems stemming from poorly designed management accounting systems, the non-use of basic ratio analysis, and outdated methods of overhead cost allocation. Their financial situation was further aggravated by management's insufficient knowledge of the market due to inadequate market research and inadequate understanding of market forces influencing price, promotion, and packaging of their products. The lack of expertise in the above mentioned areas underlines the importance of human resource development in CEE enterprises. Training of top and mid-level managers in modern business practices emerges as an effective means to galvanize the restructuring process.

In addition, it has to be noted that a restructuring process in the CEE and FSU states is not the same as in the West. To begin with, the human resource base is completely different with basic skills in such crucial areas as sales and marketing being greatly neglected or absent. The correct assessment of the enterprise such as an in-depth diagnostic analysis required in fact a decoding operation of past performance figures, to adjust them to free market concepts and criteria of a free market. One has to also keep in mind that in fact the issue was not restructuring, but a profound transformation of one type of organization into a completely different one with distinct functions and aims operating in a trade union dominated atmosphere.

To provide assistance during the transformation process, a four-step restructuring programme was developed aimed at stabilizing an enterprise's deteriorating competitive position, that often bordered on catastrophic, and developing a revenue generating strategy. A major objective, therefore, of the restructuring programme was to improve the competitiveness and the operational efficiency of the enterprises. Considering the characteristics of former SOEs, the foremost task was to rationalize the level of employment and reduce the asset base, as well as increase sales. Specifically, the four step restructuring programme reviewed an enterprise's business environment, performed a company diagnostic, developed restructuring options, and together with the management, implemented an action plan. Each of these subpoints are described below:

I. Step One - Data Review

* In step one, market and industry data was collected and analyzed to define the competitive environment and to identify possible development opportunities for the enterprise being restructured. An analysis of the enterprise's product, price, place, and promotion was performed which asked the following questions:

  1. Product - Is the product mature and facing new entrants or substitutes? Have better technologies been developed? Has the competition established local operations? Who is the competition and how are they positioned in comparison to the enterprise?

  2. Price - Are there any developments in complimentary products or services? What are the competitive pressures and policies that effect pricing? What pricing/purchase financing could be used to retain customers? What pricing should be designed for wholesalers, retailers, and final customers?

3. Place - What are the distribution channels and how are they evolving? Which channels are used by the competition and why? What regulatory policies influence the market place and the industry?

4. Promotion - What selling techniques are used and how is the sales force organized? How and by whom is promotion organized and executed? Are there any industrial organizations or lobbies to promote their common interests?

II. Step Two - Diagnostic

* Consisted of a full diagnostic to define the enterprise's competitive positioning and to prepare a financial business plan based on a competitive market and industry review. The diagnostic stage asked specific questions regarding five areas of the enterprise's operations that are described below:

1. Revenue - What is the biggest source of revenue? Who are the enterprise's clients? Do the enterprises have a clearly defined product portfolio? Is the method of distribution effective?

2. Finances - What is the current cash position of the enterprises? What is the enterprise's level of debt and how does it compare to the competition? How effective is the enterprises' method of exacting their receivables from their debtors?

3. Management - What is the organizational structure and is it appropriate? What are the management's capabilities? What are the workforce's strengths and weaknesses?

4. Cost - How effectively are costs controlled? What steps are being taken to reduce costs? What is being done to maintain a rational level of stocks? Are raw materials purchased of requisite quality at the lowest price?

5. Production and Assets - Are assets well utilized? Are there any redundant fixed assets which may be disposed? Are work methods and production technologies used effectively?

III. Step Three - Options For Restructuring

* Based on the diagnostic and competitive positioning conclusions, restructuring options were developed to place top priority on the enterprise's strategy, corporate mission, business plan development, reorganization, and training. To develop a full spectrum of restructuring options, additional questions were asked focusing on the following:

1. Mission - What is the goal of the enterprise's operations? What are the tasks of the management and employees? How will the enterprise's organizational structure assist them?

2. Strategy - How should the enterprise be positioned in the market relative to its domestic and foreign competitors? Which products should be delivered to which market segment and at what cost? How is internal business performance control defined? What organizational structures and assets are needed to carry out the strategy?

3. Business Plan - What are the external and internal factors influencing the enterprise's performance? Which scenarios should be taken into consideration? What are the range of possible results?

4. Reorganization - What organizational structure is the most competitive? What assets should be sold and/or liquidated? Which departments should be reduced in size or spun-off? What are the enterprise's core business activities? What should be done with the

ancillary services such as schools, health clinics, recreational facilities? Which employment structure is the most efficient?

5. Training - What assistance is needed to develop human resources in the enterprise? What training is needed to improve the enterprise's product/market strategy, competitive positioning and strategic planning. What training should be provided to address the enterprise's internal needs such as revenue, financial performance, cost and asset structure, and organizational management. How can the enterprise effectively utilize professional partners and advisors, communication, motivation and public relations that influences the business environment.

IV. Step Four - Implementation

* After the restructuring options were addressed and consensus reached by the management, implementation plans tailored to the enterprise's needs were developed. This entailed implementing an action plan based on the points described above, while emphasizing the need for project financing and recapitalization of the enterprise. Of specific concern were sources of available capital, the creation of a consortium to reduce risk and cost of capital, the selection of financial partners, liquidation of state shares, and privatization.

The basic purpose of the four phase restructuring programme was the development of a stabilization programme for the enterprise. Such a stabilization programme was intended to gain management control over the enterprise, establish and communicate credibility with institutions possessing a stake in the enterprise, and assess the existing management structure. These three objectives are further developed below:

Stabilization

- **Gain management control** - This may entail bringing in a new financial director, developing a cash flow forecast, and implementing centralized cash control. The implementation of controls over both capital and revenue expenditures may entail freezing employment, rejecting suppliers' price increases, and having the general manager approving all renewed or new contracts. Inventory control and debtor control are also areas where management control is of importance.

- **Establish and communicate credibility with stakeholders** - Enterprise stabilization entails developing a close working relationship between the enterprise and its key creditors by explaining the main ideas of a restructuring plan and the length of time it may take. Improved communication also entails talking to suppliers, trade creditors, customers, and trade unions and outlining the urgency of the situation and the enterprise's commitment to restructure while continuing to provide service.

- **Assess existing management structure** - Provide for face to face meetings and assign specific tasks or projects. An outside technical expert may be needed to assist in the areas of personnel replacement, recruitment, and compensation.

As in the West, enterprise stabilization provides a window of opportunity to launch a cash-generation effort. These concepts focus on the revenue generating strategy that has three basic elements:

Revenue Generating Strategy

- **Product-market change** - Based on a detailed marketing plan, this entails defining strategic business units (SBUs) and analyzing their growth and profit potential. To assist in the change, responsibility should be shifted to profit centres while simultaneously improving control and quality systems.

- **Improve sales effort** - Increased revenues for the enterprises forces the creation of planning and the controlling of selling efforts that often means managing the time sales representatives devoted to clients. In addition, motivating and training the sales force is a top priority. Monitoring of the sales force should include judging sales performance on the basis of a comparison of actual versus budget performance, key accounts, sales targets per sales representative, sales trends, and the impact of special promotion. Improved efforts should be closely followed by evaluating and, if necessary, replacing sales representatives.

- **Price strategy changes** - A review of the enterprise's pricing strategy entails performing a customer profitability review. Raising list price on all or some of the products should be considered based on a well worked policy of how much of an increase can the products stand. The enterprise's discount policy may need to be altered as well to make an impact on the pricing strategy.

A summary diagram of steps involved in the restructuring programme points out the relatively lengthy and expensive process awaiting an enterprise engaged in such an exercise. Besides time, internal and external factors influence the enterprise and play an important role in the success or failure of such an undertaking. With each step requiring full commitment and perseverance from the enterprise's staff, the human factor must be seen as one of the most decisive contributors to a successful restructuring process. Resistance to change is a serious obstacle to any restructuring programme regardless of whether it is undertaken in Eastern or Western Europe. Change is even more difficult in an environment which for nearly 50 years operated on totally different economic premises. As the case studies point out, the success of a restructuring project hinges on many factors; however, the attitude of the management toward change, an integral element of all restructuring programmes, emerges as a dominant force.

COMPANY A

DESCRIPTION AND HISTORY OF THE ENTERPRISE

Company A consists of two divisions specializing in equipment production and construction/installation services. The equipment production division assembles low and high voltage switchgears and transformer stations, while the construction/ installation division provides electrical services for the industrial and commercial sectors. The vast majority of switchgears and transformers were produced for the former Soviet Union, while the construction/installation services were primarily oriented toward the domestic market.

Company A was established as a state owned enterprise immediately after World War II along with 12 other similar operations making electromechanical products and providing construction/installation services. The central planning authorities assigned the type and the amount of goods to be produced by each company, while allowing each to maintain a monopolistic construction/installation hold over a specified geographic area. A more detailed summary of employment and financial developments in Company A from 1989 to 1992 is provided below.

COMPANY A

In million USD	1989	1990	1991	SOE 1992	JSC 1992
Employees*	988	867	770	770	693
Capital	-	-	-	-	0.01
Fixed assets	-	3.73	3.50	2.83	3.12
Current assets	-	3.08	5.51	5.69	6.54
Liabilities	-	1.08	1.18	2.17	1.13
Total sales	-	11.35	16.54	2.10	8.13
Gross profit	-	3.84	4.86	0.04	1.13
Net profit	-	1.97	2.51	0.01	0.67

Source: Company data.
* Number of Employees.
SOE - State Owned Enterprise
JSC - Joint Stock Company

MAJOR PROBLEMS AND CONSTRAINTS

Marketing and sales orientation

Ineffective marketing and sales efforts due to a lack of requisite skills by the department's personnel caused formidable barriers to the creation of a market oriented company. This problem was quite universal among large state owned enterprises in Poland which typically relied on the engineering staff to develop and manage marketing and sales efforts. In the case of Company A, both of the sales and marketing managers for the equipment

production and construction/ installation divisions were electrical engineers who for approximately 20 years were involved in production. Both of them were promoted to Sales and Marketing with little training or experience in the discipline of industrial marketing. As such, prior to the organized training offered during the restructuring process, most of the learning was done by trial and error.

For example, the manager of sales and marketing for the equipment production division treated transformers as a consumer product and did little to stimulate sales using industrial marketing methods. In addition, the two sales and marketing positions for the equipment production and construction/installation divisions did not coordinate their actions. Their cooperation seemed natural since the construction/installation division provided electrical services for industrial and commercial projects throughout Poland, while the equipment production division assembled transformers and switchgears used by the industrial and commercial facilities. The systematic collection and sharing of information between the two departments and database development received little attention.

One of the major reasons for this distance between the two divisions stemmed from the equipment production division's ongoing sales of transformer stations to the former USSR which was bringing unrealistically high profit margins of 31 per cent. Given this success, the equipment production division became complacent and did very little to pursue sales leads on the domestic market where margins were in the single digits and where competition from domestic and foreign producers continued to intensify. It should be noted that the old arrangement where Poland was divided on geographic basis among 13 enterprises, all performing the same services and capable of producing the same range of products, collapsed after 1989. The 13 enterprises commenced encroaching on each others territories, product range, and services leading to stiff competition for the recession hit Polish client base.

RECOMMENDATIONS:

Marketing and sales improvements

As Western products supported by government export schemes made inroads into traditional East European export markets of the former USSR, Company A's unit sales of transformers were reduced from 815 in 1988 to 350 by 1992. In addition, other Polish producers started competing head on with Company A in the former USSR. This competition forced Company A's equipment production division to refocus the domestic strategy and review its reliance on foreign trade organizations (FTO's) responsible for exporting transformers. The FTOs were in an advantageous position to select one producer over another depending on the personal and/or historical ties between the producer and the trader, financial incentives offered by the producer, and technological capabilities of the enterprise.

Given these developments, new emphasis was placed on creating alternative means of selling Company A's products in the former USSR and other foreign markets. Due to the FTO's strong bargaining position in relationship to the producers, Company A's selling costs jumped dramatically from approximately 7 per cent in 1990 to 23 per cent in 1991. Company A addressed this and other marketing problems by giving the marketing department increased training to meet new market challenges and responsibilities. In addition, intensive search commenced to locate an alternative private, state, and/or foreign agent to sell the products in foreign markets as a counterweight to the traditional FTO assigned to Company A under the old system by central planning authorities.

Due to Company A's weak marketing and sales skills exemplified by the department's attempt to advertise industrial products and services using consumer goods techniques, intensive training commenced to develop a vibrant marketing department employing 18 specialists. Training of the new personnel in modern business practices entailed developing new skills for each section of the department such as the market research and analysis sector, research and development, and promotion and sales sections of the department. Under the previous organization, the department acted as one body duplicating its efforts without developing a systematic way of locating clients or collecting information on market trends or the competition. Special emphasis was placed on improving Company A's market survey and data collecting capabilities that were underdeveloped due to the historical reliance on the FTOs in foreign markets and an agreement to the domestic market split among the 13 enterprises.

Human resource development

Increased training of Company A's staff in marketing and cost accounting resulted in cost reduction and monitoring systems being implemented. The need for such improvements was exemplified by the discovery that an identical product made by domestic competition was substantially less expensive. To correct the problem, a detailed

cost analysis and pricing policy review was performed by the marketing, accounting, and design and technology specialists. Through this cooperation, it was revealed that the cost of sheet metal used in production was overstated resulting in a higher final price when compared to the competition. The improvements led to a rapid turn around in Company A's fortunes. As a result, Company A's sales rebounded due to lower production costs and an effective pricing strategy.

Company A's limited exposure to modern cost accounting and financial systems illustrated many of the problems faced by state-owned enterprises. What made Company A's situation unique was the separate equipment production and construction/installation divisions that operated in two different areas, making the enterprise an ideal candidate for profit centres. However, despite many advantageous of profit centres, this concept was rejected by the management who claimed that it would destroy the historical bonds between the two divisions and also jeopardize the consensus about privatization among employees. Many examples were given showing how the divisions helped each other during times of economic difficulties. As such, explanations that the profit centres intended to improve accounting procedures and reduce cost structures, and did not necessarily threaten the "special" relationship between the two divisions, had limited influence on the management. More specifically, employees feared that profit centres would be the first step toward layoffs and further asset reductions when one of the division's sales decreased. Each division's direct accountability was sacrificed for social harmony resulting in a less efficient overall operation; whereas fixed, variable, and overhead costs could have been more tightly controlled.

Company A needed to streamline its operation since approximately one-third of the assets with a net book value of USD 15 million were either non-productive and/or non-core. Such ratio is common among state owned enterprises being restructured as a large portion of their assets consist of buildings and aged equipment and past investment on social services and assets such as nurseries and holiday homes. In the case of Company A, the equipment production division had 90 per cent of assets in buildings and the remaining 10 per cent in equipment. However, the equipment was 84 per cent depreciated while the buildings were only 26 per cent depreciated. This was in line with the trend among East European enterprises which were often located in relatively new buildings but operated with obsolescent machinery. The construction/installation division with 23 per cent of its assets consisting of buildings and 77 per cent of equipment faced a similar problem. In their case, buildings and equipment were 42 per cent and 67 per cent depreciated, respectively. The level of depreciation reached staggering proportion which directly influenced Company A's product quality and overall efficiency. For example, the enterprise's welding machines, turret lathes, cutting machines, and presses that all had an important impact on final product quality, were 100 per cent depreciated.

Finance

The company was in a relatively healthy financial shape due to the continuing sales of products to former USSR markets, Company A's internal cost controls needed to be improved. Although being able to breakdown the overhead costs into energy, wages, taxes, depreciation, interest and bank charges, and materials, Company A could not point out exactly which of the divisions were responsible for higher overhead costs. Between 1989 and 1991, growing overhead costs nearly doubled and became very difficult to allocate between the two divisions. To correct this dilemma, profit centres were proposed to determine which division needed to improve its performance. Although advantages of having the equipment production division operate as a profit centre were outlined and presented to the management and the workers council, it was not accepted as the best financial alternative to improve performance as well as to maintain the historical tie between the two divisions.

Production

Company A was characterized by inefficient production methods which exacerbated the enterprise's quality and cost control problems. In addition, the plan layout and material flow was not conducive to a rational and efficient work flow. Although production planning and control identified start dates which led to correct priority for loading time, the overall effect was reduced by the poor discipline in ensuring that progressive actions were taken. The production planning and control system in operation was manual. This had the effect of extending the lead time required to ensure the proper sequence of events from receipt of order to issuing the appropriate drawing, specification and production plan, and so on. This often resulted in needed components being bought either too late or too early leading to bottlenecks and increased inventory costs. To compound the problem, the enterprise's inventory control system was inadequate in comparison to modern practices employed by Western firms.

Ways to improve Company A's productive efficiency included combining various operations, purchasing standard parts and rationalizing designs. To improve quality, a quality trail was developed consisting of eight steps revolving around an improved documentation flow. Recommendations were made to create a properly functioning self regulating perpetual inventory control system to lower inventory costs.

It should be noted that Company A in calculating the costs connected with the direct purchase of a given product or part, include a transportation costs and the wages of employees working in storage facilities. On the other hand, the company did not calculate costs associated with inventory, such as average capital tied down in inventory or cost of inventory control. As such, active measures were recommended to reduce surplus stock through an accurate calculation of inventory needed to support ongoing production which subsequently led to drastic stock reductions.

RESULTS AND CONCLUSIONS

Company A's restructuring process led to improved financial performance as a result of increased human resource development, operational streamlining and employment reduction. In addition, Company A successfully implemented its privatization programme and is currently operating as a private firm in which 20 per cent of the shares are held by workers.

Due to historical reasons, Company A did not create profit centres revealing that traditional bonds and associations often prevail over economic and financial rationale. The management, in order not to antagonize the workers during sensitive privatization negotiations, decided to overlook the matter. After the enterprise's privatization, the issue remained very contentious and to date, no progress has been made to implement profit centres for the two divisions.

COMPANY B

DESCRIPTION AND HISTORY OF THE ENTERPRISE

Company B, a producer of pure linen and linen blend fabrics, was founded before World War II and nationalized in 1949. The enterprise, selling its products principally in bulk for use in the clothing industry, operates one manufacturing plant in the southeast part of Poland. The manufacturing plant consists of old and poorly maintained specialised machines and equipment that are 80 per cent depreciated and aging buildings that are nearly 50 per cent depreciated. At the beginning of the restructuring project Company B employed 1,160 workers which was lowered to 880 in 1992 and reduced again to 680 in 1993.

Company B produces and sells a wide range of finished and semi-finished linen products. Over the years it has become the fourth largest producer of linen by volume. Among the various products sold, tablecloths and decorative tablecloth fabric accounted for approximately 55 per cent of total sales in 1991 and nearly the same percentage in 1992. Company B focused most of its production on the domestic and the former USSR markets. In 1989 approximately 63 per cent of Company B's sales were for the domestic and former CMEA markets; however in 1990 exports to the Western markets increased sharply from 37 per cent to nearly 79 per cent of the enterprise's total sales. In 1991, Company B and six other Polish linen producers accounted for 90 per cent of the nation's total production in a sector consisting of 26 enterprises. A more detailed summary of Company B's employment and financial developments from 1988 to 1992 is given below.

COMPANY B

In million USD	1988	1989	1990	1991	1992
Employees*	1,775	1,728	1,314	1,155	880
Capital employed	-	-	10.35	9.16	5.72
Fixed assets	-	-	10.68	8.88	6.56
Current assets	-	-	3.66	4.50	3.17
Liabilities	-	-	4.11	5.53	5.04
Total sales	-	-	7.84	5.80	4.37
Net profit	-	-	-0.98	-1.94	-1.88

Source: Company data.
* Number of Employees.

MAJOR PROBLEMS AND CONSTRAINTS

Impact of selection criteria

The selection criteria adopted by the policy making institutions in Poland in identifying suitable restructuring candidates quite often done by mixing socio-political considerations with economic rationale. This was the case with Company B which was located in a region where unemployment is of over 20 per cent (well above the national level) and where regional development lags behind the rest of the country due to the fact that the region is predominantly agricultural.

Selected by a government agency for restructuring, Company B was already viewed as an enterprise with little prospect of survival. Indeed, this was pointed out in a subsequent government commissioned linen sectoral study. According to the study, the linen industry could become profitable; however, only eight out of 26 linen enterprises were considered viable and worthy of support. These eight enterprises were selected on the basis of size and potential to stimulate growth, which in turn would have a positive impact on the remaining linen enterprises. Among the eight enterprises, six are the largest producers of linen in Poland. All together, the eight enterprises account for 70 per cent of Poland's potential linen production.

Other factors taken into consideration by the sectoral study in selecting enterprises included the following: linen production making up over 50 per cent of total production, ability to produce finished goods, ecological safety, and ability to improve financial position of the firm with limited interventions. Given Company B's size and lack of strategic value, the firm was not among the eight firms selected by the sectoral study. Compounding the problem, over the last few years linen production in Poland decreased by approximately one-half. Most enterprises lacked money for raw materials, and, with the exception of one plant, all had large operating losses. These losses resulted from decreasing domestic demand, low profits from exports, and declining quality of linen due to low levels of technology and under investment in the capital stock.

Human resource development

Company B's ineffective management that lacked well qualified managers, presented a major constraint during the restructuring process. Lacking skills and awareness of the changing market conditions, the overall attitude of the management and the employees was pessimistic towards the transformation process. Despite a 40 per cent workforce reduction, Company B continued to engage in far too many non-productive activities. The preliminary recommendations made during the diagnostic phase were ignored by the management that perceived the main goal of restructuring was to obtain additional financing for the enterprise via the contacts to be made and influence to be exerted by consulting company assisting in the restructuring, despite its poor financial performance. Such a simplified view of restructuring by the management signalled not only a low level of awareness, but also revealed a lack of communication between the government institutions and the enterprise regarding the type of assistance being provided. Throughout the restructuring process, the weak and ineffective management that was dominated by powerful trade unions did little to increase sales, improve production levels and efficiency, and streamline organizational performance.

Company B's staff and management proved incapable of addressing the enterprise's financial and revenue problems. Besides the fact that Company B's internal organization was not well-suited to operating in a market economy, the management lacked experience in cost accounting, sales and marketing, production planning, and quality control. An excessive amount of support staff, an acute lack of initiative among workers, union insistence on wage egalitarianism, and generally low levels of pay that systematically discouraged potential workers and led to a brain drain of senior staff, contributed to the organizational malaise. As such, Company B was a passive partner during the implementation phase with the management placing all of its hope on outside government assistance.

Finance

Company B's revenues declined from $6.8 million in 1990 to $5.7 million in 1991, with the main source of revenue being linen cloth sold in bulk. In terms of volume, projected sales for 1991 totalled only 40 per cent of sales in 1989, and 85 per cent of sales in 1990. The main reason for the poor financial performance was the collapse of the domestic and former USSR markets. Approximately 80 per cent of Company B's products are sold for export, mostly in bulk, with the United States being the largest export market. However, profit margins are very small and

in far too many cases, Company B signed unprofitable contracts with foreign partners due to inadequate cost accounting information.

Since 1990, Company B's financial position has deteriorated due to a radical drop in domestic sales and sales to the former USSR, as well as the enterprise's inability to decrease fixed costs. Company B's financial problems were also revealed by low levels of liquidity with accounts payable exceeding receivables by more than 100 per cent. In addition, interest penalties have had to be paid on overdue accounts payable, a full 86 per cent of which have stood for at least 90 days since delivery. Compounding the financial problems were the excessively high inventory levels for work in progress and finished product inventories that are kept as bank collateral. Obtaining financing was extremely difficult given that Company B was burdened by a government decision in 1987 forcing the enterprise to involuntarily acquire a bankrupt linen factory in another region of Poland. Because of the factory's poor financial condition, the bankrupt plant's all fixed assets and factory's debt were taken over by Company B.

Organization

The role of the labour unions within the organization contributed to the internal paralysis of the company. Despite the deteriorating financial situation, the trade unions dismissed the radical plan to reduce employment. Instead, the unions presented an alternative plan in which the level of employment was to remain basically unchanged. To keep production going, the unions also agreed to continue signing unprofitable contracts which were to be balanced through overhead and support cost reductions. These cost reduction measures were: creation of a voluntary fire department, reduction of energy costs by installing energy control measuring devices, eliminating the middlemen when buying raw materials, and not hiring outside service and maintenance firms. Simply put, the unions proposed a plan to do everything internally which, contrary to the unions belief, would only reinforce vertical integration. The lack of a strong management counterweight to the unions effectively blocked the restructuring process.

RECOMMENDATIONS:

Organization

During the restructuring project, it was initially proposed that Company B's workforce be reduced by at least 185 individuals to a more manageable total of 880. As the general situation deteriorated, an emergency plan was developed to further reduce employment from 880 to 682 by reorienting activity towards the core business. The radical restructuring plan to save Company B was ignored by the management and the founding body that feared an increase in unemployment. The plan was also opposed by the Trade Unions. However, the real risk of total collapse of the company forced a re-consideration of the plan. At that point, the founding body allowed Company B to be administered by a management contract in which the old management's decision making powers were drastically reduced. However, by the time the top management was changed, approximately 18 months passed and Company B's financial situation reached a critical state.

When it was proposed by outside consultants that the organizational structure be changed, very little was done. Lack of action on Company B's behalf also contributed to poor strategic decisions. Recommendations to change the General Manager and hire a new sales and marketing director as well as a new economic director were ignored. As such, the General Manager retained all three functions leading to a vertical decision making process. The General Manager had so much power concentrated in his hands that little counterweight existed to challenge his decisions to sign unprofitable contracts. This was especially evident in the area of marketing and sales which made up a large portion of the strategic recommendations.

Human resource development

Recommendations were made to train Company B's staff to acquire skills to develop a strict and more sophisticated financial management and cost control measures. Lack of an effective cost accounting system prevented Company B from correctly calculating the costs of each product being produced. As such, the enterprise was poorly prepared for developing a pricing strategy. In addition, the lack of business planning, feasibility studies and economic modelling did not allow the enterprise to quickly calculate the breakeven point and adjust to rapidly changing markets. These weaknesses had far ranging consequences as demonstrated by Company B's financially disastrous decisions. When time arrived to negotiate new contracts, the management made strategic blunders which

resulted in money losing contracts being negotiated. For example, the General Manager, who also acted as the sales and marketing director as well as production director, signed a series of export contracts of which an incredible 96 per cent were unprofitable. When confronted and asked to justify his decisions, the General Manager claimed that the foreign markets were so important to the future of the enterprise that they had to be held at any cost. Consequently, in an effort to save Company B, financial decisions arrived at without the support of sound cost accounting systems only exacerbated the enterprise's already weak financial position.

It was also recommended that a Marketing and Sales department be developed to improve Company B's ability to monitor foreign and domestic markets. Emphasis was placed on defining the main tasks for each section of the department and each employee and the identification of export markets in the US, EEC, and Southeast Asia. In addition, an effective domestic distribution strategy had to be developed.

Production

Little emphasis was placed by the unions and the management on quality control issues which were seen as one of Company B's greatest weaknesses. As such, the reorganization of the Quality Control section was recommended that entailed making the Head of Quality Control directly accountable to the Managing Director. In addition, specific outlines of responsibilities for each inspection manager and specialist were made. However, these recommendations were ignored and Company B continued to have problems with quality. Consequently, only 77 per cent of produced linen fabric fulfilled international export quality standards, while the remaining 23 per cent of production was generally processed into simple finished products and sold domestically for a very low price.

RESULTS AND CONCLUSIONS

Despite a strong resistance to change during the restructuring and implementation phase, certain improvements were achieved. For example, employment was reduced and approximately 24 per cent non-productive assets were separated or eliminated. In addition, 26 per cent of non-core assets, such as the nursery and kindergarten, were sold. However, only when the financial situation of Company B degenerated to a point of bankruptcy were additional steps taken towards reducing assets by a new management team hired by the founding body.

Recommendations presented to Company B during the diagnostic phase addressed the most urgent problems encountered during those three months. As the financial situation continued to deteriorate over the next six months, additional recommendations were made to reflect Company B's changing realities. More drastic steps were recommended that encompassed defining a new profitable product mix, implementing a new sales and marketing strategy, reducing the organizational structure, dividing responsibilities among the top management, and identifying the main sources of profit and cost. Three new financial business plans were created based on future product mix scenarios and assets that would maximise machine and labour efficiency. Recommendations were also made to develop a better working relationship with Company B's debtors and creditors, with particular attention given to the enterprise's sources of finance available at that time.

During the implementation phase, yet more stringent recommendations were made purely as a last resort due to the collapsing financial situation of the enterprise. As a result of indecisive and delayed decision-making by the management, few options remained that did not include drastic steps. Final recommendations to the management, unions and founding body focused on creating a new entity based on core production units. Various financial and organizational simulations were presented to the enterprise in order to accelerate the implementation process needed to reduce the company to core production units. Despite these appeals, Company B's unions rejected the plan which they perceived to be too drastic in the area of staff reductions. Instead, an alternative plan was offered by the unions which also failed to correct the enterprise's problems.

Due to the intransigent attitude of the trade unions, weak management, and lack of exposure by the staff to modern business practices, the restructuring process encountered formidable obstacles. The deteriorating financial situation reached a point where, without debt reduction and an active involvement from institutional policy making bodies,little hope of survival was given to the enterprise despite the belated arrival of a new management team willing and able to implement a drastic restructuring programme.

COMPANY C

DESCRIPTION AND HISTORY OF THE ENTERPRISE

Established in the mid-1950s as one of Poland's leading manufacturers of television sets, Company C under the old system enjoyed prosperity up till 1989. However, the open market policies adopted in 1989 by the Government in the transition to a competitive market economy resulted in increased imports from Western Europe and Asia threatened Company C's domination of the Polish market. From 1989 to 1992, Company C's market share decreased at a rate of approximately 5 per cent per year. In 1991, Company C controlled 16.5 per cent of the nearly 1 million units per year Polish market for television sets. Although the systematic decline in sales stopped at the end of 1992 due to organizational changes and an increased market focus, Company C remains in financial difficulty. Besides the core plant producing television units, three other affiliated production facilities have operated under the same umbrella. These included:

- a production facility for television components
- a production facility for professional television equipment
- a production facility for wooden TV chassis

Throughout its history, Company C has been plagued by an organizational structure that included too many non-core production assets such as maintenance, chemical plating, and recreational services - along with an overgrown employment structure. A detailed summary of Company C's employment from 1988 to 1992 and financial developments from 1990 to 1992 is provided below, revealing its worsening financial condition as a result of lost domestic and foreign markets.

COMPANY C

In million USD	1988	1989	1990	1991	1992
Employees*	3,429	3,777	3,248	3,165	2,123
Fixed assets	-	-	21.46	24.87	19.57
Current assets	-	-	26.94	20.31	13.67
Liabilities	-	-	8.79	32.11	32.06
Total sales	-	-	101.20	57.35	37.39
Gross profit	-	-	10.14	-14.28	-7.22
Net profit	-	-	5.01	-14.49	-7.32

Source: Company data.
* Number of Employees.

MAJOR PROBLEMS AND CONSTRAINTS

Financial problems

One of Company C's major problems stemmed from the financial difficulties caused by declining sales of television units from $101 million in 1990 to $37 million in 1992 due to increased import penetration. Due to the rising losses, financial negotiations commenced with the main creditors: a state bank and the State Treasury. However, the management lacked skills in business planning, financial modelling, and feasibility analysis. Company C's other major problem was the lack of exposure and familiarity with modern business practices that encompassed not only financial areas but also marketing and organizational fields.

Company C relied on manual simulations of potential business scenarios that were time consuming and cumbersome. Once calculated, lack of computerization prevented quick adjustments to changing market conditions and new counter-proposals presented by the main creditors. As such, Company C was at a disadvantage when negotiating with creditors who could quickly develop an alternative position. This problem is endemic in Poland where financial institutions hold a great advantage over enterprises such as Company C in terms of knowledge, business tools at their disposal, and negotiating flexibility.

Marketing and sales

Company C's underdeveloped marketing and sales departments also contributed to its problems. Behaving more as a passive sales order processor rather than an active collector, analyzer, and disseminator of market information, these departments possessed limited knowledge of the competition and were completely unable to quickly spot trends such as the entrance of foreign producers. Overall, modern marketing and sales skills were lacking which required immediate corrective action in the form of increased and intensive training.

Organizational deficiencies

In addition to financial and marketing problems, Company C's bloated organizational structure arising from vertical integration and the previous regime's rigid employment policies made staff reductions extremely difficult. This in turn led to inefficient production, poorly motivated personnel, and tensions among the ranks. Internal conflicts were common within the management, regarding the short and long-term restructuring goals, and between the top management and lower level employees pertaining to the course and speed of needed changes. The top management was replaced three times as a result of disputes among the management and trade union opposition. This struggle and accompanying commotion over the future shape and strategic direction of Company C revealed that restructuring is perceived to be many things to many individuals and the emergence of consensus among the staff to undertake expeditious action is long and difficult.

Company C's production and asset management proved inadequate for modern television manufacturing. With a total of 2215 employees in 1991, only 885 were directly involved in production. The remaining 1330 provided indirect support consisting of facilities involved in injection moulding, stamping, plating, varnishing, holiday resorts, training, shops and service, design (construction), maintenance, and security services. Despite the presence of 62 security guards, major incidents of theft plagued Company C. Despite an overblown organizational structure, certain strategic positions were not staffed. These included the positions of a Purchasing Manager - a critical function in the industry - which resulted in limited awareness of the market for supplies. As was done under the old system, supplies were purchased from state producers with little effort devoted to reduce costs through alternative suppliers. Such organizational paradoxes point to the limited cost awareness culture in Company C at that time.

RECOMMENDATIONS:

Human resource development

To improve Company C's competitive position, one of the leading recommendations focused on human resource development. Reducing the knowledge gap between Western firms and their Polish counterparts became an urgent issue in creating a market oriented enterprise. Top priority was assigned for improvements in marketing and sales, financial planning, cost accounting, organizational efficiency, and quality awareness. Consequently, the creation of a management team well versed in modern business methods and supported by an energetic marketing and accounting departments became the top priority of the restructuring programme.

Organization

Organizational restructuring focused on streamlining the operation by concentrating on Company C's core business activities producing only television sets. As such, reduction in excessive support activities taking-up approximately 80,000 square meters became the top priority with such departments as chemical plating, tool shop, transportation, maintenance, and recreation being liquidated or spun-off. The slow process of implementing restructuring recommendations is still continuing and so far has reduced the operation to its core production units utilizing half the amount of space as before. Shedding surplus assets was not only needed to improve organizational efficiency and competitiveness of Company C, but was also a prerequisite to negotiate debt reductions with its main creditors.

Finance

As the first logical step to improve Company C's internal performance, the management tried to improve its debt negotiating position with the bank and the State Treasury. Creditors were invited to take part in a partnership that would take over those of Company C's assets which were essential for manufacturing television units. Partnership options involved debt to equity swaps based on market value, debt-to-equity swaps based on book value, and/or cash contributions by the bank or the State Treasury. As with other enterprises in the region, success or failure of a restructuring programme does not depend only on internal changes, but is influenced by the actions of many external institutions.

Company C due to its growing financial problems needed intensive assistance from government ministries, agencies, and the state banking sector during the restructuring process. Previous attempts by Company C to involve these institutions were ignored due to Company C's declining financial position, the instability of management, and the apparent inability to launch internal changes. As such, it was up to Company C to first show positive results of the restructuring programme before active involvement could be expected from the external institutions. This happened in the fourth quarter of 1992 when sales of television units increased noticeably due to internal reorganization, improved marketing and sales efforts, and increased financial awareness of the staff as a result of intensive training efforts. At that point, the bank approved Company C's new business plan. To help the company, the bank also agreed to defer part of Company C's payments (approximately 50 per cent) until the company improved its financial position.

Flexibility shown by the bank also reflects the company's improved sales as well as on-going negotiations between the EBRD and the Polish government to restructure the bad debt portfolios of Poland's leading banks. With the assistance of the leading Polish Banks, EBRD will select approximately 20 potentially viable enterprises to form a holding company. Company C is likely to be included in this group of promising companies. The holding company will take over all debts of the participating enterprises and with financial resources from EBRD and EEC's PHARE Programme will renegotiate loan terms, debts, and credit agreements. Participating Polish enterprises will have their bank debt restructured in order to open new opportunities, which were previously impossible to realize due to crushing financial obligations.

Production

Recommendations also focused on production process improvements that were costly and obfuscated. For example, in 1991 production planning was based on the level of stocked materials and components and attention to quality played an insignificant role. To improve production planning, recommendations were made to develop monthly production plans, order material and components to match the plan, collect information on sales, and monitor television stock levels. Implementation of these steps resulted in improved scheduling of volume and assortment of production by the production and procurement departments.

RESULTS AND CONCLUSIONS

The third change of management in Company C produced a stable and dedicated staff of managers actively supporting the restructuring process that led to a creation of a core organizational structure focused on television production. Company C's orientation on core business activities led to separating or liquidating support activities, and redefining plant layout and redesigning production process on a more rational basis.

The implementation of a new motivational system to retain experienced staff was a major success for the company. The main elements of the new motivational system consisted of the Managing Director earning 5.8 times more compared to a manual worker. Other differences in pay included:

- Chief Accountant - 5.2 times more
- Chief Designer - 4.2 times more
- Department Manager - 3.0 times more
- Deputy Manager - 2.4 times more
- Skilled worker - 1.5 times more

This pay scale was forced thorough despite objections from the trade unions who preferred an egalitarian pay system. The management justified pay increases on the basis of more responsibility being given to each worker

within the hierarchy. Although such pay differentials may seem small by Western standards, they are a great step forward for an enterprise where previously salary scales were roughly the same regardless of functions performed and skills possessed.

Restructuring also entailed developing an active policy to work with Company C's founding body to commence ownership transformation. In the case of television manufacturing, all legal questions regarding ownership required the founding body's approval. Due to institutional inertia, decisions concerning such vital issues as the definition of and agreement on Company C's core business were addressed very slowly which in turn influenced the speed of the restructuring programme. As such, management's drive to create a new legal entity on the basis of core production units has been slower than expected due to external factors.

Emphasis on training improved the management's financial skills in business plan development, placing the company on a more equal footing with its creditors. New financial business plan initiatives took into consideration Company C's restructuring achievements and a market study was organized by staff newly trained in market research and analysis. Based on the new business plan, Company C commenced implementing a debt restructuring programme involving the bank and the relevant government institutions. To restructure the firm's debt, the company agreed to pay the bank 10 milliard PZL in interest by the end of 1992 (approximately $ 500,000) in order to continue the debt reduction discussions. For more than one-half of Company C's supplier debt, an agreement was reached to repay the debt in instalments without additional penalty interest being charged. Company C also agreed to make regular payments to the state budget for social security. However, no decision was reached regarding back payments for turnover tax.

The management actively supported restructuring that focused on production and technological improvements. Using its own technology and relying on cooperation with Western firms led to major product improvements in technology, quality and in the aesthetic appeal of television units produced. As a result, sales of television sets increased in 1992 and 1993. In addition, marketing improvements helped to boost sales through a better pricing strategy and an aggressive promotional campaign. Company C also offered discounts during key period of the year such as at Christmas and targeted key consumer segments. Information regarding Company C's consumers was obtained through a systematic analysis of collected information. Development of a market data bank helped greatly in this area.

CONCLUSIONS

Based on UNIDO's experience in Poland, restructuring of the enterprises, in general, reduced employment by around 33 per cent, and assets by around 40 per cent. Sales in the enterprises remained around the same level as before the transformation process in Poland began, but these sales figures reflect market prices rather than agreed COMECON contracts.

Although the management and labour of the enterprises initially perceived restructuring to be a vehicle to reach new financing and investment sources to improve production, the integrated restructuring process proved to be quite different. Restructuring as shown in the three cases consisted of a series of actions needed to improve the enterprises' immediate domestic competitive position, and in the longer term meet international performance standards. In most cases, these actions entailed organizational changes pertaining to personnel and physical assets, human resource development, financial restructuring such as debt write- offs, debt/equity swaps, refinancing, technological improvements, and ownership transformation. In certain specific cases, as in Company B, restructuring also included analyzing bankruptcy options in order to minimize losses.

All three cases revealed that the restructuring process is a lengthy and complex undertaking demanding enormous commitment and perseverance from the management, expertise from advisory institutions, financial support from state and banking sectors, and active involvement and support of the founding bodies and other relevant Government bodies. This constellation of factors must also take into consideration the legal, political and regulatory environment that influences the progress and success of restructuring programmes. To be successful, the cases have shown that restructuring should be a dynamic comprehensive and integrated programme that examines both the internal and external environments influencing the enterprise's immediate, short, and long term prospects.

In the successful cases, enterprises were able to increase their competitive stand by improving modern business skills, introducing a market oriented organizational structure, and adjusting their product mix and cost structures as required by new market conditions. Training provided for the enterprises became an important agent

of change as the management improved its managerial capacities necessary to survive in a new economic environment. Also, active participation by policy making institutions in the restructuring process emerged as a critical factor for success. In difficult cases, the management and the employees provided little support for industrial rehabilitation and systematically opposed the structural changes needed to improve the enterprise's competitive position. Compounding the problem was the passivity of various policy making bodies in the restructuring programmes as witnessed in the cases of Companies B and C.

EXTERNAL BUSINESS ENVIRONMENT

The overall shortcomings of the Polish business environment in which the enterprises operated created formidable obstacles for the restructuring process. These were especially evident in the areas of banking and financial services, capital markets, institutional policy making bodies, legal/taxation issues, and physical infrastructure, particularly inadequate telecommunication and road systems. The influence of an external policy environment became that much more relevant since restructuring entailed integrating the objectives of industrial policies with micro-level enterprise decisions. The clear implication is that it becomes imperative that national decision makers should make much greater effort to understand and appreciate the difficulties faced by enterprises and their needs during the restructuring process. Assistance by well informed and concerned institutions, proved to be a significant boost for enterprises struggling to improve their competitiveness.

Enterprise Level Restructuring Constraints

The economic viability of the three enterprises was endangered by the new and unfamiliar pressures and challenges of the transformation process from centrally planned to a market oriented economy. In all cases, the enterprises encountered deficiencies in terms of knowledge of modern business practice and management skills, especially related to financial engineering, cost accounting, marketing, improved technologies, and distribution. Furthermore, the enterprises needed immediate attention to reduce non-productive assets and improve activities covering the entire spectrum of managerial functions.

The ability to quickly diagnose an ailing enterprise and recommend immediate short term changes was an important catalyst for hard pressed enterprises. The diagnostic formulation of restructuring programmes was a first, and relatively easy step, since most of the work was done by an outside expert. However, the next step was much more difficult since it entailed persuading the management to commence implementing changes in the shortest possible time. The diagnostic and implementation steps demanded a change of mentality among the management and workers which, in certain cases, required creating a completely new management team to overcome built-in resistance to the restructuring process. For example, in the case of the Polish television plant, three management teams were changed before a restructuring programme was launched.

As a result of divergent management attitudes, the diagnostic phase of restructuring produced recommendations that were sometimes accepted and sometimes rejected by the management and workers of the enterprises. Thus, although immediate decisions were needed to develop a turnaround plan and arrest Company C's and Company B's decline, management and worker inertia prevented immediate actions from being taken. In the case of the linen factory, both management and labour opposed restructuring plans to establish a new basis for viable production and overall growth. Contributing to the difficulties was management's inability to understand the implications of the ongoing economic transformation process and their direct and indirect impact on the linen manufacturing sector. The strong opposition of Trade Unions to reductions in employment also proved to be a major constraint, particularly for Company B.

Furthermore, there were difficulties in implementing differentiated pay scales commensurate with skill differentials, as there were also difficulties experienced in introducing incentive schemes.

INDUSTRIAL HUMAN RESOURCE DEVELOPMENT

The enterprises faced a number of new and challenging problems related to human resource development. Given the gap between the skills of enterprise managements and those required for managing efficient and competitive enterprises, training became a pivotal element of the restructuring process. In the particular case of the Polish linen plant, the skills of the management and labour were far behind those required to meet the emerging needs of the market economy. Consequently, this enterprise's management team produced organizational paralysis and ultimately were unable to carry out restructuring.

In addition, all of the enterprises had an underdeveloped mid-level management team resulting in an unwieldy decision-making structure that stifled creativity, undermined motivation, and diluted responsibility. Although a better trained top management team did compensate for some of the inadequacies of lower level management, the implementation of restructuring at the mid-level and below frequently encountered resistance. These problems were exacerbated by the unskilled labour force and by the trade unions and self-management groups that viewed restructuring with trepidation. In general, the success of the restructuring programmes was dependent on the skills and knowledge within the organization. Looking from the top of the organizational pyramid downwards, modern business skills and knowledge typically decreased, responsibilities were more diffuse, and resistance to restructuring became more fierce.

In many ways, training can be a powerful tool for consensus building among a enterprise's personnel by the way it creates a business culture based on shared and understood principles. The general lack of a broad set of cultural and behavioral standards among enterprise managements and labour is a considerable obstacle in the way of building corporate identity, mission, and strategy. In addition, technological change launched by the restructuring process demands a better trained and flexible workforce. Training and improved competitiveness are inextricably linked, especially as knowledge based industries evolve in CEE and the FSU countries.

The experience of the three industrial restructuring cases showed that improved competitive performance is directly tied to defining and then better utilizing the critical human, financial, and physical assets of the enterprise. The case studies indicate clearly that investment in human resource development should be made a top priority. For it is the human resources of the enterprise that will decide how efficiently and productively assets will be used and how skilfully financial engineering will be applied to improve cost reduction measures and debt negotiations with main creditors. Successful restructuring programmes depend primarily on the skills of enterprise management. It was noticeable that management teams that had been exposed to modern business practices provided more active and effective support for restructuring. By contrast, enterprises where management teams functioned as an administrative body for disseminating commands, restructuring was much more difficult to implement.

PHYSICAL AND ORGANIZATIONAL RESTRUCTURING

All three enterprises in the case studies suffered from common problems of misallocation of resources, overmanning, and bloated organizational structures surrounding the core business unit. Enterprises were all vertically integrated. How to become more "horizontal" took on a new dimension: staff accustomed to taking orders from the central planners suddenly had to adapt to radically different economic priorities. Such drastic change requires time to allow improvements in the capabilities of enterprise management before they operate with similar business skills, knowledge, and information as their Western competitors. Unfortunately, time has been a very scarce commodity in Poland.

Besides establishing a proactive marketing and sales department which all of the enterprises lacked, a market orientation required departments to refocus and coordinate their activities and make the customers' needs their top priority. Creating a network of interactive departments sharing information and defining common objectives is thus a vital element in restructuring enterprises as market oriented business entities.

FINANCIAL RESTRUCTURING

In all three cases, the restructuring programmes revealed that Poland's banking and financial sector needs training to develop skills and improve capabilities in supporting enterprises being restructured. Corporate finance requires a sophisticated cadre of working specialists well trained in risk management, forecasting, and familiar with the general objectives of restructuring programme. The shortages of experienced and trained staff in both the banking and financial service sector and in enterprises themselves, had in the case of Company B, a deleterious influence on the pace and the eventual outcome of the restructuring programme. To alleviate this problem, it is essential to develop joint bank and corporate client training programmes so that both sides recognise they are really partners. In the long term, Poland will need a well functioning banking system to monitor, assess, and where necessary, control the behaviour of those enterprises currently being restructured.

In the more difficult cases of Company B and Company C, the banking sector's reluctance to engage in financial restructuring was tied to the dangers of the banks existing non-performing loan portfolios. Consequently, restructuring efforts that could have included such financing options as debt-equity swaps, debt consolidation, and maturity extension were not even considered by an illiquid and undercapitalised banking system. As the balance

sheets of the enterprises and the loan portfolios of banks deteriorated in parallel, the political and economic pressure increased on state government to intervene and recapitalize the banks and clean up the enterprise balance sheets.

Poland's underdeveloped capital markets have also proved of limited use as a source of financial support for restructuring and privatization programmes. In the case studies, all enterprises experienced financial difficulties. Financial restructuring and privatization continues to be dependent on the pace of development of the Polish banking system, the strength of the emerging stock market, and the availability of specialized financial engineering expertise for enterprises.

As capital markets develop, financial institutions will undoubtedly play an influential role in corporate control and thus in the corporate governance of restructured and privatized enterprises. With the anticipated growth of investment funds based on a diluted system of ownership, capital market institutions will be in a powerful position to monitor and instill discipline in the interests of improved corporate governance of privatized enterprises.

PRIVATIZATION AND CORPORATE GOVERNANCE

A key element of restructuring, and some would argue the most important, is privatization. The importance of ownership change at the macro-economic level is related to the critical mass of private owners that CEE states desire to create in the shortest possible time. An expanding private sector is, it is argued, an indispensable ingredient of an efficiently operating market economy. At the micro-economic level, privatization is seen as the most effective method to create an innovative managerial class familiar with modern business practices and, driven by incentives, to increase the enterprise's competitive position by improving cost efficiency and allocation of human and capital resources, and to establish a flexible organization capable of adjusting to market changes.

The case studies are a fair reflection of the uneven pace of privatization among state owned enterprises. For example, Company A privatized using one of the most popular methods, the purchase of an enterprise by the managers and employees. However, to run a newly privatized operation successfully, the managers and the employees still needed a crash course to improve their skills in such critical areas as financial management, cost accounting, marketing, and modern technological methods. Generally, the higher the skill level of the management and employees, the more likely the enterprise is to become private and compete effectively in a market oriented economic system. In short, human resource development, or lack of it, can be as much a constraint on privatization as shortages of capital.

The issue of corporate governance is also important in privatization. In the cases of Company B and Company C, the lack of active involvement by the state founding bodies, the legal owners of the two enterprises, slowed the restructuring process and subsequent privatization efforts. The absence of a corporate governance culture where, the owner takes the necessary time to ensure that the enterprise is well managed and profitable, resulted in confusion and contradiction in those enterprises experiencing serious financial difficulties. Thus, Company C failed to receive quick support from the founding body necessary to permit timely liquidation of non-productive assets and re-organization of the enterprise around a core production unit focusing solely on the main product. In the case of Company B, the founding body feared increasing regional unemployment and failed to support the painful restructuring steps needed to be taken in the shortest possible time to save the collapsing enterprise.