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21763

# RESTRUCTURING OF ZP „ĆMIELÓW”

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34 p.  
table  
diagram

## Final Implementation Report



21763

A BRITISH KNOW-HOW FUND PROJECT EXECUTED BY  
UNITED NATIONS INDUSTRIAL DEVELOPMENT ORGANIZATION WITH THE  
SUPPORT OF THE POLISH INDUSTRIAL DEVELOPMENT AGENCY

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BMF/ERNST & YOUNG

January 1997

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## 1. THE PROJECT

ZP "Ćmielów" is a state-owned enterprise supervised by the Tarnobrzeg Voievode. The company produces white porcelain goods and sells both to the domestic and foreign markets. In 1992-93 the company's position seriously deteriorated due to:

- decline of sales due to the rapid decrease of the domestic demand and the collapse of the former Soviet market
- increase of costs and in particular the financial costs
- lack of funds for capital expenditures needed to upgrade depreciating assets
- difficult access to external financing which brought about liquidity problems

Accumulating of debts forced the company to apply in June 1993 for the so called "Bank's Conciliatory Proceeding" – a debt-reducing procedure introduced by the special law "Act on the Restructuring of Banks and Enterprises".

British Know-How Fund and UNIDO in cooperation with the Polish Industrial Development Agency selected the consortium of BMF and Ernst & Young to carry out the restructuring project for "Ćmielów". The project started in January 1996 and its objectives were established as follows:

- to provide the company with immediate advice to solve its short-term technical, marketing and financial problems,
- to develop the comprehensive restructuring programme based on detailed analysis of company's operations and analysis of its competitive position
- to assist in the implementation of the restructuring programme
- to provide company's management with the relevant, both ad hoc and formal, training

In the course of executing the project, consultants prepared a number of reports and presentations including: "Interim Restructuring Report", "Presentation of First Results", "Draft Restructuring Report" and "Restructuring Report: Part I – Diagnostic Recommendations". Reports contained both analysis of "Ćmielów"'s position and restructuring recommendations. Company's management was also provided with the support in the form of trainings and ad hoc advice related to current problems.

## 2. MAIN PROBLEMS OF ZP “ĆMIELÓW”

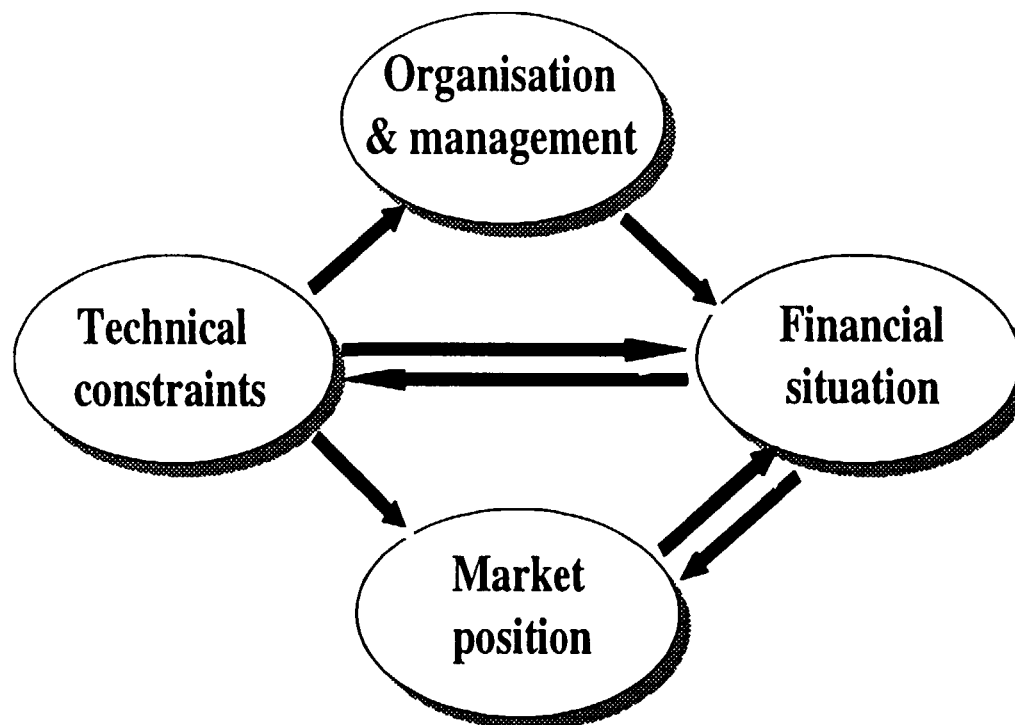
Main findings of the diagnostic part of the project indicated that the company required improvements in virtually all areas of its operations. “Ćmielów”'s position in the beginning of 1996 was difficult and the following problems were identified as the most important:

- weak market position:
- low share in the domestic market and in exports of the polish porcelain products
  - lack of the clearly defined market strategy
  - lack of the developed marketing and sales department
- poor financial position:
- inability to service debts owed to creditors within the framework of the bank's conciliatory procedure
  - high ratio of total operating costs in net sales of products
  - liquidity problems leading to the increase in financial costs
  - lack of the financial director and ineffective financial information system
- inefficient organisation:
- excessive overall employment with shortage of specialists in finance and marketing
  - lack of the motivational system
- serious technical constrains:
- obsolete and highly depreciated machinery and equipment
  - highly labour intensive production
  - inability to increase the volume of production without substantial additional expenditures.

Company's inability to fulfill the terms of the Bank's Conciliatory Agreement was identified as the most serious problem. There were more than fifty creditors at that time and if any one of them demanded full repayment, “Ćmielów” would have to go bankrupt. Furthermore, the company could not undertake any serious attempt of finding external financing, as long as the BCA problem remained unsolved. “Ćmielów”'s situation was a kind of “cul de sac”: the company could not improve its position without investments, could not invest without external financing and could not find this financing without solving the past debts problem.



Given the scale and complexity of “Ćmielów”'s problems the restructuring had to encompass all fields of company's operations taking into account existing interrelations and constraints. The picture below illustrates some important interrelations:



Arrows in the picture show the important factors determining “Ćmielów”'s situation. Poor organisation and management (especially financial management) had a clear negative impact on company's financial performance. The latter was also affected by “Ćmielów”'s weak market position (low level of revenues) and technical constraints (high costs due to obsolete machinery and excessive labor). On the other hand, the poor financial situation was the major barrier for change: the company was unable to invest in new production technology, computerization, marketing and distribution system. Finally, technical problems had an impact on company's market position: “Ćmielów” could not exploit its best market niche (high value-added, luxury products) due to inability to produce good quality porcelain.

### **3. RESTRUCTURING RECOMMENDATIONS**

Based on the analyses of different aspects of “Ćmielów”’s operations, the following recommendations have been made:

#### **3.1 Financial Restructuring and Privatisation**

- 3.1.1 ZP “Ćmielów” should be transformed into the commercial code company (preferably: joint-stock company), with the use of the Law on Privatisation of July 1990 (Art. 37.1.2);
- 3.1.2 Current BCP creditors should be offered shares in newly created company;
- 3.1.3 Active investor should be identified to provide new equity.
- 3.1.4 New company should negotiate new debt arrangements with banks to finance its investment programme.

#### **3.2 Management and organisational improvements**

- 3.2.1 Modern cost accounting and control system should be implemented
- 3.2.2 Financial and Marketing Departments should be strengthened by hiring skilled personnel and/or training
- 3.2.3 Certain non-core activities (like transportation and catering) should be separated from company’s operations
- 3.2.4 Quality control system should be improved and moved under the direct control of the Managing Director
- 3.2.5 Non-productive assets should be disposed

### 3.3 New market strategy

- 3.3.1 “Ćmielów” should focus on the needs of higher end of the market.
- 3.3.2 Development of sales in the domestic market should be given a priority
- 3.3.3 More efficient distribution system should be established
- 3.3.4 Low quality products should be sold under a separate brand name or with a different logo.
- 3.3.5 There should be a reduction in white porcelain sales to intermediaries.
- 3.3.6 The number of products (i.e. dinner sets) should be reduced
- 3.3.7 Prices in the international markets should be increased.

### 3.4 Investment program

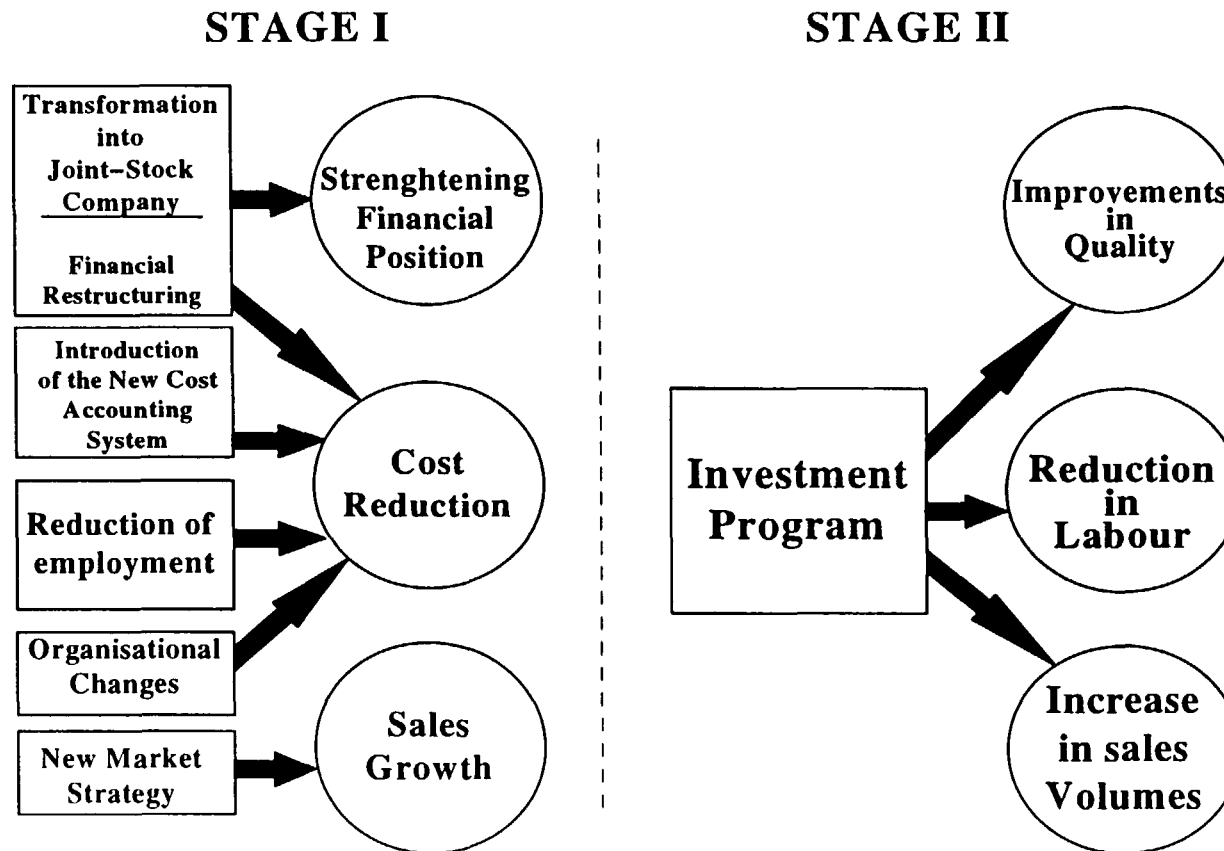
The following priorities have been established:

- 3.4.1 Purchase and installation of the second chamber kiln.
- 3.4.2 Purchase and installation of the cup producing machine.
- 3.4.3 Purchase of laboratory equipment to improve products quality.
- 3.4.4 Purchase of two, second-hand izostatic presses.
- 3.4.5 Purchase of the spray dryer working with izostatic presses





Main elements of the restructuring program are summarized in the picture below



## 4. IMPLEMENTATION.

### 4.1 Financial Restructuring and Transformation:

#### 4.1.1 Bank's Conciliatory Agreement

Bank's Conciliatory Agreement came into force in May 1994. In 1994 and 1995 "Ćmielów" was not able to repay its creditors in line with terms of the BCA. As a result, in the end of 1995 the company still owed to creditors 2.2 mln. PLN. The structure of BCA was as follows:

Debt (PLN)	No. of creditors	Value	Structure (%)
up to 10,000	26	56,082	2.6
10,000 – 50,000	20	209,038	9.7
50,000–100,000	4	111,675	5.2
over 100,000	7	1,778,960	82.5
<b>total</b>	<b>57</b>	<b>2,155,755</b>	<b>100.0</b>

The large portion of debt (31%) was owed either to State Treasury or to different administration institutions.

Given the financial performance of "Ćmielów" (inability to generate cash needed for repayments), converting part of the BCA debt into shares of the newly established company seemed to be the only possible solution. Consultants proposed that ZP "Ćmielów" should be liquidated as the state-owned enterprise with the use of Art. 37 of the "Law on Privatisation" and both its assets and liabilities should be contributed to the newly established, commercial code company. New company would take over employees and all the activities of liquidated "Ćmielów"; it would also use its brand name. Adoption of such a solution would enable creditors to swap their debt into shares of the new company (if creditors would decide to do it) and also, potentially, to bring new investors in.

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If the proposed solution was to be implemented, it had to be accepted by the current owner – State Treasury (represented by Tarnobrzeg Voivode and Ministry of Privatisation) and by creditors. It was intended, that only big creditors, possessing approximately 87% of BCA debt would be invited to swap it for shares. The rest was to be repaid in cash. Finding a potential investor would certainly help the deal. Things to be done included:

- presentation of the privatisation concept to representatives of the state Treasury and getting their approval and support
- negotiations with creditors to convince them to participation in the program
- identification of the potential investor

Starting from recommendations of restructuring program, consultants prepared business–plan with financial projections illustrating results of the transformed company. The program was accepted by “Ćmielów” and representatives of the State Treasury and the process of privatisation formally started.

### 4.1.2 Privatisation programme.

The following steps have been undertaken so far:

- Voievode of Tarnobrzeg established Negotiating Committee to supervise “Ćmielów”’s privatisation; BMF has been appointed as an advisor to the Committee
- an invitation for the potential investors to participate in “Ćmielów”’s privatisation was published in press
- Consultants prepared Information Memorandum describing proposed transformation of “Ćmielów”; Memorandum was distributed among investors and creditors
- valuation of “Ćmielów” was prepared
- draft shareholders agreement and articles of association for the new company were prepared
- series of negotiations with big BCA creditors was conducted; consultants participated in the few meetings with the Board of Creditors (a body established by BCA) and with: Kombinat Budowlany “Ostrowiec”, Izba Skarbowa, Bank Depozytowo–Kredytowy, Komitet Badań Naukowych, Państwowe Górnictwo Naftowe i Gazownictwo
- “Ćmielów”’s non–core assets (Factory “Świt”) were sold and proceeds used to repay smaller BCA creditors



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- few potential investors have been identified and initial negotiations conducted; as a result the most serious investor (a consortium of companies and private individual) was selected

As a result of all these actions, the principle terms of “Ćmielów”’s transformation has been agreed:

- (1) State Treasury accepted that “Ćmielów” would be liquidated and its assets and liabilities contributed to the newly established company; in exchange, State Treasury would get shares worth 1.15 mln. PLN
- (2) Investor would contribute 2.2 mln. PLN in cash and would accept the obligation to invest additional 3.4 mln. PLN in the next three years
- (3) the potential investor reached the agreement with “Ćmielów”’s labor unions concerning so called “social package” after privatisation
- (4) 18 creditors accepted swap of their debt for shares; combined face value of their debt is 1.13 mln. PLN.

The remaining BCA debt (approximately 0.6 mln. PLN) is owned by 9 creditors. “Ćmielów” is trying to negotiate favorable terms of repayment, with installments spread over the 2–3 years.

The actual amount of debt converted into shares will depend on negotiations between new investor and creditors. The potential investor may chose to repay the debt rather than swap it into shares.

### Things to be done:

The most important task is now to reach the final agreement between State Treasury, potential investor and creditors and to close the deal. This would let the bank (BDK) to announce that the Bank’s Conciliatory Procedure is completed. After the transformation the company could start its investment program.



### 4.1.3 Financial Projections.

#### Assumptions

Long-term machinery and equipment utilisation, the necessity of labour and material costs reduction, and the growing competition and increasing quality requirements for the products of ZP "Ćmielów" were the main reasons behind the Company starting to consider the implementation of an investment program.

The main changes in basic assumptions of this scenario resulted from negotiations of the Company's representatives with a potential investor. In comparison with the previous scenario included in the Final Restructuring Report, they concern two issues, namely:

- (i) the amount of the total liabilities included in BCP, which will be converted into shares, equals to 1 000 000 PLN (versus 1 453 000 PLN in the previous version),
- (ii) the structure of the project financing is limited to capital injection in cash amounting to 5 600 000 PLN contributed by an investor during the first three years (versus long term debts amounting to 5 100 000 PLN and investor's contribution equal to 1 000 000 PLN in the previous version).

According to this, we conducted a financial analysis on the assumption that the Company would be privatised through the conversion into shares of 1 000 000 PLN of total liabilities included in BCP, and that the remainder would be repaid through the sale of "Świt" Plant, through capital injection and using internal financial means generated from ZP "Ćmielów"'s current activities.

The analysed scenario involves total investment outlays of **5 439 000 PLN** (including 5% of reserves, 3% of import tax and 13% of customs duty), in which the purchase of machinery and equipment will amount to 4 807 400 PLN, while the remaining amount will include: construction works – 365 400 PLN – and a laboratory equipment – 266 200 PLN. The investor is expected, in this scenario, to contribute 5 600 000 PLN. Capital injections will be contributed in cash according to the following schedule:

- (1) 2 200 000 PLN – at the starting point (the beginning of 1997),



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- (2) 2 400 000 PLN – at the end of 1997,
- (3) 1 000 000 PLN – at the end of 1998.

No long term debts were envisaged.

The projections of sales, operating costs, working capital needs and other parameters, were not changed for the purpose of comparison with the previous version.

We have not included the possibility of obtaining an investment tax allowance (based on the Council of Ministry's Decree of January 25, 1994).

The projections cover five years, beginning from 1.01.1997 to the year 2001.

All calculations were made on a yearly basis. As the opening balance sheet we assumed the last available Balance Sheet of the Company as at 31.12.1995. Unless stated otherwise, all calculations have been made in thousands of "new" Polish zloties (PLN), and in constant prices from the end of December 1995.

### Results

Our analysis of the feasibility of the investment scenario was based on two groups of criteria:

- (i) financial liquidity,
- (ii) profitability.

In the case of the financial ratios, we used the same methodology as in the historical analysis of the Company's financial statements.

The analysed scenario shows positive cumulated cash within all periods, except the second year of projection, when the negative cumulated cash amounts to 42 000 PLN. On the other hand, there is a significant surplus of cash at the starting point and in the first year of the projection



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caused by lower financial costs. This suggests two solutions;

- (1) revision of the assumed investment timetable with the purpose to start a part of investment programme earlier, which would allow to speed up its completion and to use its benefits earlier,
- (2) revision of the proposed schedule of investor s contribution in cash in order to optimise the use of sources.

**Table 1 – Income Statement**

thousand PLN	1997	1998	1999	2000	2001
Total revenues	13,974	16,045	17,330	19,011	20,880
Variable costs	7,540	8,649	8,786	9,664	10,539
<b>Gross margin</b>	<b>6,434</b>	<b>7,396</b>	<b>8,544</b>	<b>9,347</b>	<b>10,342</b>
Fixed costs	5,005	4,935	5,146	5,674	6,184
Adjustment (change in inventories)	(710)	(91)	(58)	46	45
<i>Operating costs/Total revenues</i>	<i>95%</i>	<i>85%</i>	<i>81%</i>	<i>80%</i>	<i>80%</i>
<b>Total operating costs</b>	<b>13,255</b>	<b>13,676</b>	<b>13,990</b>	<b>15,292</b>	<b>16,678</b>
<b>Gross profit</b>	<b>719</b>	<b>2,369</b>	<b>3,340</b>	<b>3,719</b>	<b>4,202</b>
Depreciation	450	626	869	1,025	1,025
Prepayments	133	133	68		
<b>EBIT</b>	<b>136</b>	<b>1,610</b>	<b>2,403</b>	<b>2,694</b>	<b>3,177</b>
Financial costs	339	160	60	0	0
Financial incomes					
Extraordinary profits/losses	568				
Result on the other sales	100				
<b>EBT</b>	<b>465</b>	<b>1,450</b>	<b>2,343</b>	<b>2,694</b>	<b>3,177</b>
Income tax	0	566	937	1,078	1,271
<b>Net profit</b>	<b>465</b>	<b>884</b>	<b>1,406</b>	<b>1,616</b>	<b>1,906</b>



**Table 2 – Balance sheet**

	0	1997	1998	1999	2000	2001
<b>Assets</b>						
<b>Current Assets</b>						
Cash	709	1,659	(42)	1,577	3,795	6,303
Inventories: Raw materials	517	494	570	586	627	658
Work in progress	755	689	761	778	856	933
Finished goods	979	402	444	454	499	545
Goods for sale	4	4	4	4	4	4
Trade debtors	1,127	1,409	1,632	1,774	1,956	2,158
Tax receivables	85	85	85	85	85	85
Others debtors	9	9	9	9	9	9
Receivables from budget (investment's VAT)	263	191	688			
VAT receivables		57	80	103	126	154
<b>Total current assets</b>	<b>4,447</b>	<b>5,000</b>	<b>4,232</b>	<b>5,369</b>	<b>7,957</b>	<b>10,849</b>
Gross fixed assets		17,623	18,490	21,619	21,619	21,619
Depreciation		9,936	10,561	11,430	12,455	13,481
<b>Net fixed assets</b>	<b>5,984</b>	<b>7,687</b>	<b>7,929</b>	<b>10,189</b>	<b>9,164</b>	<b>8,139</b>
Investment in progress	1,142					
New investment in progress	1,443	867	3,129	0	0	0
Financial assets	5	5	5	5	5	5
Prepayments	334	201	68	0	0	0
<b>TOTAL ASSETS</b>	<b>13,355</b>	<b>13,760</b>	<b>15,363</b>	<b>15,563</b>	<b>17,126</b>	<b>18,993</b>
<b>Liabilities</b>						
<b>Current liabilities</b>						
Trade creditors	1,840	1,399	1,274	1,048	894	750
Tax liabilities	871	203	218	273	322	382
Social security liabilities	513	342	171	128	144	15
Payroll liabilities	257	257	257	265	300	330
Other liabilities	178	178	178	178	178	178
Short-term credits and loans	1,362	893	893	0	0	0
Accruals & deferred income	106	106	106			
<b>Total current liabilities</b>	<b>5,127</b>	<b>3,379</b>	<b>3,097</b>	<b>1,892</b>	<b>1,838</b>	<b>1,799</b>
<b>Other liabilities</b>						
Long-term credits and loans	0	0	0	0	0	0
Long-term liabilities	712					
<b>Equity</b>						
Own funds	7,793	10,193	11,193	11,193	11,193	11,193
Previous year's profit	(337)	(276)	189	1,073	2,479	4,095
Profit/loss for year	61	465	884	1,406	1,616	1,906
<b>Total equity</b>	<b>7,517</b>	<b>10,382</b>	<b>12,266</b>	<b>13,671</b>	<b>15,288</b>	<b>17,194</b>
<b>Total liabilities</b>	<b>13,355</b>	<b>13,760</b>	<b>15,363</b>	<b>15,563</b>	<b>17,126</b>	<b>18,993</b>



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**Table 3 – Cash Flow**

<b>CASH FLOW (thousand PLN)</b>	<b>0</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>
<b>Sources</b>						
EBIT	0	136	1,610	2,403	2,694	3,177
Depreciation	0	450	626	869	1,025	1,025
Other incomes	0	100	0	0	0	0
Extraordinary profits/losses	0	568	0	0	0	0
Changes in equity	2,200	2,400	1,000	0	0	0
Long term debts	0	0	0	0	0	0
Short term debt						
<b>Total sources</b>	<b>2,200</b>	<b>3,654</b>	<b>3,236</b>	<b>3,272</b>	<b>3,719</b>	<b>4,202</b>
<b>Uses</b>						
Investments	1,443	867	3,129	0	0	
Changes in existing fixed assets		(432)				
Increase in working capital	263	882	1,214	(275)	423	424
Taxes	0	0	566	937	1,078	1,271
Installments of long term credits	0	0	0	0	0	0
Long term liabilities	0	712	0	0	0	0
Short term credit repayment	0	469	0	893	0	0
Interest	0	339	160	60	0	0
Accruals/Deferred incomes	0	0	0	106	0	0
Prepaid expenses	0	(133)	(133)	(68)	0	0
<b>Total uses</b>	<b>1,706</b>	<b>2,704</b>	<b>4,936</b>	<b>1,654</b>	<b>1,501</b>	<b>1,695</b>
<b>Net cash flow</b>	<b>494</b>	<b>950</b>	<b>(1,701)</b>	<b>1,618</b>	<b>2,218</b>	<b>2,507</b>
<b>Cumulated cash flow</b>	<b>215</b>	<b>709</b>	<b>1,659</b>	<b>(42)</b>	<b>1,577</b>	<b>6,303</b>



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**Table 4 – Financial Ratios**

FINANCIAL RATIOS	31 XII 1995	1997	1998	1999	2000	2001
<b>Liquidity Ratios</b>						
Current Ratio	0.72	1.48	1.37	2.84	4.33	6.03
Quick Ratio	0.28	0.94	0.54	1.82	3.18	4.76
<b>Creditability Ratios</b>						
Debt Coverage Ratio	0.31 *	1.72	11.24	2.52	N/A	N/A
Debt/Equity	0.42 *	0.09	0.07	0.00	0.00	0.00
<b>Profitability</b>						
ROA	0.55% *	3.43%	6.07%	9.09%	9.89%	10.56%
ROS	0.51% *	3.33%	5.51%	8.11%	8.50%	9.13%
ROE	1.15% *	5.19%	7.81%	10.84%	11.16%	11.74%

Based on the value of liquidity ratios it can be stated that the Company's liquidity may be threatened until 1999 – the value of the Quick Ratio is lower than 1.

The Debt Coverage Ratio has a very high value during the whole projection period and the Debt/Equity Ratio is decreasing, due to the assumed structure of financing.

The level of values of ROE Ratio is lower than in the previous version due to the assumed structure of project financing.

The sensitivity analysis describes the maximum change regarding prices and operating costs when the cumulative value of cash in each period of the projection remains positive. The basic conclusion from the above analysis is that the project is still sensitive to changes in operating conditions. This would imply a very high risk for the project.

## 4.2 Management and organisational improvements

### 4.2.1 Designing and implementation of the cost accounting system.

“Ćmielów”'s MIS was poorly developed and inefficient. There was no modern cost accounting system. “Ćmielów”'s Financial Department was unable to generate information required for the effective management of the company. Detailed information costs and profitability of separate product lines was not available. As a result, many important decision were being made on the base of intuition rather than knowledge.

Consultants prepared the “Budgeting and Cost Control System for ZP “Ćmielów”“. The system consists of the four modules:

- I. Sales budget
- II. Production budget
- III. Budgeted wages fund
- IV. Budgeted income statement

#### Present situation.

General ledger of accounts of ZP “Ćmielów” has been changed since the 16th of November 1996 according to suggestions included in Ernst & Young report as of March 1996 “Budgeting and cost controlling system – project for ZP “Ćmielów”, namely new analytical accounts were introduced into the section 521 “Departmental costs of basic production” allowing for allocation of indirect costs to different stages of basic production.

The set of technological standards for consumption of: (1) direct labor, (2) energy, (3) gas and (4) raw materials and indirect materials by department, was prepared by the company.

Since 1st of November 1996 the indices of individual products were introduced in finished goods storage, including the following data:

- (1) SWW symbol



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- (2) shape
- (3) quality
- (4) size
- (5) price–list position

The next step should be introduction of production cards and further action aimed to prepare budgeting and variance analysis.

ZP “Ćmielów” purchased the new accounting software and has been in a process of entering historical data for October – December 1996.

### Barriers

- Hardware:** there is a definite need to increase the number of PC's and to implement a network between the main departments (Sales, Stores, Accountancy)
- Software:** the existing accounting software should be linked with the management reporting system developed by the Company in a standard spreadsheet or bought as a specific package.
- People:** lack of skilled employees, who would be able to use spreadsheet and database in the manner that enables preparation of financial information sheets.

### Training

The implementation of the new cost control system is to be supported by the training seminar organized for “Ćmielów”'s employees. The description of the program is presented below:

- Topic:** Cost controlling
- Time:** 13–14 February 1997



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- Purpose:** The basic aim of this training would be to review main problems related to changes from the current full cost accounting system to the cost controlling, based on variable cost of production, budgeting and variance analysis.
- Scope:**
- (1) Basic ideas and definitions.
  - (2) The difference between the concepts of financial and managerial accounting.
  - (3) The use of different cost systems.
  - (4) Practical methods of data collection and exchange for various needs within the managerial accounting system.
  - (5) Standard product unit cost.
  - (6) Basis of absorption costing and marginal costing.
  - (7) Budgeting and analysis of cost variance.
  - (8) Accounting in cost centers.
  - (9) Break even point.
- Participants:** Participation has been declared by 10 to 12 persons from: Managing Board, Financial Department, Production Department, Marketing Department.
- Methods:**
- (1) Several 40–80 min. interactive workshops with the short theoretical introduction, analysis of cases based on Company's example data, summary and discussions.
  - (2) Solving comprehensive exercise presenting techniques and steps of budget construction, summary and discussion.
  - (3) All participants will receive a set of materials from the training for further study of these topics which would be most useful in their job.
- Benefits:** Improvement in skills of actively participating employees.
- Possibility to use presented tools, methods and techniques for the company's internal needs.
- This training will be helpful to managers responsible for the future implementation of such system with better understanding of the proposed changes, and to bring ideas how to solve main technical and calculation problems.



Top managers should have a clear understanding that the new system will provide information required for:

- analysis and control of costs created in cost centers
- creation of computer budgeting models (spreadsheets) with the possibility of different scenario analysis.
- subsequent monitoring of the performance of those budgets
- assessing the product's profitability (broken down into different profit centers, ie. assortment)

### 4.2.2 Strengthening the Financial and Marketing and Sales Departments.

“Ćmielów”'s Financial Department is responsible for the book-keeping and generating the financial information and analyses for the management. These functions, as it was mentioned before, were not performed properly. Part of the problem was, that the Financial Department did not have enough well-trained, skilled employees. For the most of the 1996 the company did not have the Financial Director either.

Consultants recommended strengthening the Financial Department by nominating the appropriate professional to the position of Financial Director and hiring few skilled individuals.

In September 1996 “Ćmielów”'s Managing Director decided to promote the former Chief Accountant to the position of Financial Director. The company also hired two computer skilled accountants.

As far as the Marketing and Sales Department was concerned, consultants' aim was to strengthen its operations by conducting training on for its employees on the marketing issues. The training seminar took place in June 1996.

### 4.2.3 Separation of non-core activities.

General recommendation was that the company should try to separate non-core activities from its main business. Such a solution should help “Ćmielów” to control costs better and to focus on the core business. The following activities could potentially be separated:

- transportation unit
- screen-print unit
- maintenance
- catering

“Ćmielów”’s management accepted in principle the need of separation of some non-core activities, but argued that it should be done after the transformation into the commercial code company. In their opinion such changes would be difficult to implement in the structure of traditional, state-owned company.

In case of transportation and screen-print units, there were doubts, whether such move would be cost efficient. “Ćmielów” provided calculations showing that buying these services outside could be more expensive than providing them by the internal structures. This issue is to be further examined, since calculations prepared by the company could not include all the options available.

The most important organizational change discussed with “Ćmielów”’s management was the separation of Maintenance and Investment Department in the form of the independent, limited liability company. The final conclusion was that maintenance function (given “Ćmielów”’s highly depreciated and obsolete machinery) should remain within the company, but in the structure of the Production Department. Such a solution should allow for certain cost savings and also should improve cooperation between maintenance and production.

Catering is the only non-core activity that was separated from the company’s business so far.

#### 4.2.4 Improvements in the quality control system.

Consultants’ recommendations in the area of quality control included several technical changes that could be made in the production process and the proposal to move the Quality Control Unit out of the Production Department and to make it directly reporting to the Managing Director. This proposal is still being discussed within “Ćmielów”’s management.

#### 4.2.5 Disposal of non-productive assets.

The non-productive assets were not a major problem for "Ćmielów". The land and building of the factory "Świt" was the only exception. These assets were sold to the private investor and proceeds (155,000 PLN) were used to cover part of the BCA debt.

#### 4.3 New market strategy.

The scope of work relating to the marketing aspects of restructuring program for "Ćmielów" was comprised of three main elements:

- (1) Marketing recommendations for the company (included in the Restructuring Report)
- (2) Training for the company's marketing personnel.
- (3) Support in the implementation of the marketing recommendations through workshops and ad hoc meetings addressing the most urgent issues relating to the trade and marketing performance of the company.

Consultant's basic task in the marketing part of the restructuring project was to convey our knowledge and experience in various marketing related areas in order to help the company to adjust to its changing environment. The knowledge transferred to the company was to increase "Ćmielów"'s ability to create and sustain a long term competitive advantage. This main aim could only be reached with the active participation of the personnel of "Ćmielów"'s different departments.

The marketing related aims of the project have been reached. The company's management and personnel with whom we discussed our recommendations have accepted our ideas and begun to implement them. A number of steps have been taken to implement our marketing suggestions.





### 4.3.1 Marketing recommendations.

After careful analysis of “Ćmielów”’s sales performance during 1993–1995, and after examining the developments on Polish and international porcelain markets, the following recommendations to the company were made:

**ZP “Ćmielów” produces and sells too many products.** Therefore the company cannot achieve the benefits of economies of scale. The over diversification of production and sales is most prevalent in their activities on the domestic market. We stated that the company should stop the production of one style of dinnerware.

We also proposed that there should be a **reduction in white porcelain sales** to intermediaries. In the second half of 1995, the volume of sales of white porcelain were 2.4 times higher than sales of dinnerware sets on the domestic market. However revenues from the sales of the former were 25% lower than from the latter. The value of sales could increase substantially if “Ćmielów” could switch from white porcelain to dinnerware or other sets directed towards final customers. The quality of the white porcelain, even after ornamental work, is inferior to other existing Ćmielów products. As this could have a negative impact on the brand’s image, we recommended selling such products under a **separate brand name or with a different logo.**

ZP “Ćmielów” receives substantially higher prices for those products sold domestically compared to those it exports. We advocated efforts **to increase prices on international markets** and that this should be done in the following ways:

- (1) Changes in agreements with major foreign purchasers who have exclusivity in a given market
- (2) A more active search for new foreign partners offering better prices.
- (3) Changes in the structure of export orders in terms of quality. Instead of almost exclusively selling I class quality products for export, more II class quality products should be offered. The I class quality products obtained should be reallocated to the Polish market, thus helping in the creation of a consistent, high quality brand image and helping increase prices.

We also recommended that they **switch some of the sales on international markets to the domestic market.** This suggestion was based on the fact that demand on the Polish market is growing substantially, while on international markets there is growing competition amongst suppliers.

Ćmielów, as the smallest Polish producer of porcelain products, has the greatest ability to respond quickly to new market trends. We recommended that the company should start monitoring demand trends on the international and Polish markets on a regular basis and on the



basis of this data make the appropriate adjustments to its production.

In the domestic market we suggested that the company should *focus on the needs of the higher end of the market*, as the segment presents opportunities of growth for Ćmielów, as opposed to the mass market (on which higher volume producers have a better chance of competing successfully).

We recommended that the company should become more *oriented towards end users* rather than wholesalers and retailers. This implies introducing sales of individually packed tea and coffee cups, and the development of sales of ornamental products through reputable shops. Serving this higher market segment requires, as suggested by us, attractive packaging to be prepared for the products (colour picture and/or transparent top on the box). The orientation towards end users requires stronger distribution channels to be developed—including their *own shops* in larger Polish cities and a more *active price policy* to be undertaken (discounts, rebates given to their best customers).

We recommended that “Ćmielów” should work out its own distinguishable style, which will enable consumers to differentiate between its products and those of other Polish manufacturers. This will require the introduction of new designs which will gradually replace the existing ones. We believe that two new sets should be introduced before the year 2000 and should be addressed to the consumers in the upper segments. These two sets are:

- (1) new dinner tableware set
- (2) new coffee/tea set

In our recommendations we also showed that the *marketing and sales department needs to be strengthened* in order to fulfil its required tasks/challenges. This seems to be essential if Ćmielów wants to: (1) move from being a local manufacturer operating mainly in south-east Poland to being a producer operating throughout Poland and (2) develop more efficient distribution channels.

We advocated the strengthening of promotional activities which should be made coherent, as well as targeted at the realisation of identified goals. This included preparing unique Ćmielów stands, posters which will help customers to identify its products from others available in

shops (department stores) and participating in three or four fairs on international markets (including Frankfurt). We also suggested the creation of a promotional slogan which would associate Ćmielów products with meeting “good taste” needs.

### 4.3.2 Marketing training.

The following issues were discussed during the training seminar that took place in June 1996:

- (1) What is the essence of marketing, what are the main actors in a marketing system, what are the different approaches toward marketing in companies and how does it usually influence sales performance?
- (2) What are the main marketing decisions within a company, what marketing tools can a company use? What and how should a company state its marketing goals?
- (3) What are the main types and methods of conducting market research that can be used directly by a company?
- (4) What sources of information can/should be used systematically in a company to assess the attractiveness of entry into particular domestic/foreign markets?
- (5) What information is required to assess the attractiveness of domestic and foreign markets?
- (6) What are the basic factors influencing the demand for consumer goods – with special reference to the porcelain products? How should a market be divided into specific sectors? How should a company measure the size of specific segments?
- (7) Why does a company need a marketing plan? What are the basic elements included in a marketing plan?
- (8) What are the basic marketing strategies regarding product and price promotion?
- (9) What are the basic guidelines concerning trade promotion ?
- (10) What criteria should be taken into consideration when selecting different advertising media?
- (11) How should the effectiveness of different advertisement media be evaluated?

All participants received a set of materials from the course, for further study of those topics which would be most useful in their job. The training was arranged in the informal way in order to facilitate the active participation of “Ćmielów”’s employees.

### 4.3.3 Support through workshops and ad hoc meetings

During the four workshops we conducted during the October – December ‘96 period, we worked on the implementation of the marketing recommendations. The main results of this process are presented below.

*Increase in sales in the second half of the year.* As a result, the company virtually fulfilled its plans. In comparison, the first six months of ‘96 recorded only 42% of the annual sales.

*Switch in the structure of sales.* Whilst in 1995, the company exported 43% of its global sales, in 1996 the share of exports declined, (as we suggested), to 33% with the remaining 67% sold on the Polish market.

*Substantial reduction in sales of white porcelain.* On certain products Ćmielów introduced its own decorations as it enabled them to increase the price of these products (by approximately 43%). This was possible because white porcelain products are currently only sold separately.

As we suggested, *third quality products are marked with a different stamp*, thus leaving the existing stamp for those products aimed at the higher market segment. As a result the “Ćmielów” brand is now reserved for high quality products.

To improve the distribution and to increase its orientation towards end users – Ćmielów began operating its *own shop* in the centre of Kraków. Shops provide a great opportunity for products to be displayed to consumers from the higher market segments. Within the shop, tea is served for free in porcelain cups from Ćmielów. A lot of effort was put into the promotion of this shop with 200 posters detailing the opening of the shop, information in the local media and an official opening which was attended by representatives of local businesses, the political community and gained local press and TV coverage.

Throughout the year Ćmielów looked for new distributors both in Poland and abroad. In Poland, the company began to trade intensively with two new distributors. The company is also investigating exporting to Russia. A pilot delivery, with a broad range of products was sent to a Russian wholesaler to test the market’s response.

In line with our suggestions, the company made changes in its agreements with its major western European distributors. Under the new terms, the company is able to sell more II quality products to foreign markets, thus leaving more I quality products for the higher segments in Poland.

In 1996 the company *introduced a new product onto the market – serving the needs of the targeted segments*. The new “KULA” tea set is distinctively different from the products offered by other Polish producers, in terms of its shape, design, price and the methods used to sell it. Although this product is unlikely to be a “cash cow” for the company, it might help in changing the image of the company. With this product, the company attempted to enter the market with stylish designs from the ‘30’s.

In reference to our recommendations, Ćmielów is analysing whether it should limit production of some of the existing dinnerware. Production of the MATEUSZ dinner sets will more than likely cease.

Since November the company has been able to monitor what it sells in terms of shape and decoration type. Regular analysis of the sales performance, with respect to the different shapes and decorations sold, would be very useful in optimising the company’s product portfolio.

In 1996 the company reduced the price of dinner and coffee sets by 10–12%, thus increasing its competitiveness on the market. Until November the products it sold separately were relatively uncompetitive in price terms. However after obtaining exemption from VAT, the competitiveness of these products increased. To increase sales the company reduced prices for certain periods of time.

During the implementation workshops we also discussed some additional issues proposed by the company such as:

- advertisement and promotion of porcelain products,
- price as a marketing strategy tool,
- new product development and the co-operation between different departments within the company during this process.

### 4.3.4 Major conclusions

With the increasing implementation of our marketing recommendations in the second half of the year, the sales performance of the company improved. In our opinion the effects of the activities implemented will have a larger impact on the company's sales in 1997.

One major barrier which may create problems in the further implementation of our suggestions is the low level of employment in the sales and marketing department.

We understand that financial obstacles prevented the company from introducing Ćmielów posters and stands into shops, as well as from introducing attractive packaging for individual products. In 1997, the company should focus on those points which have not yet been fully solved, as well as on the further development of their distribution network in Poland.

### 4.4 Investment programme.

“Ćmielów”'s machines and equipment are obsolete and highly depreciated. They are not reliable, and frequent stoppages increase costs of production. Technically, “Ćmielów” is not able to produce high quality products, what puts the company's market strategy in question. According to “Ćmielów”'s management, without new capital expenditures, the company will not be able to survive in the medium and long term.

Managing Board have elaborated a three-stages investment programme. Its implementation would mean the full modernization of production leading to dramatic improvement in the quality of products. It is estimated that costs of such programme would be approximately 14 mln. PLN. In our opinion it is doubtful, if the company (even after the succesful financial restructuring) will be able to find sources of financing for such a programme.

Consultants recommended to limit the investment programme prepared by the Managing Board and to concentrate on items that should be treated as a top priority. The focus should be on pieces of equipment without which the very existance of the factory could be in question

or on these that would eliminate bottlenecks. As a result, the current priorities of the investment programme are stated as follows:

- (1) Purchase and installation of the second chamber kiln.
- (2) Purchase and installation of the cup-making machine.
- (3) Purchase of the laboratory equipment
- (4) Purchase and installation of the two second-hand izostatic presses
- (5) Purchase and installation of the spray-dryer.

According estimates from September 1996 the cost of such programme (including taxes, duties etc.) would be approximately 5,5 mln. PLN. Implementation of the programme would be possible before the financial restructuring is completed. It is due to the fact that without external financing "Ćmielów" would not be able to cover costs of the programme.

Implementation of the investment programme is one of the important issues negotiated by representatives of State Treasury with the potential investors.

### 4.5 Study Tour in the United Kingdom.

Members of ZP "Ćmielów"'s management team visited United Kingdom between 14 and 25 July 1996 to participate in the study tour organized by the consortium. The general aim of the tour was to acquire as much information as possible about the way the British pottery industry is organized and about conditions of the British pottery market. An important part of the tour were also meetings with producers of machinery and equipment for the porcelain industry.

It should be stressed that, due to the intense competition between the British producers of bone china ("soft porcelain"), in general, they are unwilling to discuss the business issues with anybody – especially with the potential competitor from abroad. That is why "Ćmielów"'s visits to British potteries were rather brief and were able to obtain only the basic information.

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The following individuals participated in the tour: Ms. Wanda Koziarz (ZP "Ćmielów – Managing Director), Ms. Halina Batugowska (ZP "Ćmielów" – Production Director), Mr. Jan Radoń (ZP "Ćmielów" – Maintenance and Investment Director), Mr. Maciej Czuba (ZP "Ćmielów" – Export Specialist) and Mr. Leszek Filipowicz (BMF).

The first part of the tour consisted of visits and meetings in the Stoke on Trent area – the "capital" of the British pottery industry.

### Visit to Wellman Engineers Ltd.

The company producing kilns. Few years ago Wellman acquired Gibbons Brothers – well established producer of kilns for the ceramic industry. One of the kilns produced by Gibbons were in use in "Ćmielów" until 1991. During this visit "Ćmielów"'s management discussed possibility of Wellman supplying new intermittent kiln and tunnel kiln to "Ćmielów". Certain technical and technology issues were reviewed as well as the financial aspects of such contract. As a result, it was agreed that Wellman will submit its offer by the end of August.

### Visit to Royal Worcester

Royal Worcester is the only British company producing both hard paste porcelain and fine bone china. The others produce only bone china. Royal Worcester is the old company producing traditional, luxury items. We were shown the production facilities with the particular stress given to kilns, forming and pressing machines. "Ćmielów"'s management had a chance to ask questions concerning the production process, technology and other issues.

### Visit to Steelite Ltd.

Steelite specializes in the mass production of hotelware. It is owned by management. Its facilities are modern and equipped in the newest technology. Among others, we had a chance to see the computer system that controls firing process.





### Visit to Dorst Ltd.

The UK "Dorst Ltd." is a company 100% owned by the German producer of izostatic presses. Since "Ćmielów" is planning to acquire one or two machines like this, during the visit we discussed benefits and problems of using pressing technology in the ceramic industry.

### Visit to Bricesco

Bricesco is one of the two leaders in production of kilns for the pottery industry. "Ćmielów"'s management visited its production facility, discussed the technological and financial issues.

### Visit to Service Engineers Ltd

This company supplies forming machines and equipment used for the transfer decoration. Management of "Ćmielów" was most interested in the machine for cup production, since this type of machine is urgently needed in their company. Various options were discussed and as a result it was agreed that "Ćmielów" would get from SE a formal offer.

### Visit to Portmeirion Ltd.

The company is well known for its production of earthenware. We visited the plant and talked to one of the managers. Particular attention was given to the forming sections and especially cup making lines.

### Visit to Royal Doulton

The plant is one of the few owned by the Royal Doulton Company. We visited decorating department.



### Visit to Drayton Kilns

Another kiln producing company, one of the two leaders (the other is Bricesco) in the industry. During the visit “Ćmielów” discussed the same issues as with Wellman and Bricesco.

### Visit to China Clay International

The company supplies the clay, which is the most important raw material for the ceramic industry. “Ćmielów” buys from CCI up 200 tons per year. The other prucedust of CCI is a special granulate that could be for direct forming of ware. The use of granulate allows to eliminate the mass preparation phase of the production. Participants of the tour visited CCI facility and met the regional sales director. The scope of further cooperation was discussed.

### Visit to John Tams and Crown Trent China plants

These were brief visits during which “Ćmielów” management could see the pieces of equipment that they are going to invest in. John Tams is a mass producer of cups and mugs with different decorations. This type of product line should be developed in “Ćmielów” and sold as a giftware.

### Visit to CMS

The company produces colours and transfers for the pottery industry. “Ćmielów” was interested in their offer because their own screen print plant is obsolete and not capable of producing high quality decorations. One of the options is also to buy from CMS certain patterns that could be used by “Cmielów” for the domestic market.

### Visit to H.G Stephenson – Stockport

The company is a distributor of household products, including chine. It is a family owned business with more than hundred years tradition. It specialises in distribution of hotelware and tableware used in catering (restaurants, bars, pubs). We discussed the organization of distribution in the United Kingdom.



### Meeting with Maurice Birch – CPIC

During this meetings we discussed the recent trends in technology and management in the ceramic production. Some conclusions from the current “Ćmielów”’s situation were also drawn.

### Visit to Spode Ltd.

Spode is a tableware producer belonging to the same group as Royal Worcester. It is one of the oldest and most famous china producing companies in the United Kingdom. The factory is located in the same site since the end of eighteen century. We saw the museum and visitors center. We were shown the process of hand decoration with a use of different techniques.

### Visit to Wedgwood Visitors Center

“Ćmielów” learned about history and current production of Wedgwood. It was very interesting to see how much time and effort was devoted by company’s owners to development of products of the highest quality. We saw the exhibition covering both past and the present production.

During the second part of the tour (three days in London) we concentrated on visiting outlets selling porcelain. These were both department stores (Selfridges, Debenhams, John Lewis, DH Evans, Fortnum and Mason, Harrods) and specialised china shops (Chinacraft, China Reject Shops). The aim was to see how these products are sold and what promotion materials are used. In few places we had discussions with shop managers. The most interesting conclusion was that most of the well established producers (Wedgwood, Royal Doulton, Aynsley, Spode) either own their shops or hire space in department stores – so called “concessions” system”. In such system, managers selling products to individual clients are producers’ employees reporting to sales department.

As a part of the visit “Ćmielów”’s management visited also Victoria and Albert Museum to see the largest collection of pottery in the world. It is very interesting exhibition showing evolution of pottery (by geographical regions) from the past until recent years.

