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Strategic Restructuring: Making Capitalism in Post-Communist Eastern Europe

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Comments Welcome

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Strategic Restructuring: Making Capitalism In Post-Communist Eastern Europe

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The transition to capitalism in the post-communist countries was historically unique for two reasons.[1] First, it was an attempt to create capitalism in a context where there were hardly any capitalists. Unlike many other historical attempts to create capitalism without capitalists,[2] there was no large scale class of private owners of any type (such as agrarian elites or prosperous peasants) that could be easily transformed into capitalists. Only a modest group of small scale "socialist entrepreneurs" was allowed to grow in Hungary, a class which was

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[1] The decision to write about the transition to capitalism in the past tense is in a sense inappropriate. I am not sure that something resembling "modern capitalism" has emerged in many parts of the post-communist world. However, in the countries with which this paper is concerned, Hungary, the Czech Republic and Slovakia, I am convinced that a variant of capitalism is now in place. This is not to suggest, however, that this process is completed.

The decision to use the term post-communist also requires some explanation. This term has become quite ideologically loaded, and has shifted in meaning to generally refer to ex-members of the former Communist Party. I think that this meaning is unfortunate, for it denies the legacy of the communist period for analyzing current East European society. Even anti-communist former political dissidents are "post-communist" because their habits and practices were formed under communist rule. Thus, the more restricted meaning of post-communism that has come into use implicitly denies the importance of history in studying the transition process.

[2] Essentially all non-socialist attempts at modernization can be so construed.

almost non-existent in most other Communist societies, such as Czechoslovakia. One problem of the transition, then, was the need to create a group of private owners -- the pillar of any "capitalist" economy.

While this task posed great problems, it was complicated by the historically unprecedented fact that the transition to capitalism had to be accomplished in a context of prior massive capital accumulation. On the one hand this was an advantage because it meant a class of "free wage laborers" did not need to be more or less violently created from a peasantry. On the other hand, the inherited capital stock, it is universally agreed, was terribly outdated and inappropriate for the successful integration into the world market economy.

The logic of accumulation in the Communist era was driven by political considerations -- in which an industrial structure developed that maximized the "redistributive power" of those in the Communist party/state hierarchy (Kornai 1992, Konrad and Szelenyi 1979). As a result, the state owned enterprises inherited from the socialist period suffered from terrible diseconomies of scale and outdated technology. Collectively, they created an economy that suffered from an unusual degree of monopolistic and oligopolistic markets, and under-investment in

the consumer and service sectors. Furthermore, the advantages of a late transition to capitalism -- making easy gains by combining new technology with cheap labor -- were eliminated.

Thus, those seeking to make a market economy out of the ruins of Communism faced an incredibly daunting task. They had to create a "private economy" where there was no pre-existing social group of "private owners," and simultaneously restructure the vast majority of the capital stock of the economy to make it competitive on world markets.

This paper, then, is about how capitalism has been and continues to be made in Central-Eastern Europe. The policies of the first post-communist governments -- liberalization and privatization -- were intended to allow "efficiency" considerations to shape the organizations of the new capitalist economies.[3] By creating "private property" and introducing market competition, so the theory goes, economic actors can then compete over scarce resources. Without the state to prop-up

[3] The most influential advocates of this position are Oliver Williamson's transaction cost approach (1975) and the business historian Alfred Chandler's account of the rise of the corporation (1977).

inefficient actors only the capable will survive. This formula, it was asserted, would quickly create "normal" economies as found in Europe and America.

Analyses of economic organizations in the capitalist West that focus on efficiency, however, have come under increasing attack. It seems that corporations did not rise strictly as a function of economies of scale resulting from new technologies (see Roy 1997) and corporate organization can not be explained merely with reference to savings on transaction costs (see Perrow 1986). Similarly, this paper argues that post-communist capitalism has been created through many practices that are not based on ideal-typical capitalist procedures.

Based on fieldwork in 50 firms in Hungary, the Czech Republic, Slovakia and Slovenia during 1995-1996, I identify different ways, or "strategies," by which firm insiders, primarily former communist-era managers, cope with the transition and simultaneously create the new "private economy." These strategies consist of the former manager or group of managers utilizing networks they took part in during the socialist period by combining them with various "assets" from their own firms as well as their firm's environment. These strategies are by no means mutually exclusive, and are often

combined in any given case. The end result of these strategies is: (1) the personal accumulation of wealth by the insider or insiders; or (2) the transformation of either part or the entirety of the old state firm into a new "private" enterprise; or (3) the creation of completely new private firms. The different strategies create different types of firms, which will have different likely consequences for the functioning and developmental potential of post-communist capitalism.

The first section of the paper will lay out the key strategies employed by managers and others and discuss the conditions under which they are selected. The second section will follow up the logical elaboration of these strategies with brief case studies to illustrate how they work. The final section will discuss the different types of firms that are formed by these strategies and their likely developmental consequences.

Ideal-Typical Strategies

The various strategies employed by managers (and sometimes employees) to survive the transition and transform firms all involve the combining of various resources.[4] Table 1 lists these

[4]As Balzac once observed, behind every great fortune there

lies a crime. While this certainly overstates the case, the formulation contains an important element of truth. In the rightful euphoria over the collapse of the oppressive Communist regimes, it is sometimes forgotten that capitalism is not now, nor ever was, a particularly "fair" or just system. For capitalism to exist there must be capitalists as well as workers, those unfortunate many who are motivated to work by what Weber called the "dull whip of hunger." As Weber argued, one of the essential steps in the historical formation of what he called "modern economic capitalism" was the enclosure movement -- the separation of the direct producers from their means of production and means of subsistence. What was common land used by all in the community was captured by the few, turning it into private property.

This process of creating private property out of common property has occurred in the creation of post-communist capitalism no less than in the initial rise of capitalism in Western Europe. The following strategies detail the mechanisms by which this was accomplished. In so doing, the temptation to make moral judgements on these strategies is inevitable. However, I find Weber's injunction to value neutral research important: values should influence what you choose to study, but they should be bracketed as much as possible during the analysis. Many analyses of the transition are clearly normative -- and in simply condemning ex-communists as crooks add very little of interest to the corpus of knowledge on the transition process. The argument, to drastically simplify, is that the transition to Western style democracy would be smooth and easy if not for the corrupt and immoral ex-communists and criminals engaged in corrupt and immoral activity. I try to avoid repeating this story.

Furthermore, in the context of the transition from communism to capitalism, it is quite unclear from which moral vantage point one could make value judgements. Some of the managers from the state owned enterprises worked their whole lives in their companies. Faced with massive uncertainty during the transition period, who can blame them to want to preserve part of what they labored over, even if the means they selected to do this were illegal or at least questionable? The most popular show in the Czech Republic, aired on the new private TV station NOVA, is Dallas featuring the modern day Robber Baron J.R. Ewing. This version of "capitalism" only reinforces what was learned under Communism -- that capitalism is the unbridled pursuit of self

resources by the strategy in which they are employed. The most important type of resource used when strategizing is the network managers were embedded in during the socialist period. As Stark (1996) has emphasized, these networks, consisting of personal relationships between socialist era managers and others, are the most important factor shaping the emergence of organizations in Eastern Europe. Almost all other assets can be obtained and utilized only through network ties.

Another resource that has been highlighted in the literature is political power(Staniszkis 1991). Access to individuals with formal or informal political power can prove decisive during enterprise restructuring. The direct, if quite modest, political power of employees as voters can also have an affect on firm transformation because the threat of politically dissatisfied

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interest. In a situation of massive uncertainty, only with the knowledge that society is moving to "capitalism," it seems any practice is fair game. If there is any fairly unambiguous "bad guy," it is the predatory Western company seeking to purchase post-communist markets -- destroying jobs, local industry, and aggregate demand. As for the rest, the reader will have to decide for themselves.

unemployed voters can not be completely ignored by elected officials. Also important is access to capital for investment. This may come from the personal savings of managers, the cash reserves of the old company, investment by foreign companies, or domestic financial sources such as banks, investment funds and other financials. Another resource, thus far overlooked in the literature, is what I call specific knowledge. This encompasses the local knowledge that firm managers have of their specific markets and production processes. Finally, secrecy, the ability of managers to cloak their activities or their firm's true resources, can be utilized to the managers advantage.

Table 1: Ideal-Typical Strategies and Resources

Strategy	Network	Foreign Capital	Internal Savings	Specific Knowledge	Secrecy	Domestic Finance	Political Power
Foreign Privatize	X	X		X	X		
Joint Venture	X	X	X	X			
Clone	X		X	X			
Short term Satellite					X		
Semi-perm Satellite	X				X		
By-pass Satellite	X				X		
Clientelist Finance	X					X	
Political Capitalism	X						X
MEBO			X			X	X
Partial Self Own	X		X				
AutoCross Ownership	X					X	

Strategies Involving Foreign Investment

One set of strategies involve joining forces with foreign capital. Foreign investment was almost universally trumpeted as a necessary component to the remaking of the post-communist economy. It was supposed to provide a vast array of benefits to the transforming economies, among them: new technology; new quality control techniques; new production techniques; a source

of new jobs; access to Western markets; ties to global research and development networks; investment capital; small and medium sized enterprises that were "missing" under socialism; competition to reduce the monopolization of the economy; new management techniques; new business standards and business ethics; Western standards of labor intensity; and entrepreneurial attitudes. (See Svetlicic, Artisjen and Rojec 1993:10; Dunning 1993:30; Hamar 1994: 188; Mann 1991: 184; Zloch-Christy, 1995: 1; Csaki 1995:108; Faur 1993:204. See also Kennedy's contribution to this volume for his analysis what he calls "transition culture" for a discussion of the expectations actors have about foreign involvement in the transition process).

There are a number of ways in which foreign investment and local economic elites join forces. The most conspicuous type of foreign capital penetration consists of local managers assisting a multinational in the privatization of their company. Managers employing this strategy seek to become members of the upper management of a foreign Multinational Corporation that privatizes an old state owned enterprise. This is sometimes referred to as becoming a member of the "comprador intelligentsia," a term which implies that one grows wealthy by assisting foreigners in gaining economic control and dominance of one's own society (See Szelenyi 1995).

This is an attractive strategy for most managers, as the

wealth and prestige that go along with being a member of the management of a foreign multinational are quite substantial. Managers are very rarely fired in this situation, and often earn extremely high salaries. In exchange for this treatment, socialist managers provide either exclusive and accurate information on the firm's capacities, or they hide firm assets so as to lower the price of privatization. While these services might not be highly ethical, the firm can be significantly strengthened by the capital, management expertise, and market access such privatization bring. The key to selecting this strategy involves having a buyer, a situation which exists only if the firm has some potential. Such potential might stem from a production process that can create commodities which have an international market. Another source of potential, unfortunately, lies in a firm's market share and distribution system. Multinational firms suffering from excess capacity may choose to buy a firm simply to gain control over its market.

While much of the discussion of the role of foreign direct investment in the transition economies envisions the large scale privatization of state owned enterprises, as in the case discussed above, the reality is much different. In Hungary, at least, foreign firms are smaller than average. They are over-represented among firms with less than 100 employees, while they are quite under-represented in the larger firms. My fieldwork

indicated that a large portion of foreign investment took the form of small scale joint ventures with former managers of state owned enterprises.

This strategy is a variant of a very common method of establishing a private business, which I call establishing a "clone" company. A manager employing this strategy forms a private company that is a duplicate or "clone" of his or her old division (or part of a division) of the state owned enterprise in which the manager formerly worked. The employees of the old enterprise provide the initial labor for the new enterprise.

The primary asset used in this strategy is the manager's specific knowledge of his or her firm and his or her personal savings. Thus the old manager takes either a part of or the entire network of human capital of a division (or a section of a division) of a state owned enterprise. The former manager then establishes a legally separate company, with some or all of the same personnel, in the same business line as the old division. In this case what is "privatized" is the network of accumulated human capital (made more valuable by existing as a network of inter-dependent behavior) of a division of an enterprise. This includes contacts with old business partners, both foreign and domestic.

The foreign variety of this process consists of a manager (or group of managers) forming a clone company, and then

negotiating a business arrangement between the clone company and a representative of a foreign company. Typically the manager met this representative during the socialist period. The foreign partner may be a part owner of the firm, thereby establishing a joint venture; or they may have a symbiotic relationship based on the local firm selling the products of the foreign firm. This process of joining foreign capital with local managers/nascent-capitalists occurs on a much smaller scale than most other types of foreign direct investment, usually in companies employing 50 people or less.

Strategies Relying on Domestic Resources

Foreign direct investment, while logically an excellent solution to the double dilemma facing the transition economies, simply was not substantial enough to get the job done. In Central Europe only Hungary has really significant foreign ownership. In 1992, 21.6% of the top 3000 firms in Hungary were 30% or more owned by foreign proprietors.[5]. FDI inflow per capital in 1995 US dollars was $346 in Hungary, $243 in the Czech Republic, and $47 in Slovakia, whereas the average for Central and Eastern Europe -- including the former Soviet Union -- was

[5] According to a data set consisting of 1001 randomly sampled firms out of the largest 3000 firms in Hungary carried

only $31.50. Still, FDI in the region is quite low over all. In England, for example, the corresponding figure is $513.50. Indeed, Hungary accounts 9,934 and the Czech Republic 5,008 out of the 33,565 million dollars worth of FDI in the region up through 1995 (United Nations 1996: 64).

Thus, it simply wasn't possible for most managers to utilize foreign capital as they strategized to reconfigure state owned property. The other strategies they employed relied on creating domestic ownership. The most common approach was the "clone" company, discussed above. This strategy can be selected whenever the economies of scale are small enough that a manager or group of managers can afford to "go independent." Often, these managers have specific technical skills that do not require expensive machinery to utilize.

Satellite Companies

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out by the Tarki research institute in Budapest.

Equally interesting to the establishment of clone companies is the appropriation of "property" broadly conceived from state owned enterprises via satellite firms created and owned by managers.[6] Managers of state owned firms, primarily relying on secrecy, are able to create side businesses in the form of satellites revolving around the state owned enterprise. Three different types of satellites exist. Short-term satellites perform imaginary work, such as "presentations" or "consulting" and serve as mechanisms for "privatizing" the financial assets of the firm. The key to the successful use of this strategy consists in controlling both ends of the transaction. Managers make contracts between their satellites and their own divisions and pay themselves for their non-existent services. This is the only strategy that does not necessarily involve the use of a network -- as a manager can do it all on his or her own. Although typically other managers know what is going on and must be willing to be silent.

The second type of parasitic satellite tends to be more durable than the first, and operates on a much larger scale. Managers of state owned firms form "satellite corporations" around the old state owned or privatized company. These satellite

[6] See Walters 1990; Nuti 1990; Mejstrik 1995: 56; Voska 1993: 106; Staniszkis 1991:38-40.

firms are also created during a period in which there is no effective controlling owner, and rely on secrecy. However, unlike the short-term parasitic satellites, they may continue to exist after ownership has been clarified. These firms are sometimes subsidiaries of the "mother" company, sometimes privately owned. Whichever situation exists, the profit is taken by their managers (or manager-owners). Managers employing this strategy profit by utilizing their networks formed in the socialist period. There is almost always some kind of a kick-back so that the satellite owner can establish themselves as either an intermediary company with the right to sell to the old company after taking a large portion of the profit margin, or as a competing company that takes the old company's markets.

A third type of satellite utilizes the same types of resources as the other two. It involves a manager creating a type of private company which has been referred to in Eastern Europe as a "by-pass" or "tunneling" company. In these companies, the original firm's assets are transferred, possibly in exchange for the debts of the new enterprise.

The context in which managers employ satellite strategies is a period of radical uncertainty prior to privatization, or in the absence of effective monitoring following a privatization. The self-seeking nature of humans emphasized by principal-agent theory (Demsetz 1988, Alchian and Demsetz 1972, Fama and Jensen

1983a and 1983b) seems to flourish in this situation. In essence, the "agents" are left unsupervised and unmonitored.

Aside from utilizing satellite strategies, actors can also draw on clientelistic financial networks to obtain the capital needed to privatize state property. This strategy involves employing a network of particular people formed in the socialist period. This network uses the power held by members in banks and other financials to issue loans to companies owned by members of the network. The members then typically use the loan to purchase shares of other companies. This practice can be both legal and illegal.

Obviously, this strategy, like most others, is employed when it can be. That is, only the lucky few with connections to those that run or influence post-communist financial institutions employ this strategy.

Financial networks are not the only arena where clientelistic ties are useful. Network ties to members with political power can also be exercised. Actors use their ties to incumbents in positions of political authority to: a) gain appointment to positions as managers and as members of boards of directors; b) demand the sale of shares of a company to a client; and c) procure large and lucrative contracts from the state. They can then return some profits to those with political authority to further their political careers. This type of

strategy, which Weber (1978) (see also Schlucter 1989) called "political capitalism," exists in all capitalist systems. Its prevalence, however, varies greatly between different post-communist societies.

In general, where democratic structures are strongest, and in particular where a free press is firmly entrenched, this strategy will be less prevalent. A transparent political system, in which the mass of the citizenry can find out what is going on, and hold political actors accountable for their actions, will limit this process. Consequently, this strategy is comparatively rare in Hungary and the Czech Republic and more prevalent in Slovakia. It is much more typical of the former Soviet Union and the Balkans than Central Europe. Nonetheless, it does exist even in Hungary and the Czech Republic. In the Czech Republic, Klaus was forced to resign due to revelations of this type of activity. Similarly, according to an interviewee at the Hungarian State Property Agency and Holding Company, politicians try to exert pressure for the appointment to various boards of the five biggest corporations, and one hears that someone is fired and replaced as a manager for political reasons approximately once a month.

Strategies Relying on Managerial and Employee Ownership

A straight-forward alternative way to create domestic owners without recourse to clientelistic networks and satellite companies is a manager and/or employee buy-out. This is a strategy in which a group of managers, often with the cooperation of workers, privatize the original state owned enterprise (or a division of such an enterprise). This is typically accomplished by forming a limited liability company that privatizes the original company, often on very favorable terms. It seems that cheap management buy-outs may be used by the state as a way to prevent bankruptcies and save jobs. Thus, the resources used to employ this strategy are the political power of workers and managers as well as the personal savings of firm insiders and/or the firm's cash reserves which can be used to purchase the company.

Whether this practice may take the form of a manager and employee buy-out, or simply an employee buy-out, all commentators and researchers report that managers then go on to dominate the new "employee-owners." First, the opportunity to subscribe to shares are often based on seniority and salary, which favors management (Karsai and Write 1994: 1005). And if seniority is not the principal of share distribution, then money is, which obviously also favors management. Furthermore, the diffuse ownership among employees as well as managerial monopolization of information, again, according to fairly preliminary data, further

strengthens managers relative to workers.

Thus, in Hungary "Employee-owners were typically, because of their low and diffuse equity stakes together with lack of expertise, unable to exercise an effective supervisory role. Moreover, employees were presented with insufficient information with which to exercise control, either in terms of proper representation or a system of weekly and monthly reports. Feasibility studies and business plans were neither detailed nor concrete enough to make these documents suitable for exerting some sort of external control."(Karsai and Write 1994: 1007). Indeed, employees "with their generally low equity stakes, did not see themselves as owners. As the proportion of their incomes made up by dividends was insignificant, the focus of employees' attention was on receiving higher wages and keeping their jobs" (Karsai and Write 1994: 1007). While these findings are based on interviews in 17 firms, this is more evidence, to my knowledge, than anyone else has mustered on this point.

My own fieldwork also confirmed this view. In one Czech company, the CEO told me that the managers completely dominated the legally mandated process by which workers appoint one-third of the seats on the Supervisory Board. Similarly, the Chief Economists of the Hungarian State Property Agency told me that it was "common knowledge" that managers dominated employee buy-outs. More-over, I found in my fieldwork that over time managers tend

to buy shares from employees. This was the case of five firms which I studied in Slovenia -- where the privatization law mandated that insiders receive 60 per cent of their firm's shares.

Another strategy relies on the fact that managers need not buy a majority stake in their firms to maintain control. Instead, they can purchase a block of shares in their own company, in order to fragment outside owners and insure their own domination. This strategy allows management to gather a sufficient block of votes on the Board of Directors and/or the Supervisory Board to block a combination of non-management (outside) owners attempting to gain control of the corporation. A typical mechanism consists of managers creating a company that then purchases some shares of the firm in which the managers work. It is clear that this is a strategy to increase the control of managers. By creating another "owner" with voting shares on the supervisory board, a partially self-owned firm can ensure that "outside" owners can not gain a majority or, sometimes, the 2/3rds majority on the supervisory board necessary to appoint the chairman of the board of directors. Managerial control is thereby secured, since supervisory boards are typically mandated by law to have one third of their members be representatives from "employees." This term includes both managers and workers, but in actuality usually refers to managers. Thus, these additional

"self-owned" votes, combined with the one-third of the members that are representatives of employees, allows the management to block any move by outside owners.

This strategy seems to be possible when a firm is owned by more than several institutional owners. I saw only two examples of this out of the 50 firms I studied, both in the Czech Republic. Given the voucher privatization in this country, and the subsequent formation of investment funds which then purchased a majority of the privatized companies, many companies were owned by large institutional investors whose monitoring capacities was stretched quite thin. This would seem the ideal environment for this type of strategy. However, the dense network of inter-firm holdings that Stark (1996) describes for the largest firms in Hungary would also probably be a fertile ground for this strategy.

Another form of self-ownership, certainly the most unusual and perhaps the most important type, is what I call auto-cross-ownership. Managers, using institutional power derived from their incumbency as managers, institutionally purchase other companies in a strategy of reciprocal cross-institutional ownership. These lines of cross-ownership are reinforced through interlocks of boards of directors and supervisory boards. Thus, the primary resources used by managers employing this strategy are the inter-firm networks formed during the socialist period

and internal cash reserves.

This strategy creates an auto-cross-owned business groups that perhaps can be called "the Czech Business Group". This organization is built around networks of managers in privately owned firms (consisting of firms in some manufacturing sector, along with affiliated companies that provide services, including banks, investment companies, and insurance companies). The most important real property rights of any group of concrete actors associated with the Czech Business Group are exercised by the top managers of these firms, with a network of power emanating from the board of directors and the supervisory board of the central "holding company".

These networks of firms are both "private" (to the extent that they are not owned by any organs of the state) and "self-owned". The resulting "networks of firms" resemble Japanese *kigyoshudan*, or to a lesser extent Korean *Chaebol* (See Stark and Bruszt (1995) for a similar finding, although one that focuses more attention on the role of continued state ownership of large banks). The chief specificity of the Czech Group is that it is controlled by its top managers. There are no "ultimate private interests" with ownership based on the collective ownership of a large amount of capital and wealth by an extended family (See Zeitlin 1974, Zeitlin and Ratcliff 1988, Domhoff 1986). Unlikely as it may seem, this is a non-state owned property form without

any significant "natural individuals" as shareholders. This goes beyond the managerialist claim that diffuse ownership by individual shareholders creates a situation in which managers control the corporation. There are no individual "shareholders" to speak of. The shareholders are the companies in the group.

This strategy can be pursued under only certain conditions. First, a peculiar institutional structure must be in place. In particular, a large company must be formally owned by many smaller companies. This is a purely contingent historical outcome. Second, the large company must have a substantial amount of money, or access to financial institutions, in order to purchase the owning companies.

Case Studies

Having outlined the ideal-typical strategies, I will briefly provide case studies to flesh out these practices.

An example of foreign direct investment by large scale privatization in my fieldwork was ChocolateCo. in Slovakia. The history of this firm represented, in world system theory's terms, the movement of Slovakia from the capitalist semi-periphery in the late 19th century, to the capitalist semi-periphery in the late 20th century.

ChocalateCo. began with foreign direct investment in 1896. In 1890 the government in Budapest granted numerous concessions

in an attempt to spur foreign investment in Greater Hungary. A German confectionery company seeking to expand into south-eastern Europe decided to establish a factory in Bratislava to take advantage of these concessions as well as to take advantage of the low wages in this part of the Austro-Hungarian empire.

The company went through many permutations as German, Hungarian, Czech, and Slovak power rose and fell, until it was seized by the Red Army in 1945. It then provided the Red Army with confectionery and artificial honey until it was handed over to three "national administrators" appointed by the Czechoslovak state in July of 1945. German and Hungarian staff was expelled from the company, and in September 10, 1946 the company's assets were seized because of its German origin. The company was formally nationalized in 1947 and continued to be go through organizational changes as it was moved from one socialist conglomerate to the other. The last change was in 1988, when ChocalateCo. became part of Confectionery s.p., also a state owned company. By the end of these changes ChocalateCo. had about 36% of the domestic market in cocoa, 20% in chocolate bars, and 18% in chocolate confectionery.

In 1992, the National Property Fund, the sole shareholder, established ChocolateCo. as a joint-stock company, and sold by direct sale 67% of the stock to the largest European coffee and confectionery producer, Jacob Suchard for 600 million SK. Thus,

almost 100 years after it was founded, the company returned to German ownership. This was not to last too long, however, as Jacob Suchard was acquired by Kraft, which in turn is owned by Philip Morris Companies Inc., the biggest producer of packaged foods in the world.

This privatization closely mirrored the managerial strategy elaborated above. Part of the privatization agreement was that no managers would be fired in the first several years. The supervisory board, with the exception of the director from Kraft headquarters, was entirely composed of local managers. The board of directors was all local management as well. In addition, ChocolateCo. does regular salary surveys three or four times a year, and makes sure they pay their management above average wages. For example, in 1996 the average wage for Slovak managers was 7470 SK per month, and ChocolateCo.'s average was 9000 SK.

Unlike firms privatized by local investment companies, foreign investment resulted in strong ownership able to set a coherent strategy, with capital for investment. The first reorganization after privatization was the creation of a sales and marketing departments. Then, ChocolateCo. launched a massive modernization program. Since 1992 Philip Morris has invested 400 million SK ($13.3 million) in the company, to bring it up to Western European production standards. Thus the new owner invested almost as much as it paid for the company in only

three years. The result is that after only three years of operation, the company had 40% of the chocolate market in Slovakia. Last year, ChocolateCo. launched ten new products. They have begun to export as well, mainly to Russia and the Ukraine, which now accounts for one-third of their turnover.

This type of foreign direct investment, according to a number of observers of the Eastern European environment, can be, and typically is, abused. The most telling critique is that foreign investment has been essentially market-destroying (See Matzner 1996). Market destroying behavior primarily consists of buying the distribution networks for domestic output and replacing domestically produced goods with foreign produced commodities. Former managers who assist in this process exhibit behavior deserving of the title comprador (see Bakos 1995 for evidence to this end). It seems that Hungarian supermarket privatization fits this model. Bought by German multinationals, Hungarian food retail stores carry mostly German and European foodstuffs, as Hungarian agriculture, once the showpiece of "Goulash Socialism," has experienced a devastating crisis that has literally cut the output of this sector in half. Another example is the Hungarian plant oil market, where several firms were purchased via privatization by a Dutch company, creating a foreign monopoly as sole distributer. Prices were subsequently doubled.

While large scale privatization by foreign capital certainly is an important process, small scale joint ventures are much more plentiful. An example of forming a partnership with foreign capital ownership was GateCo. in Hungary. I interviewed the president and 50% owner of the company. The other 50% is owned by a German company. For 30 years the Hungarian owner worked for a state company that processed metal, starting as a technician. For the last 7 years he was the director of the division that planned metal construction. When he made buildings he realized that gates and doors were of insufficient quality. So he looked for a Western company to make them. In 1986 there was a big European exhibit, where he met his current business partner. This partner at the time wanted to work with his company, but in 1986 he did not have the freedom to make a deal. In 1988 Hungary allowed his division to start importing gates from his future partner. Then, in 1990 the law changed to allow the formation of joint stock companies.

By 1990 the interviewee had become the director of the division of the state owned enterprise that made and repaired gates. He described his motivation to form his company as stemming from his frustration with the way the state owned enterprise was run. Things were simply too bureaucratic, and permission from the hierarchy was required for all activities, even simple practices like fixing gates they had installed. By

the time he got permission to fix something, he said, the owner of the gate had either already fixed it, or more likely, there was now something else that had to be fixed.

Apparently fed up with the situation, the interviewee inquired of the German gate maker if they still wanted to form a partnership, which they did. The initial capital was 1,000,000 HUF, with each side contributing half. At first GateCo. simply imported gates made in Germany and sold them on the Hungarian market. The founder took about 10 workers from his old division with him, but all but two have quit because of the greater demands of work compared to what was expected in the old state owned company.

In the five years of operation, his company has grown substantially, if not spectacularly. It's assets are now 35,000,000 HUF ($270,000), and his work force has doubled. His is a capitalist enterprise cut from the classical mold. He works at the plant all day supervising his labor, and his wife heads.the staff and keeps the books. Of his 16 non-clerical workers, he always has 6 located in Germany making gates. They get very high pay, and, he stressed, "learn how to work hard." He rotates these workers every two years, and he said it was an effective motivator and helped retain his skilled workers.

While they initially only imported gates from his German partner, they have increased the style of gates they carry, and

now import from French and Spanish companies as well. He explained that one of the advantages of importing gates is that when demand falls, he doesn't have to lay off his employees. Currently, out of the 18 foreign and domestic companies selling automated gates, his company has 20% of the market share, worth about 100 million HUF ($770,000) in turnover per year.

Domestic Strategies

The first domestic strategy, creating a clone company, has basically been illustrated with the example of GateCo. above. The process is essentially the same as the creation of the joint-venture, with the obvious difference that there is no foreign partner and thus no foreign capital. Often, even a purely domestic clone company will eventually seek a foreign partner to raise capital.

While clone companies produce firms that are reminiscent of the idealized capitalist firm, satellite firms seem completely alien to what Weber called "modern economic capitalism." The simplest satellite strategy is the creation of a short-term parasitic satellite. This type of "privatization by theft" exists, in terms of the larger picture, on a fairly small scale. For example, one huge company from Czechoslovakia, employing more than 20,000 people, was "bled" by its managers using this strategy for a total of 50 million crowns until it was split up and privatized in 1995. This represents a very small percentage

of the operating expenses of this company.

An example of the employment of a long-term parasitic satellite company is LuxTrade, which had the Czechoslovakian state monopoly on various imported luxury goods. During Communism these shops allowed Communist elites to spend special credits they exchanged for hard currency they accumulated abroad. With these credits they purchased certain high quality consumer goods unavailable to the rest of the population (such as imported scotch and fine cigars). As a result of its long history, LuxTrade has many outlets, and excellent name recognition. LuxTrade was a state-owned enterprise until the first wave of privatization. It is a typical large "private" Czech enterprise, with the majority of shares in institutional ownership, in which the owners are investment companies owned by banks or other financial institutions that are in turn majority owned by the state.

After Privatization, according to my interviewee, control was dispersed and didn't function very well. The representatives of the owning investment funds did not have any expertise with foreign trade. He joined the company in March of 1995 year because of the resulting bad situation.

He explained that members of the Board of Directors get paid for coming to the meetings. He said that in the last four years none of the owners took an interest in the running the firm and

providing leadership or strategy. The members of the board were lower level employees of the investment funds, who did not know anything about the business and did not really care. He said "They give some stupid advice -- and I give them lots of materials on the business which they don't even bother to read."

This type of "absentee" ownership creates a situation ripe for those problems predicted by principal-agent theory. Again, we get a large company with no clear supervision or monitoring by owners. The company was ripe for satellites. According to the interviewee, after privatization, when there was no real control, the old managers of LuxTrade set up independent companies that signed exclusive rights for various items, bought them wholesale from the West, and then resold them to LuxTrade, taking 80% of the profit margin in the process.

Thus, LuxTrade went from being a state monopoly to being the launching pad of tiny parasitic mini-monopolists for certain specific luxury commodities (like RayBan Sunglasses, Scotch, etc). These firms add nothing to production, nor do they make the Czech market any less monopolistic. Their parasitism is predicated on the existence of the large chain of distributors and name recognition of the mother-company (or more accurately the "host" company). They take the profit out of the company, sucking it dry of funds not only for innovation, but even of

money to buy new goods.

A "by-pass" satellite strategy is illustrated by the Slovak firm VeggieCo. This company used to hold the state monopoly for seed production and distribution. There were over 1500 people in various branches of the company and in 12 retail shops. From 1990 up to July 1994, the companies separated from each other. The first to separate were the ones being liquidated, and thus the least valuable property was unloaded onto the state. According to the owner/CEO the worthless property was liquidated at no cost to the managers, and then "each manager wanted to be independent, so they split up the rest."

This fragment of the old company, with 100 employees, is now owned by 5 managers, and has 20 to 25 percent of the domestic market in vegetable seeds, but only for small consumers who mostly do gardening as a hobby. They market their seeds in the 12 shops they still own throughout Slovakia (along with other gardening supplies), as well as selling wholesale.

The director and owner explained a situation where a fairly significant "satellite" seems to have been formed. Since 1992 the company has been in court because of the happenings at a branch of the company that was separated and privatized in 1992 under the small privatization act. The company got a loan to pay for privatization of 100 million SK (about US$ 33,000), which they never repaid. According to the interviewee, all stock and workers

disappeared over night, leaving an empty building sitting on property they illegally sold along with the debt still owed for the privatization (and thus the court case). The interviewee was visibly upset at this recollection as he pointed out the window at the rusted iron roof of a large and crude adjacent building, bitter at the loss of his firm's assets.

Whereas satellite strategies essentially involve "stealing" domestic assets, the most efficient way to amass large amounts of domestic assets is by employing a strategy of gaining clientelistic access to financial resources. A perfectly legal example comes from GoldenGroup in the Czech Republic. This financial holding company was established in 1992 as a brokerage house, and did investment banking for three years. The brokerage forms the heart of the company and it acquired the other firms currently in the group. In the spring of 1995 it was changed into a holding company I call GoldenGroup. It lists among the top ten brokerage houses and asset managers in the Czech Republic. It also includes the most important investment fund for the second wave of voucher privatization, two investment funds from the first wave of privatization, and an insurance company with 300,000 subscribers as well. The total assets of the group consists of 10 billion Crowns (about $333,000,000) and has shares in over 70 companies.

GoldenGroup is fully private -- 99% of its shares are in the

hands of the top two mangers -- 94% with the 32 year old CEO and founder. The founder secured money for his firm's expansion from cooperation with two banks. In one GoldenGroup is the majority owner, and in the other GoldenGroup is a significant share owner. After the initial infusion of cash, the group grew rich as a result of trading in securities and buying vouchers during two waves of privatization. The initial money used to purchase shares in the group's two banks, the interviewee openly admitted, came from the owner/CEO's contacts made while working in two state majority owned banks.

Just as access to finance can be a crucial resource in the creation of new firms, power is similarly useful. An example of a management buy-out will illustrate both the strategy of using political connections as well as the strategy of managerial buy-outs. VeggieCo. of Slovakia, discussed above as an example of a "by-pass" satellite, was also an example of management ownership that had quite generous terms in its buy-out. The payments for the company are to be made over ten years. In the first three years, all payments go into investment in the company. After this, the firm is supposed to pay out of its profits. VeggieCo's new owners made their first payment not from their own money, however, but from their turnover. This "payment" went to purchasing a machine from Holland that upgraded the packaging of their seeds.

This management buy-out strategy seemed to be combined with a political capitalist strategy, demonstrating once again that in many cases there is not a single strategy employed, but rather a combination of strategies. The CEO admitted the privatization was quite a bargain. Where the company had a book value of 39 million Crowns (about 1.3 million US dollars), the final privatization contract (with the extremely favorable payment scheme described above) was for only seven million Crowns. When I asked how he accounted for this, he told me "don't ask how it was so. You need the right person, at the right time, in the right place to privatize". It seemed political connections continued to help beyond the privatization, as the company received subsidies from the government of 30 per cent for buying seeds, chemicals and equipment, and 30 to 35 per cent for the costs of developing new breeds.

While VeggieCo. became a medium size capitalist firm owned completely by its managers, managers can also maintain control of a firm by employing the strategy of simple-self ownership. One example of this that I found in my fieldwork was CzechPress, a new company founded in 1994.

CzechPress is a private alternative to the Czech state run press agency (a local version of the Associated Press). The ownership and control of this company is very complicated. It is owned by seven companies. Six are investment funds (which are in

turn owned by larger investment funds, most of which are owned by banks which have significant state ownership) and one publishing company. They have two main owners: GoldenGroup (of the previous example on the clientelistic allocation of investment capital), which owns 35%, and the InvestGroup, which owns 34%. The Supervisory Board, which appoints the Board of Directors, has proportionate representation from the owners, of which none have a majority stake. The twist in this ownership scenario is that the top six managers of CzechPress, who founded the company, own 90% of InvestGroup. So they are one of their own major owners. My interviewee (the Chairman of the Board and Managing Director for the economic division) said that the managers control the firm in order to divide outside owners.

The media division is run by the editor-in-chief. The economics division is headed by the director of the firm. The only way to remove either of them is through the supervisory board. The supervisory board has nine members, with a mandatory three from the employees and six from the shareholders. However, the three employee appointed members, along with the representatives of the managers' own company, can always block any supervisory board action, since any decision requires agreement by two-thirds of the supervisory board. The interviewee said "the company is completely run by the managers". These other owners were brought in simply to gain additional money for

investments.

This strategy of simple-self-ownership creates a situation in which ownership and control are separated. As managerialists would predict, this created a situation in which managers were able to control the corporation. This type of managerialism takes on a more bizarre form when the strategy of auto-cross-ownership is employed. A case study of auto-cross-ownership is MegaChem from the Czech Republic. The MegaChem group is the second largest enterprise in the Czech Republic, trailing only the state owned electricity monopoly in terms of economic importance. Moreover, it is one of the only post-communist multinational corporations, with subsidiaries in over 20 companies located around the world. Depending on what it owns on any given day, according to the manager in charge of human resources, the group has about 10,000 employees. The annual turnover of enterprises in the group is about 30 billion Crowns, or about 1 billion U.S. dollars.

MegaChem was founded in 1948 as the state owned foreign trading company with a legal monopoly on all imports and exports of chemical, pharmaceutical and petrochemical related products. In 1968 it, along with a number of other trading companies, was converted into a "corporatized" firm or a "normal limited shareholding company". This meant that shares of MegaChem were formally owned by the firms whose products they traded. Thus,

MegaChem was owned by the refineries, chemical firms, and pharmaceutical firms in Czechoslovakia as well as the state foreign trade bank that made loans for exports and imports.

These firms did not have to pay for these shares, and in fact did not exercise any control rights. Like virtually all firms in Czechoslovakia, MegaChem was controlled by a state ministry. The reason for this change in ownership is probably related more to trying to legitimize the regime with "reforms" than any economic logic. Another reason, according to one of the interviewees, occurred because Western firms, which as a trading company MegaChem had contact with, understood the meaning of a "joint stock company". Thus the formal change in ownership was an effort to smooth interaction with Western companies.

The structure of ownership of MegaChem remained unchanged from 1968 until this day. Over 100 companies owned, and still own, MegaChem. In addition, about 4.5% of MegaChem's shares were owned by employees (mostly managers). After 1989, these owning companies were forced to pay for their shares, creating a huge source of cash for MegaChem. Many of these companies, once forced to trade through MegaChem in the communist period, now attempted to eliminate the middle man and do their own marketing and distribution. These companies discovered, however, that this was not such an easy task.

MegaChem had a distribution network already set up, and the

costs of establishing their own networks proved to be much higher than many firms expected. This problem, combined with the severe "transitional recession" that rocked the Czech Republic after the destruction of the COMECON trading block, created major problems for most firms in this sector. The President of MegaChem USA worked for one such company until 1993. He said his company, like many in the sector, borrowed money from MegaChem equal to the value of their capital stock. Then, when the privatization process began, MegaChem made a debt-for-equity swap and acquired ownership of the company. In fact, MegaChem acquired a controlling interest in many firms in the sector. According to my interviewee, they were able to acquire over 50% of shares in most cases. If MegaChem doesn't own over 50% of the shares, it can still exercise control by collaborating with other shareholders. In particular, MegaChem has a reciprocity based working arrangement with a large, and quite famous, private institutional investor which votes with MegaChem to insure MegaChem's control of these companies, in return for MegaChem's help in other sectors.

In June 1994, MegaChem formed a holding company, MegaChem Group, with ownership in over 60 different firms. The old MegaChem a.s. is now just one company (albeit the largest and most important) in this group. These Firms are mostly the privatized firms in the petrochemical, chemical and

pharmaceutical industries. However, there is also an airline, hotel, printing company, several professional sports teams, and significant banks, pension funds and investment funds.

These investment funds themselves own shares in some of these companies, further strengthening MegaChem's control over the sector. MegaChem frequently places members from their boards of directors on the supervisory boards of other firms, reinforcing its control. Thus, for example, the chairman of the Board of Directors of the Czech based pharmaceutical producer, which is one of the largest owners of MegaChem, is the Chairman of the supervisory board of MegaChem, just as the chairman of the Board of Directors of MegaChem Group is the Chairman of the supervisory board of that pharmaceutical company. Obviously, interlocking directorates are being used as a way to link businesses to each other.

Thus, MegaChem privatized its own owners, a process referred to sometimes as privatization by incest. Not only is ownership dispersed, but it is literally an example of self-ownership.

Thus MegaChem is a self-institutionally owned holding company with many subsidiaries, cooperating with each other to maximize profits. The companies within this network of firms are controlled by the center, which is itself controlled by the top management of the holding company, as well as the top management

of other major firms in the group. The relationship between firms in the group was described to me as "regulated competition". The individual firms definitely coordinate their activities and gave preferential treatment to firms within the group when selecting business partners. Indeed, this is even stated quite clearly within the annual report.

If, however, one of the firms performs poorly, it can be replaced with a firm outside of the group. If it delivered overpriced or inferior goods, for example, it can be replaced as a supplier of inputs by another company. More importantly from the perspective of budget-constraints, the interviewees all claimed that, after a few years, any firms in the group which are not profitable will be allowed to go bankrupt. Finally, the transactions of firms within the group are arranged to minimize taxation, through the well known multinational strategy of "transfer pricing". This is a process in which commodities sold between subsidiaries of the same MNC have set the prices to minimize "profits" in subsidiaries with already high profits (thus reducing the total tax bill).

Conclusion

This paper has attempted to elucidate the ways in which agents have "made capitalism" in post-communist Eastern Europe.

I have identified a number of strategies or patterns of action by which actors combine diverse resources to survive the transition, and in the process reconfigure the existing capital stock and remake themselves as capitalists. Most restructuring occurs not because it is more "efficient" than others ways to restructure property, but because of the actions former managers utilizing networks formed in the socialist period to mobilize a wide range of resources. The question remains, however, what type of capitalism has been made by this process?

The strategy of making capitalism through privatization by foreign direct investment creates two, diametrically opposed outcomes. This strategy can bring the most advanced business techniques and capital for modernization and expansion. As in the giant corporations of the U.S., the majority owners delegate the right to control the daily activity of the firm to managers, but retain the ultimate authority to set strategy and run the business.[7] Thus, the state owned enterprise privatized by the multinational firm takes on the structure and functions of the most advanced business form in the world. However, the predatory variety of foreign investment, in which the purchasing company does not move production to Eastern Europe, has the opposite

[7] The issue of the separation of ownership and control in the U.S. has a long and contentious history. The evidence, however, does not support Berle and Mean's thesis of "managerial control" (See Zeitlin 1974; Scott 1997).

effect. Rather than reconfiguring domestic industry, this type of foreign investment merely destroys domestic industry. This is a path towards underdevelopment.

The joint venture and the domestic clone company on the other hand, create easily recognizable small capitalist firms. Whereas the large scale privatization by foreign capital creates the most modern specie of capitalist firm, the resulting property form from the clone and joint venture strategy looks much like the small capitalist enterprise of the period of "competitive capitalism" in which the owner also directly managed the firm.

Strategies involving the creation of "satellite" firms create structures of property rights that are both typically and not typically found in the West. Those satellite strategies that are analogous to "theft," such as funnelling funds or capital out of firms and leaving liabilities, do not necessarily result in unique property rights configurations. To the extent that these activities take place only in a brief time period, they can be seen as a mechanism of creating a class of wealthy individuals. These individuals may or may not invest their pilfered money into new, capitalist enterprises. When this strategy involve taking fixed capital and leaving liabilities, this can be interpreted as a kind of post-communist "primitive accumulation." The resulting structure of property rights in these new firms are no different from small Western capitalist firms. When satellites are not

one-shot deals, when they involve the creation of more or less permanent satellites, the resulting property rights structure does not resemble the firm organization we expect to find in capitalist economies. In these cases there is a radical separation of the right to sell property and the right to control the enterprise and obtain its residual income. It is hard to imagine this type of firm structure openly existing in the advanced capitalist core. And it is hard to imagine this not having deleterious economic consequences.

As with the strategies involving the "theft" of assets from state owned enterprises, the use of clientelistic access to financial capital does not result in the creation of firms with unique structures of property rights. This is merely another example of a means of making capitalists -- another modern version of the enclosures.

Similar to the clientelistic allocation of bank loans, when political power is used to influence who wins a privatization bid, the resulting business structure may not be very unusual. Of course, the new owners, or "winners", do not succeed by virtue of superior qualifications for running an efficient business. In this case the process of the creation of capitalist enterprises is not driven by efficiency but rather by power. According to economic sociologists, however, this is not unusual even in the West (Perrow 1986; Roy 1997). When actors utilize political

power to secure continued opportunities for profit, however, the resulting structure of property rights diverges from the ideal-type of the modern capitalist enterprise. Inter-enterprise relationships are not mediated by the market, but through the state. Businesses do not prosper by adopting efficient practices and providing goods and services superior to their competitors, but by maximizing their political muscle. If generalized across the system, this practice can only have negative economic consequences in the long-run.

While the strategies elaborated above are not typically thought of as "capitalist" practices, with the exception of long-term parasitic strategies they are not unheard of in capitalist economies. However, the strategy to create auto-cross-ownership seems unique to the post-communist world. In the property forms relying on institutional ownership such as partial-self-ownership, the control rights of the owners are eliminating through dispersion. This leaves managers in control, close to what the Western managerialist theorists such as Berle and Means thought was emerging in the West. With auto-cross-ownership, however, a unique system of private property without private owners (dispersed or not) emerges. The developmental consequences of this type of property seems, on balance, beneficial. In the MegaChem example, auto-cross-ownership clearly reduces the "market integration" of firms in several

related sectors. This prevented the destruction of many firms devastated by the "market shock" of liberalization exacerbated by the political dismantling of COMECON trade. Furthermore, this strategy created a massive multinational company, collectively subject to market discipline, capable of competing with Western multinationals. This may be the post-communist world's best chance for joining the world economy on equal terms.

So far auto-cross ownership has only been found in the Czech Republic. This indicates that the different countries of Eastern Europe undoubtedly have different types of capitalist systems. This paper, however, does not attempt to elucidate the rather substantial divergences between the countries in which I did my fieldwork. Instead it treats them instead as a "sample frame" from which I drew case studies. This paper, however, by creating a typology of strategies, lays a baseline by which the different countries can be compared. In essence, different strategies will be pursued to different degrees in the different countries, creating different types of enterprises.

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