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Management 101: Behavior of Firms in Transition Economies

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MANAGEMENT 101: BEHAVIOR OF FIRMS IN TRANSITION ECONOMIES[1]

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ABSTRACT

This paper uses published case studies of firms in the Czech Republic, Hungary and Poland to examine how firms are reacting to the pressures of transition. Most firms made short run adjustments to output and input use; fewer firms began to make strategic adjustments. The paper examines how short-run responses influence the ability to implement long-run strategies for survival and growth and identifies common elements in the long-run behavior of firms that appear to be successful. Among these elements are the strengthening of the marketing function, the reorganization of internal decision making and information systems, investments in human resources and creation of effective mechanisms of corporate governance. The willingness to shed labor and the ability to make large investments in capital and technology are, rather surprisingly, less common features of successful restructuring.

EXECUTIVE SUMMARY

This paper examines the way in which firms in the Czech Republic, Hungary and Poland are adjusting to the transition. Evidence is drawn from a body of systematic case studies of enterprise behavior.

In the short run, most firms responded to the shocks of inflation and output collapse by reducing output and altering input use, but there were important differences in how fast and how well they did so. Those that were not successful suffered financial losses that greatly hampered their ability to undertake a long-term adjustment of their activities. A smaller proportion of firms also began to undertake strategic decisions about their future profile and business activities. The willingness of managers to undertake such strategic thinking depended on their autonomy and on the likelihood that outside owners would eventually establish control over the firm.

Longer-term responses of successful firms were relatively uniform. These firms made significant improvements in their marketing organization and expenditures to make up for the collapse of the state distribution network. They also placed tremendous emphasis on quality and quality control. Successful firms also undertook major internal reorganizations, often supported by improvements in their management information systems. Human resource policies were also important, chief among them better compensation systems and an emphasis on education and training for managers and workers. Shedding of redundant labor and investment in new technologies or equipment

seem to have been much less important for a successful restructuring than were the measures described above.

I. INTRODUCTION

To a large extent, the success of the transition in East Europe and the former Soviet Union depends on the ability of the formerly state-owned firms in the region to increase the efficiency with which they employ resources and to conform to the dictates of the market. While it is true that macroeconomic stabilization is, if not an absolute prerequisite for, at least an important facilitator of, improved economic performance, without major improvements in the performance of the region's firms, the best that stabilization can achieve is an equilibrium characterized by stagnant output, low incomes and lack of international competitiveness. Only if productivity, profitability and competitiveness at the level of the individual firm improve can output grow, incomes increase and integration into the global economy begin.

At the start of the transition, there was considerable skepticism that managers of state-owned enterprises would be up to the task of modifying the behavior of their firms so as to respond effectively to the emergence of markets and of hard budget constraints (Kornai, 1990; Lipton and Sachs, 1990; Phelps *et al.*, 1993). Once privatization programs began to be implemented in the transition economies, the concerns shifted from the ability of managers to manage to the ability of the new owners to exercise adequate control over firms through the available mechanisms of corporate governance (Boycko, Schleifer and Vishny 1995; Desai, 1996; Dittus and Prowse, 1994; Kenway and Chlumský, 1995; Litwack, 1995; Schleifer and Vasiliev 1994; Stark, 1994).[2]

Unlike the macroeconomic outcomes of transition, which can be quantified by data on output, inflation, the amount of property privatized, employment, etc., changes in the behavior of managers and in the way that firms are run are less amenable to quantification. Indeed the changes are often so subtle that it may be difficult either to establish objective criteria by which to judge change or to accurately determine whether such changes in managerial or firm behavior have taken place. Accepting this caveat, in this paper we use detailed case studies of a relatively large sample of firms to determine how managers and firms in three transition economies, the Czech Republic, Hungary and Poland, are reacting to the transition and to determine whether some common patterns of behavior are evident, particularly among firms that are judged to be adjusting successfully.

II. SOURCES OF EVIDENCE: INTRODUCTON TO THE CASE STUDIES

Evidence on the behavior of firms in transition economies is drawn in large part from cases developed by the World Bank under its project "Enterprise Behavior and Economic Reforms." Two rounds of interviews were carried out in Czechoslovakia, subsequently the Czech Republic, Hungary and Poland, These countries were selected in part because transition was most advanced there when the project was designed. In each country, a local project leader was selected and a team of case study writers was assembled. These teams selected firms according to a partially-structured selection process that was designed to provide for coverage of major sectors of the economy; to include a variety of ownership forms, size and likelihood of economic survival; and to be flexible enough to allow for national peculiarities and the willingness of managers to participate in the interviews and data collection that the cases required. The case study interviews, data gathering and presentation were carried out according to a common format.

The first round of case studies was completed in late 1992 and the 36 cases as well as a synthesis of their implications are published in Estrin *et al.* (1995). The second round of 18 cases, completed in late 1993 and early 1994, is published in Brada and Singh (1998). These cases were supplemented by eight additional case studies of Hungarian firms completed in 1992 (Brada, Török and Singh 1994) six additional case studies of Polish firms carried out in 1994 (Wosinska, 1995).

The use of a common questionnaire and of a small team of case writers gives this body of case evidence a consistency of approach and an interpretive validity that permit stronger inferences to be drawn than could be from cases compiled for differing objectives and by disparate methods and researchers. The use of parallel cases from three countries also helps to guard against biases within any one national team, especially because cross-country comparisons are facilitated by efforts to match some firms across countries by sector, by size or by ownership type.

At the same time, it should be borne in mind that firms in the three countries did have to agree to participate in the case studies, and thus there may be an element of self-selection in the sample because firms that are doing well in the transition are more likely to participate than those that are likely to fail. While this self-selection within the sample would pose problems for some types of analyses, the purpose of this inquiry is to identify the commonalities in behavior that exist among both foreign-owned and domestically-owned firms that appear to be restructuring successfully. Thus an overweighing of the sample toward successful firms is desirable. The sample, nevertheless, includes firms that have been liquidated or dismantled since the case studies were written as well as firms whose future existence remains in doubt.

III. FRAMEWORK FOR RESTRUCTURING

The business strategies that any firm selects as well as its ability to implement these strategies are both path dependent, that is, they reflect the firm's past environment, business decisions and their outcomes. In transition economies, where all firms faced major and relatively similar changes in their external environment and in their internal organization, such path dependence is both striking and particularly important in determining how firms undertake their restructuring.

Figure 1 illustrates this path-dependent relationship between a firm's response to the early stages of transition and its ultimate ability to develop and implement a coherent set of measures for its restructuring and survival. At the onset of transition, firm behavior is conditioned by the firm's macroeconomic and business climate, by firm specific factors such as past debts, the level of the firm's technology, its dependence on foreign markets, etc., and by the shocks of early transition measures, including the emergence of markets for the firm's inputs and outputs, changes in managerial responsibilities and the possible imposition of hard-budget constraints.

How firms respond to these short term shocks proves to be critical for their long-term survival. The quality of their short-term responses determines many of the factors that relate crucially to their ability to restructure themselves in the longer term. For example, an inadequate short-term response can saddle a firm with debts and strangle its cash flow, making it unlikely to be selected for accelerated privatization and rendering it unattractive to foreign investors. In such ways, short-term responses help to determine who a new firm's owners will be and the amount of autonomy they will grant managers. They also help determine the access that the firm will have to outside funds to finance restructuring and to other vital resources such as managerial skills and qualified workers. At some point, short-term responses begin to cumulate into a long-term trend, and, thus, the sooner a firm is able to shape its short-term behavior to conform to its long-term strategy, the more likely it is to be successful.

IV. SHORT-TERM RESPONSES

In the early transition, changes in the economic environment were so overwhelming that firm-specific factors, except for managerial skills and managerial autonomy, did little to differentiate the short-term responses of firms. Thus, the indebtedness of firms prior to transition had a much smaller impact on firm behavior in the short run than had been expected because inflation sharply reduced the real value of this debt, and the explosion of inter-enterprise debt also eased the debt burden in the short run. Firms whose exports were directed toward the CMEA suffered a relatively abrupt demand shock as the CMEA collapsed, but the magnitude of the output declines in the three countries was such that virtually all firms faced a sharp fall in demand. Moreover, despite the belief that it was the so-called heavy industry of the region that was overdeveloped, consumer-oriented sectors such as textiles and food processing suffered comparable, if not greater, demand-side shocks as consumer incomes fell and as consumers retrenched in the face of growing economic uncertainty. Regional factors played an ambiguous role, with firms located in distressed areas of high unemployment facing more serious obstacles but at the same time benefiting in their relations with their workers and with local authorities due to the desire of the latter to keep firms operating.

Managerial skills at individual firms did appear to be important in determining how firms responded to these shocks. In the short run, the specific business skills of managers appear to have been less important in determining whether a firm would respond to the challenges than were managerial attitudes. Some managers did not view their government's transition measures as credible, and thus they persevered with old business policies or continued to work toward satisfying old constituencies in their supervisory ministries or to cater to the interests of workers. Such failures by managers to accept the realities of the transition and of the stabilization measures that were introduced in these countries were often accompanied by efforts of managers to resist the introduction of new ways of exerting outside influence over the firm. In part this manifested itself in managerial complaints about the inability or unwillingness of the government to protect the firm by means of industrial policies, tax breaks or trade policy. These managers also resisted changes in the way that the state exercised its role as owner, even if such changes implied greater managerial autonomy, and they also sought to resist the introduction of outside owners through privatization where such privatizations were proposed.

According to Estrin *et al.* (1995), the principal factors serving to promote active short-term adjustment were the degree of autonomy enjoyed by managers and the credibility of the prospects of privatization. Autonomy of managers was related to the clarity of current property rights and to the lack of worker input into enterprise decision making. Clarity of property rights does not necessarily mean that the firm is being or has been privatized; rather it means either that there is a credible set of new owners, domestic or foreign, in place or on the horizon or that the state's ownership is sufficiently well defined to limit the possibility that managers or workers can appropriate the firm or its revenues to their own benefit with relative impunity. Managerial autonomy was also strengthened to the extent that the firm's budget constraint was hardened and its financial accountability toward the government, toward its suppliers and toward its creditors increased. In this regard, Estrin *et al.* concluded that managerial autonomy was weakest in Polish firms because of the influence of workers' councils in the selection and retention of managers and because of the ambiguity of property rights caused by the competing claims of the workers and the state to exercise ultimate control over these firms.[3]

Firms making passive responses to the pressures of transition were those that made little, slow, or no adjustment to their levels of output and input use despite the sharp decline in demand experienced by virtually all firms and the large changes in input and output prices. As would be expected, this passivity had negative financial consequences in that firms that were passive in their production responses had smaller profits or larger losses than other firms, and, thus, they tended to accumulate debts, often in the form of payment arrears to suppliers, to the government and, sometimes, even to workers.

Active responses toward the transition took two forms, changes in the real or productive sphere and changes in the business sphere. Changes in the real sphere involved changes in output in response to changes in demand. The most obvious response was to reduce output. Firms also responded by altering their product mix, so that production was concentrated on product lines that had the best market potential. In some cases, this involved improving quality so as to improve competitiveness on western markets; in other cases it meant concentrating on the lower end of the domestic market. Such changes in product mix were generally made within the limits imposed by current capacity and technology. A second production response was to alter the input mix in response to changes in prices and availabilities of inputs. While some firms faced temporary difficulties in obtaining necessary inputs, supply side bottlenecks were not a major source of output declines. Many firms also took advantage of trade liberalization to begin importing inputs from western suppliers, who were seen as more reliable and whose higher quality, albeit at higher prices, was seen as lowering production costs and smoothing the production process. The fall in real wages and rise in prices of other inputs caused labor costs as a share of total costs to fall in most firms, and this may have served to cushion falls in employment.[4] Changes in output and employment, the "real" or physical activities of firms were relatively common in the firms surveyed, in part because they were imposed by environmental factors, above all the decline in aggregate demand and the imposition, however imperfectly, of hard-budget constraints. Nevertheless, there were differences in the speed and extent to which firms carried out these changes, and these differences did have palpable effects on firms' long-term prospects.

Active responses of a more sophisticated kind, what might be called responses in the business sphere, emerged in fewer firms than the number exhibiting active responses in the "real" sphere; nevertheless, a majority of firms, particularly in the Czech Republic and Hungary, began to formulate and implement strategies for long-term survival. Such strategies involved changes in the way that these firms did business, meaning the way in which they were owned; their internal organization and means of motivating workers and managers; the mix of business activities they carried out; the strategies they deployed to remain or become competitive on specific markets; the technologies they used to produce and distribute their products; and the alliances they formed with other firms, financial institutions and government agencies. Estrin et al. were able to identify firms that were undertaking such strategic responses and to link this behavior to managerial autonomy and to the credible prospects of privatization even more strongly than they could responses in the physical sphere, but their cases ended too soon to determine whether these strategies could be sustained and whether impending ownership change would introduce effective mechanisms of corporate governance.

V. LONG-TERM RESPONSES AND ENTERPRISE

The cases in Brada and Singh (1998) and Wosinska (1995), because they were compiled later, provide greater evidence regarding strategic changes by firms and how these relate to privatization and the introduction of new forms of corporate governance.

Before turning to the evaluation of the long-term behavior of the firms in our sample, two key legacies of short-term responses that appear to be critical for the success of long-term efforts of restructuring should be mentioned. The first of these is the importance of maintaining the profitability of the firm during the early period of transition. Firms that managed to remain even marginally profitable in the first years of the transition appear, to have made greater progress in their long-term transformation. Indeed, these firms have not only made greater progress in adjusting their business strategies to the new environment, but they also appear to be enjoying higher rates of output growth, profitability and also greater managerial autonomy. To some extent, of course, this ability to remain profitable may be due to firm- or sector-specific characteristics that then also work to promote good performance in the long run. However, a reading of the cases relating the difficulties of firms that incurred significant losses early in the transition shows how difficult it is to turn around the fortunes of loss-making firm in the economic environment that characterizes the transition period. Indeed, the paralysis that affects such firms, who then wait for rescue by either the state or by a foreign owner, may well reflect the lack of a viable solution to these firms' problems.

The second finding about legacies from short-term behavior has to do with the clarification of ownership rights to the firm. In those cases where clear ownership rights were established early on, managerial responses appear to be more active, more comprehensive and more successful. Indeed, it can argued that, in every case where the future of the firm remains in doubt, ambiguities about ownership are at least a significant contributing factor. This is particularly evident for the Polish firms in the sample. In many of these, real transformation began only when the firm's corporate structure was changed to eliminate the role of the workers' council. While this change often resulted in the workers becoming shareholders, they usually became minority shareholders while managers tended to hold a controlling, or at least decisive, share of the firm's stock.

Although each firm's experience is unique, a reading of the cases quickly turns up a number of common behaviors among firms that can be judged as making a successful transformation to the new market environment.

A. Marketing

Every firm that can be judged as having achieved long-term viability made significant changes in its marketing behavior. A common one was to expand the sales staff and to increase marketing outlays. Firms operating in a command economy had little need for marketing. Production for business customers went directly to the state-run wholesale network; sale to consumers went directly to the state retail network; and exports were usually handled by specialized export houses, thus leaving almost no marketing function for firms to undertake. The domestic distribution systems collapsed and firms thus had to deal directly with firms who were their customers and with a private retail network consisting of many small sellers, all of whom required their suppliers to both produce goods and serve as a wholesaler. The collapse of the state-run distribution channels not only forced firms to expend greater resources on marketing and distribution, they also forced firms to change how they distributed their products. Some firms sought, with varying measures of success, to develop their own retail outlets, others to link with newly-emerging wholesalers.

Most firms also abandoned the foreign trade houses that had handled their exports in the past. In part this was due to the fact that the expertise of the trading houses was much more oriented to the former socialist countries than it was toward the West where producers wished to explore sales opportunities. However, not all successfully transforming firms sought out foreign markets and many relied largely on success on the domestic market as their main source of income.

Overall, foreign-owned firms enjoyed some advantages in their ability to penetrate foreign markets, but there are significant exceptions. For example, the Hungarian firm Tungsram, wholly owned by General Electric, found it surprisingly difficult to break into western markets, while the Czech Glavunion had its access to some western markets restricted by its Belgian parent. In some cases, foreign owners clearly focused the strategies of the East European acquisitions on the domestic market.

B. Workforce Reduction

Much of the literature on transformation of firms stressed that abandoning state ownership would force firms to lay off workers if they were to remain competitive. In our sample of firms, some firms made reductions in their labor force of as much as 50 percent, but others made relatively small changes in employment. In some cases, failure to eliminate redundant workers was due to outside pressure, and in other cases it was due to managerial reluctance to do so. It should be noted that both wages relative to other input costs and labor costs as a share of total costs declined, reducing the need for aggressive labor shedding. Foreign-owned firms seemed as differentiated in their approach to workforce reductions as were domestically-owned ones. In general, large cuts in employment did not seem to be the central or key element of restructuring that many observers expected.

C. Restructuring Output

There was no clear pattern in terms of the strategies firms adopted for revamping their product mix. A small proportion of firms expanded their range of products while most others narrowed it, eliminating lines in which they were not competitive. Given the relatively large size, broad product range and high degree of vertical integration of the typical socialist enterprise, this behavior is not surprising.

In addition to narrowing their product lines, firms also tended to undergo a certain amount of vertical disintegration. In part, this was due to the process of privatization wherein several units of a firm that formed a vertical supply chain found themselves separated into independent firms, and therefore forced to rebuild their dealings on a market rather than intra-firm basis. There was also a tendency to spin off auxiliary service activities. Social services such as company vacation and health facilities are common examples of this, but some firms began to outsource janitorial, repair and transportation activities as well.

D. Quality and Quality Control

One of the major areas of emphasis in virtually every successfully transforming firm was quality and quality control. This stress on quality was independent of whether the firm's product strategy was oriented toward higher-quality export-oriented production or whether its products were aimed at price-conscious domestic consumers. Also noteworthy is that the cases suggest a relatively high reliance on outside consultants and on western quality control technologies. This reflects both the importance attributed by managers to quality improvements and to the dearth of expertise and resources for improving quality in the region. In terms of emphasis on quality improvements, domestically- and foreign-owned firms seem not to have differed.

E. Human Resources

Many of the successful firms revamped their human resources practices in a variety of ways. Changes in the system of remuneration were almost universal among successful firms. Generally these changes involved a widening of pay scales designed to reward needed skills. This usually meant that, in relative terms, white-collar and managerial employees with skills in critical areas such as marketing gained at the expense of production workers, especially unskilled workers. Also almost universal was a shift in managerial remuneration and prestige away from managers engaged in day-to-day production toward those engaged in making strategic decisions or involved in finance, control, marketing and accounting. Such changes reflect needed changes in the organization of firms because, under the old system, strategic planning or the need to consider how to finance the firm's activities simply did not exist. Also noteworthy is the number of firms that, despite difficult circumstances, undertook programs to develop the human capital of workers or managers through in-house training and education programs.

F. Decision Making

Most of the firms in our sample undertook major changes in their management structures. One of these was to separate strategic decision making from the management of day-to-day operations. Under the old regime, an enterprise manager's key responsibility was to maintain production, and, thus, the organization of the firm and the prestige and authority accorded to managers responsible for production was very high. Under the new circumstances, the firm's top managers had to devote most of their attention to strategic issues having to do with the firm's long term survival, and, thus, lower-level managers on the shop floor had to make decisions regarding production independently, something to which they were not accustomed. At the same time, the socialist corporate culture, which gave primacy to production, had to be changed, so that the firm's business activities were not run to serve the needs of managers responsible for producing output. Instead, a new culture where production had to reflect the needs of the marketing department and to operate with constraints imposed by the firm's financial capabilities had to be created. Numerous cases describe the cultural tensions that these changes brought about.

There were two organizational changes that many firms implemented to bring about these changes in culture. One was to move toward a divisional structure, with a headquarters staff responsible for strategic and control activities and divisions whose managers were responsible for day-to-day operations. This served to elevate the status of strategic management and at the same time to give division managers both greater responsibility and greater autonomy. The other response, which in some cases was a complement to, in other cases a substitute for, the divisional structure, was the organization of the firm into profit centers. To some extent, this, too, was an effort to increase the responsibility and autonomy of lower-level managers, but a reading of the cases suggests that it was also seen as a way for top management to get a grasp on how viable various units of their firm were so that they could allocate investment resources to profitable units or that were not viable in the new environment.

The greater need for information about the firm's activities brought about by the transition to the market is also reflected in the number of firms that introduced new management information systems or extensively revamped and upgraded their old ones. The use of outside consultants in the implementation of these organizational and information systems changes reflects both managers' uncertainty over what their firms require in these activities to be successful and a lack of experience in implementing organizational change.

G. Investment

Investment is often seen as a key component of the restructuring of firms in transition economies, and the lack of capital in these countries is therefore considered to be a serious barrier to enterprise restructuring. Thus it is quite surprising that the case studies show rather heterogeneous investment behavior on the part of firms judged to be restructuring successfully. The lack of capital is a key barrier for some firms such as Glasunion and Radiotechnikai (Brada and Singh, 1998), which are clearly prevented from restructuring and are in danger of collapse precisely because they are unable to undertake vitally needed investments.

Among successful firms, the amount of investment being undertaken varies but in most it is quite small. The largest investment among the firms described in the cases was that of General Electric in the Hungarian firm Tungsram. Clearly these investments, which not only served to modernize Tungsram's products, technology and operations but also to cover several years of operating losses, are a classical example of the anticipated largesse of foreign "strategic" owners who acquire East European firms. However, there are also examples, including Glavunion and Matra Cukor (Brada and Singh, 1998), where foreign owners chose not to make large investments in increasing the capacity or improving technology of the East European acquisitions. Thus, while foreign owners clearly have better access to capital markets than do domestically-owned firms in East Europe, this potential advantage does not always result in greater investments by foreign-owned firms.

Domestically-owned firms in many cases admitted to difficulties or the outright impossibility of obtaining credits from banks or other sources. Therefore, much of the investments they make must be financed by funds that are generated internally. This fact underscores the finding mentioned at the start of this section that firms that are able to maintain profitability generally have a much better record of restructuring than do those that begin to operate at a loss. While the volume of investment that self-financing allows may not be large, it may often represent the difference between moving forward toward survival and growth and corporate stagnation. A number of firms were able to obtain outside financing, mainly from banks. Firms owned by single entrepreneurs or small groups of owners were the most successful in obtaining outside funds.

The investments that firms undertook served a number of different objectives. The most common objective was to change the product mix, so that the firm's output would better reflect market demand. In some cases this involved increasing productive capacity for one or several products while the total capacity of the firm was being reduced. Also common were investments designed to replace productive activities that had been carried out within the framework of a large integrated enterprise in the socialist era but than now belonged to another firm that was spun off from this socialist-era conglomerate by privatization or administrative edict. Also common were investments to renovate and modernize production, to lower production costs and, somewhat surprisingly, to ameliorate environmental damage from the firm's activities.

Investments designed to increase production over a broad range of products were very rare among formerly state-owned firms where overcapacity tended to be the norm, but those firms that had been started up by private entrepreneurs had a more appropriate scale of production and thus were willing to invest to expand as market conditions dictated.

In all, it is rather striking that investment activity was not the key element of successful restructuring, contrary to early concerns about the amount of money that would be required to restructure East European industry. Indeed, relatively "soft" measures such as human resource policies and reorganization seem to be much better agents of restructuring than is investment.

H. External Organs of Control

Also critical to the success of the firms covered by the case studies is the emergence of effective corporate governance. In part, these organs of corporate governance emerge as the result of actual or incipient privatization. The exception here is Poland, where the role of workers' councils tended to block needed restructuring and to limit managerial autonomy; in effect workers exercised control without the responsibility of ownership, often with deleterious effects. Thus, as many Polish cases show, Polish legislation that exempted firms no longer owned by the state, and thus not subject to the rule of workers councils, from the popiwek, the tax on large wage increases, proved to play a critical role in strengthening the autonomy of managers and enabling them to begin serious restructuring. The cases show that workers were often willing to trade the existence of a workers' council for exemption from the popiwek in the expectation that, under the new ownership structure, they would enjoy higher wages. The cases also show that, in many such cases, workers' expectations were not met because the harder budget constraints and greater managerial autonomy that resulted from this change in corporate structure and governance made large wage increases impossible.

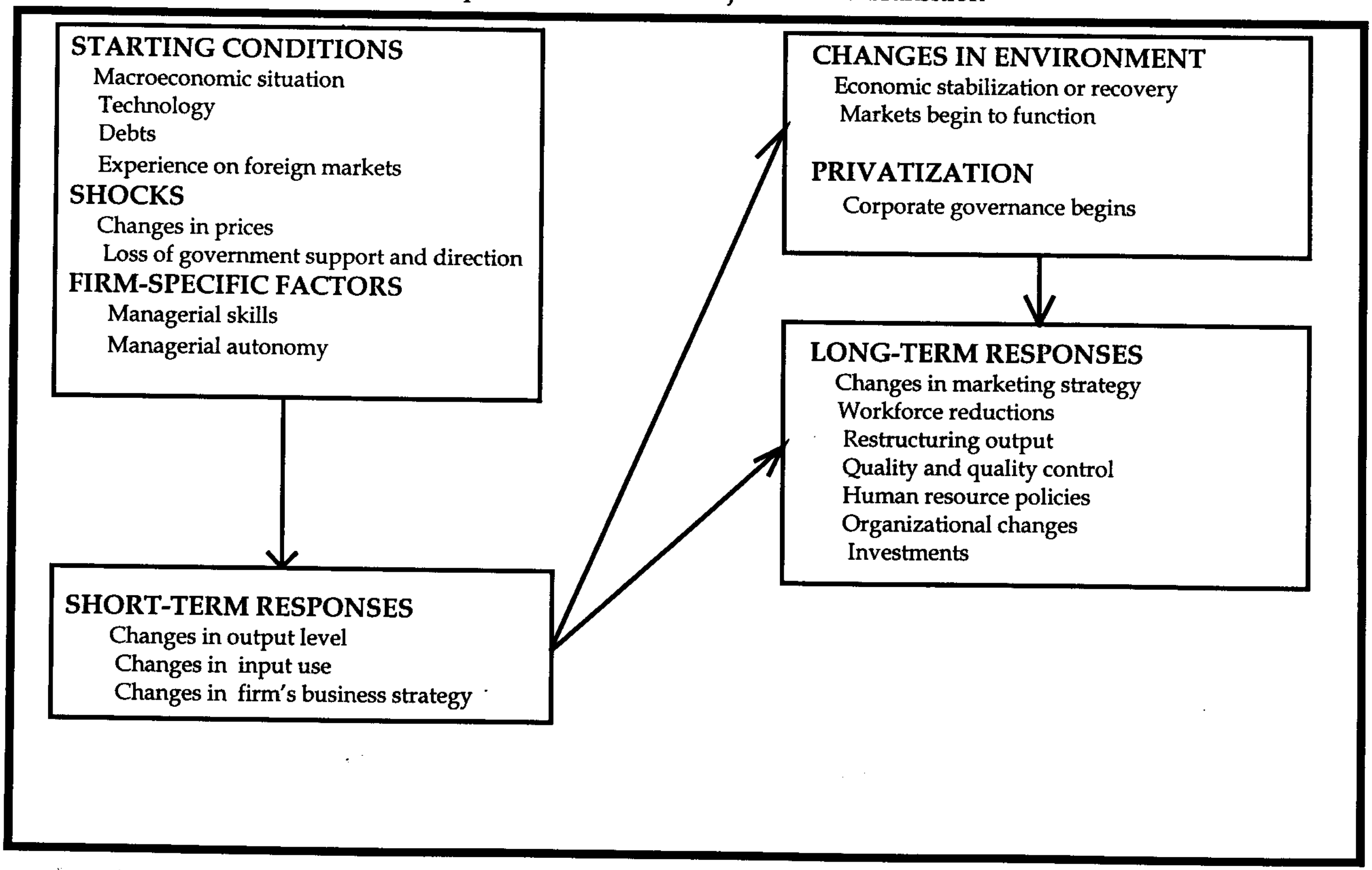
Also evident from the cases is the division of labor that exists between managers and the various boards that form the organs of corporate governance. In exceptional situations, for example when managers are replaced or new outside owners are being courted, corporate boards play an active and almost day-to-day role in the affairs of the firm. However, under normal circumstances, it is the managers who are called upon to devise strategies, to make the difficult decisions and to set the future course of the firm. This is not so say that managers are always up to this task. The cases do report instances where serious business mistakes were made, and the frequent reliance on outside management consultants or foreign owners for strategies and managerial inputs is perhaps indicative of the doubts that assail managers in the region. Nevertheless, setting of strategy and the day-to-day operations of these firms is not the task of their supervisory boards, and the hands-off approach of these boards seems to represent an effective form of corporate governance.

V. CONCLUSIONS

The cases of corporate governance in firms in transition economies suggests that managers in the region, given appropriate incentives and autonomy by the owners of these firms have reacted vigorously to the challenges facing them. Moreover, their strategies and responses appear, in the main, to be relatively similar and to have been quite successful. The measures and strategies adopted to ensure the survival and restructuring of the firms examined seem quite consistent with what would be viewed as good and appropriate managerial behavior in developed market economies. Thus East European managers appear to have mastered the basic lessons of Management 101 in that they are applying what might be seen as "textbook" or "commonsense" solutions to the problems that they face in restructuring their firms.

FIGURE 1

Path Dependence of Firms' Adjustment to Transition



FOOTNOTES

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[2] For a description of privatization programs, see Brada (1996). Hart (1995) provides a useful survey of corporate governance from both a theoretical and a practical standpoint.

[3] Nevertheless, there were positive short term responses from a number of Polish firms, as also evidenced by the cases compiled in Wosinska (1995) and the studies of Pinto (1995), Pinto, Belka and Krajewski (1993) and Pinto and van Wijnbergen (1994).

[4] Larger falls in output than in employment are commonplace in early transition; see Duflo and Senik-Legoyne (1997) for some quantitative evidence.

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