Post-Privatization Enterprise Restructuring

By: Morris Bornstein

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Morris Bornstein

Department of Economics
University of Michigan
Ann Arbor, Michigan 48109-1220, U.S.A.
Telephone: (734) 764-2355
Fax: (734) 764-2769
E-mail: morborn@umich.edu

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Abstract

Post-privatization restructuring of former state-owned enterprises (FSOEs) encompasses both shorter-run “defensive” actions and longer-run “strategic” measures. Restructuring involves changes in corporate governance, organizational structure, management, labor, capital, technology, output, and sales. Various performance indicators may measure the results of restructuring, but care is required in the selection and interpretation of indicators. In the restructuring of FSOEs foreign strategic investors have many advantages over domestic investors. The study includes examples from experience in the Czech Republic, Hungary, and Poland.

Journal of Economic Literature Classifications: F23, G34, L33, P31.

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1. INTRODUCTION

This study analyzes the restructuring of former state-owned enterprises (FSOEs) after their "corporatization" into joint-stock companies (JSCs) in which the state initially held all shares and then, by one method or another, transferred a controlling portion of the shares to private hands.[1]

Thus, the study does not consider (1) the restructuring of state-owned enterprises (SOEs) without, or before, privatization[2]; (2) the post-privatization restructuring of SOEs so small that they are privatized as sole proprietorships or partnerships, rather than as JSCs; or (3) the development of startup private firms.[3]

In this study, "restructuring" refers to the transformation of the individual firm, rather than to the reallocation of resources across sectors of the economy. The conception of enterprise restructuring is broad, including changes in corporate governance, organizational structure, management, inputs, outputs, and sales. Enterprise restructuring thus encompasses both short-run or "defensive" actions and long-run or "strategic" measures (Estrin and others, 1995, pp. xix-xxiii; Grosfeld and Roland, 1996). The former set, addressed to the immediate survival of the enterprise, comprises, for example, reduction of employment, substitution of cheaper material inputs, disposal of unneeded inventories and equipment, and adjustment of the current product mix to increase sales. The latter set, altering the entire business strategy, comprehends, for instance, a different organizational structure, investment for new production processes and product lines, and stronger quality control and marketing.

This study focuses on the restructuring of nonagricultural and nonfinancial firms, chiefly in manufacturing, construction, and trade. Restructuring of former collective and state farms involves special issues of food policy and rural development.[4] Restructuring of banks is linked to the creation of a multi-tier banking system, the development of the tools of monetary policy, and bankruptcy procedures.[5]

By way of illustration, the study mentions experience of post-privatization enterprise restructuring in the Czech Republic, Hungary, and Poland. They are leaders in privatization and other components of economic transition among the countries of Central

and Eastern Europe and nations of the former Soviet Union (EBRD, 1999, pp. 210-213, 226-229, and 250-253).[6]

Part 2 of the study analyzes key elements of the restructuring of the firm. Part 3 discusses measurement of the results of restructuring. Part 4 considers restructuring by foreign direct investors. Part 5 presents some general conclusions.

2. ELEMENTS OF RESTRUCTURING

Key elements in post-privatization restructuring include changes in corporate governance, management, labor and capital inputs, and outputs.

Corporate Governance

In this study corporate governance involves control over the firm's major policies about production, investment, and the disposition of profit, as well as the selection, motivation, and monitoring of top managers who are to implement those policies.[7]

Before privatization, governance of an SOE in a socialist centrally planned economy was exercised in principle by the ministry supervising the branch to which the firm belonged. However, governance responsibilities were sometimes shared by others, for example by enterprise managers in Hungary and by employee councils in Poland.

The method of privatization determined the new controllers of the enterprise and, in turn, the likelihood of its extensive restructuring as a result of their desire, knowledge, and resources for its transformation. From the experience of the Czech Republic, Poland, and Hungary, four main cases can be distinguished, in ascending order of the probability of restructuring (Bornstein, 1997; Havrylyshyn and McGettigan, 1999, pp. 15-27).

Management and Employee Buyouts

The shares of the firm (or its assets to form a new company) were sold to the employees in an employee buyout (EBO), to the managers in a management buyout (MBO), or to both groups in a management-employee buyout (MEBO). Managers may have held only about one-fourth of the shares in an MEBO, but their control of the firm was usually not challenged by the workers, who as a group owned a majority of the shares. MBOs and MEBOs were more likely than EBOs to try to control labor costs by reducing

employment and restraining wage increases, but, understandably, they ordinarily avoided major changes in managerial personnel. MEBOs may have wished to expand the capital stock and modernize processes and products, but their ability to do so was limited by the burden of debt incurred to finance the privatization buyout.

Vouchers to Bid for Shares in Operating Companies (OCs)

In the Czech Republic about 40 percent of the book value of property in the Large Enterprise Privatization Program was divested through a mass privatization (MP) program.[8] For a nominal fee, each adult citizen could buy a book of coupons with "investment points" to bid in auctions of state shares in JSCs formed from SOEs.[9] Private investment funds (IFs) were not included in the original MP plan of the government, which expected that voucher privatization would lead to dispersed individual ownership of JSC shares divested in these auctions. It was therefore a surprise that some 440 IFs emerged to collect about two-thirds of the investment points.

Initially, an IF was permitted to own a maximum of 20 percent of the shares in an individual OC. Most IFs were passive investors aiming for income and capital gains from holding and trading OC shares, rather than active investors seeking to affect enterprise policies and to supervise managers regarding those policies (Kotrba and others, 1999, pp. 38-40). In some cases, IFs sought to establish control over enterprises, for example by acting jointly with other IFs or with parent banks that sponsored the IFs. More typically, however, with dispersed individual ownership of shares and passive institutional investors, the enterprise was controlled by the incumbent managers, who had a weak commitment and limited resources to restructure the firm (Mertlík, 1997, pp. 77-81).

In 1996 new regulations authorized IFs to be transformed into holding companies that are not subject to the 20-percent rule and thus can more openly seek control of OCs. Some converted IFs acted as speculators aiming to resell their stakes at higher prices, or to generate revenue from asset-stripping,[10] but others intended to pursue the long-term development of the OC. Thus, after initial voucher privatization, "secondary concentration" of ownership by "core" investors can restructure enterprises (Mertlík, 1998).

Vouchers to Obtain Shares in Investment Trusts Controlling OCs

In the Polish MP program, for a nominal fee each adult citizen could get one freely tradable master share certificate (MSC) representing proportional ownership in 15 investment trusts called National Investment Funds (NIFs) (Lewandowski and Szyszko, 1999; Hashi, 2000).[11] Subsequently, the MSC could be exchanged for one separate freely tradable share in each of the NIFs. The government included in the MP program 512 large and medium-sized OCs, mostly in manufacturing, with about 10 percent of industrial sector sales. Each SOE was corporatized as a JSC, and 60 percent of the shares was allocated to the NIF scheme, 15 percent was given free to employees, and 25 percent was retained by the state. A controlling 33 percent of the shares in each OC was assigned to a "lead" NIF, and 27 percent was apportioned among the other 14 NIFs. The lead NIF positions were distributed in a 15-round lottery, each with a different sequence in which the various NIFs chose OCs for which they would play the lead role. In the end, each NIF got the lead status in 31-35 OCs.

The NIF is a JSC with elements of a closed-end mutual fund, a holding company, and a venture capitalist. With clear dominant ownership, a lead NIF exercises corporate governance over the OCs it controls, is supposed to restructure them as appropriate, and can sell its shares in an OC and buy other company shares in an effort to increase the value of the NIF's portfolio. Thus, in contrast to the Czech scheme, the Polish program provided a core shareholder for each OC, made it responsible for restructuring the OC, and enabled the controller's performance to be evaluated by the sale price of the OC or its stock market quotation.

Each NIF contracted with a fund management company, whose sponsors typically included one or more Polish banks or consulting firms and one or more foreign financial or consulting firms. The foreign organizations were expected to provide experience in enterprise restructuring and banking services, whereas the Polish partners were to contribute restructuring and financial advice as well as specific knowledge of the country's business environment. Fund managers were remunerated by a combination of three fees: (1) an annual fixed fee; (2) an annual performance fee from the sale of 1 percent of the

NIF's assets; and (3) a "loyalty" fee of 5 percent of the NIF's assets at the end of the 10-year contractual period.

Almost all of the OCs required some restructuring, but their condition varied greatly. At one end of the spectrum, about a fifth of the OCs were strong enough to be considered for early listing on the Warsaw Stock Exchange. At the other end, some OCs needed immediate rescue to avoid bankruptcy.

An NIF commonly assigned a team of its employees to supervise and restructure 5-6 OCs. Measures to transform them included labor-shedding; changes in the organizational structure, management personnel, output mix, and customer mix; and investment in new processes. NIFs often got domestic or foreign loans to alter OCs. In some cases, an NIF sold off all or part of one OC in order to raise cash to restructure another OC.

However, there was a conflict between the shorter-term goal of maximization of the net asset value of the NIF's portfolio and the longer-term goal of restructuring individual OCs, since the two goals competed for the limited advisory and supervisory capabilities of the NIF. The NIFs' managers often favored the former objective, by improving the best OCs and selling off the weak firms instead of attempting to restructure them. The NIFs' supervisory boards, composed of government appointees, had a longer-term horizon with more interest in restructuring OCs. In disagreements, the NIFs' managers' views usually prevailed, because they had extensive information about the OCs, whereas the supervisory boards had no professional staff to argue their position.

Some NIFs have adopted distinct styles concerning this conflict of objectives. Certain NIFs now consider themselves purely financial investment funds, concerned with the purchase and sale of OC shares. Other NIFs deem themselves predominantly venture capitalists that seek to enhance the value of their OCs through restructuring and to acquire new, privately established OCs in order to develop them.

Direct Sales to Strategic Investors

Such direct sales may occur through competitive bidding in open tenders for JSC shares (or SOE assets) or through closed negotiated sales of JSC shares (or SOE assets) to particular buyers. In both cases the usual aim is to transfer a controlling interest to a domestic or foreign investor. The privatization contract often specifies aspects of

restructuring, such as the purchaser's business plan, employment guarantees, and investment commitments.

In Hungary the main method of privatization was case-by-case direct sales of SOEs, preferably to foreign investors, such as multinational corporations (MNCs), paying in convertible currency (Major and others, 1999, pp. 289-296).[12] Foreign investors were more likely than domestic investors to pursue strategic as well as defensive restructuring, changing the firm's organizational structure and management personnel, reducing employment, investing additional capital, altering the product mix, and raising the share of exports in total sales. Domestic investors, typically burdened by heavy debt service undertaken to buy the enterprise, often lacked resources to upgrade the company's technology and product structure. They frequently had a short-term aim of an immediate and regular return on their investment, rather than a longer-term program of technological development and market expansion.

Enterprise Management

Restructuring of enterprise management encompassed both (1) organizational restructuring and (2) replacement, training, and changes in compensation of individual managerial personnel.

Organizational restructuring altered the number, hierarchy, and duties of managerial posts (Brada, 1998; Major and others, 1999, p. 271).

The scope of the firm itself was sometimes changed. Some enterprises shut down or sold individual plants with unfavorable prospects or a poor fit with the new business strategy. Some vertically integrated companies spun off supplier units, and some enterprises outsourced janitorial, repair, or transportation activities. Finally, in some cases firms divested or closed non-production facilities such as housing and health clinics.

In many firms the organization chart was flattened by a reduction in the number of decision-making levels. Many enterprises shifted from a more centralized to a more decentralized structure with a headquarters staff responsible for strategy, investment allocation, and control, and divisions whose managers were in charge of day-to-day operations.[13] In some companies, certain units were designated as profit centers, and others as service or cost centers, to measure profitability as a guide to top management's future

channeling of investment. Also, organizational restructuring created, or upgraded the status of, units for specific functions, such as marketing, product quality, and finance. New communication systems were established for management information and production control.

Restructuring led to the appointment of new general directors in about a third of the privatized firms in a large EBRD-World Bank survey (EBRD, 1999, pp. 138-139). The probability of replacement of the top manager increased when the enterprise faced harder budget constraints and more product-market competition. About 40 percent of the new general directors came from outside the firm, and 60 percent from promotions within it.[14]

Also, restructuring entailed changes in managerial remuneration. First, the base pay of managers engaged in strategic decisions on finance, accounting, and marketing grew relative to that of direct production managers. Second, within the total compensation package, the share of performance-related components, such as bonuses and merit increases, rose.

Labor

Enterprise restructuring affected both employment and compensation of workers.

SOEs often were overstaffed. In some countries, the enterprise's plan assignments stressed output rather than cost or profit. In others, enterprise councils sought to protect workers' jobs. Thus, privatization was expected to lead to dismissals of redundant workers in many firms. Significant cuts in the labor force did occur in some enterprises. But in others the reductions were modest, because of pressure from local government authorities (particularly in a "company town" with a dominant employer) or because of managers' reluctance to fire workers (Brada, 1998). The extent of dismissals was influenced by the level and length of unemployment benefits and the effectiveness of government "active" labor market measures, such as placement and (re)training programs (Boeri, 1997). Also, some firms avoided employment cuts by increasing sales through changes in the product mix, quality, and marketing (Frydman and others, 1999, pp. 1177-1178).

The liberalization of the labor market ended state controls over wages that were intended to limit inequality in incomes. Wage differentials increased significantly to reflect the scarcity of labor services more closely. In privatized firms, relative wages rose in jobs

requiring more education and skills, and incentive compensation was used more widely (Rutkowski, 1996).

Capital

Restructuring the firm's capital stock after privatization often involved both subtractions and additions (Major and others, 1999, pp. 267-281). The former comprised sales of unneeded inventories, equipment, workshops, warehouses, and land; write-off of unfinished investment; and closing of loss-making plants. The additions consisted of new buildings and equipment, often embodying superior technology to modernize production processes and introduce new products. In some cases, the aim was to raise productivity and quality, rather than to increase capacity.

However, the ability of many enterprises to improve or expand the capital stock was severely constrained by the lack of finance from internal or external sources (Chvojka, 1999, pp. 90-102). Little new investment could be financed from internal sources, such as amortization allowances, retained earnings, and proceeds from the disposal of surplus assets. Among the potential external sources, bank credit was limited for several reasons. Government anti-inflationary monetary policies restricted the growth of the money supply and kept interest rates high. Government efforts to harden enterprise budget constraints discouraged automatic rollovers of loans, and indeed pressed bankruptcy programs to clear up companies' bad debts to banks. Also, the banks themselves preferred to provide short-term commercial credit rather than longer-term loans for plant and equipment. Most firms had little possibility of raising funds by initial public offerings or bond issues floated on the domestic or Eurobond markets. Only foreign-controlled enterprises were able to finance their restructuring easily, through funds from the MNC parent or bank loans obtained on favorable terms because of the parent's guarantee.

Output

There were three main types of post-privatization restructuring of output (Brada, 1998).

The first altered the product mix to concentrate on the product lines with the best market potential and to reduce or abandon those with weaker prospects. The net effect in

most firms was to narrow the product range. This result was not surprising in view of the typical pre-privatization SOE's relatively large size; broad product assortment; and high degree of vertical integration, often intended to avoid reliance on outside suppliers deemed unreliable in meeting delivery commitments. Thus some firms increased the output of particular products while cutting total output.

The second adjustment improved product quality in order to compete more successfully on the domestic market against national products and imports, and on foreign markets, especially the demanding Western markets.

Third, firms commonly strengthened their marketing efforts. On the domestic market, many companies, especially those supplying consumer goods, increased and revised advertising, in an effort to differentiate their products and thereby gain some pricing power to bolster sales revenue. On foreign markets, many enterprises redirected their exports from traditional Eastern markets, where GNP and imports had fallen, to Western, particularly West European, customers.

Product-market competition exerted pressure on firms to restructure in the shorter-run by shedding excess labor and other steps, as well as in the longer-run by innovation in processes and products (EBRD, 1999, pp. 135-137). The extent and nature of product-market competition was influenced by government policies in several spheres. Competition by private startups depended on government regulations and practices concerning registration and licensing, use of real estate, financing, employment, and taxation (EBRD, 1999, pp. 150-159). Formal "competition policy" established a set of rules about the formation of cartels among producers, with agreements on prices, output, or market-sharing; mergers or acquisitions that create or enhance market power; and abuse of a dominant market position by an individual firm (EBRD, 1997, pp. 86-89).[15] Competition increased significantly after the liberalization of foreign economic relations, including currency convertibility, elimination of quantitative restrictions on imports, and reduction of barriers to entry of foreign direct investment (FDI) in the privatization of SOEs, the formation of joint ventures (JVs) with domestic firms, and "greenfield" initiation of new foreign-controlled projects.

3. MEASURING RESULTS OF RESTRUCTURING

There are numerous performance indicators to gauge the results of post-privatization enterprise restructuring, though some care is needed in the selection and interpretation of indicators.

By way of illustration, Table 1 shows the principal performance indicators used in selected studies of post-privatization enterprise restructuring in the Czech Republic, Hungary, and/or Poland. They refer to aspects of costs, revenues, productivity, and profitability.

The number of employees is often used in one form or another, either by itself or as the denominator of ratios concerning different gauges of productivity. For measures of efficiency, the number of worker-hours, including part-time and overtime as well as straight-time work, is a better denominator than the number of employees. However, the data sets available to researchers often report employment but not work-hours. Among the revenue indicators, the share of exports in total sales is sometimes regarded as an indicator of competitiveness on foreign markets and thus as a proxy for quality. "Labor productivity" is characterized by sales or value-added per employee or per worker-hour, although sales and value-added depend also on capital inputs and management, for example. Changes in total factor productivity measure changes in the firm's efficiency in using labor, material inputs, and capital to produce a given level of output. This is the broadest measure of productivity, but its calculation is complex and requires many assumptions (Claessens and Djankov, 1998, pp. 11-13). Profitability can be evaluated in relation to sales, shareholders' equity, or total assets -- respectively, profit margin on sales, return on investment, and return on all assets under management's control, regardless of how financed.

Because they are the most comprehensive, profitability indicators may seem superior to "partial" indicators of costs, revenues, and the productivity of factors in generating output and sales. However, the narrower indicators may answer specific questions of interest. For example, the employment indicator reveals the extent of labor-shedding. Sales reflect the effects of changes in the product mix, the customer mix, and

marketing effort. A comparison of employment and sales shows how far the enterprise succeeded in avoiding dismissals through adjustments in output and revenue.

Moreover, the profitability ratios may be unreliable, because of flaws in the figures for profits and assets, especially in the earlier years of the post-communist transition (Frydman and others, 1999, p. 1158). In a period of rapid inflation, profits were exaggerated, since costs were understated relative to sales revenue because of the rise in prices between the date inputs were bought and the later date the output embodying these inputs was sold (Carlin and others, 1999, p. 6). On the other hand, some companies overstated costs and understated profits in order to reduce their tax liabilities (Major and others, 1999, p. 168). In turn, asset values were listed on balance sheets at historical costs expressed in administratively-set nonscarcity prices of the era of socialist central planning. Buildings and equipment were inadequately depreciated according to excessively conservative depreciation schedules. Land was not valued properly, if at all, because it was not traded (Bornstein, 1999, p. 66).

Thus, some performance indicators were more reliable and more relevant at different stages of the restructuring process. In the earlier phase of "defensive" restructuring, focused on labor-shedding and adjustment in output of the initial product mix, employment and sales were pertinent indicators. Profitability indicators became more appropriate during or after "strategic" restructuring, when new accounting systems corresponding to international standards were adopted, the organizational structure and managerial personnel were changed, investment in product and process innovation began to bear fruit, and the effects of greater domestic and foreign competition were felt.[16]

4. RESTRUCTURING BY FOREIGN DIRECT INVESTORS

Many studies have concluded that in restructuring FSOEs foreign strategic investors have been more successful than domestic "outside' and "inside" controllers.[17] Likely reasons for this superior performance, and some offsetting considerations, can be analyzed in the framework of the elements of restructuring in Part 2.

In regard to *corporate governance*, MNCs obtained clear control, though not necessarily full ownership, of FSOEs. The foreign investor had a definite plan for the transformation of the enterprise, encompassing both defensive and strategic restructuring,

to accomplish objectives of investment, production, sales, and profitability. Yet the authority and discretion that foreign owners granted local managers varied across FSOEs. The independence of local managers was related more to the overall strategy and style of the MNC, or to the technical characteristics of production, than to the MNC's ability to project its power as owner (Brada and Singh, 1999, pp. 38-39).

With respect to *organizational restructuring*, the foreign strategic investor was guided by its intentions for the FSOE and the post-restructuring fit into the MNC's international structure, as well as by the parent's experience elsewhere in combinations of centralization and decentralization of managerial decision making. But some of the downsizing that reduced the scope of the enterprise occurred earlier as a precondition of privatization. For example, the government separated out units or assets of an SOE – such as obsolete plants and non-production facilities like housing – that were not included in the package sold to the foreign investor. The new owner was thus spared the effort and consequences of restructuring, divesting, or closing these parts of the SOE.

Foreign investors brought FSOEs a body of *management* know-how about such functions as procurement, production, sales, and financial control. However, getting an FSOE's managerial staff to act in the style of the new foreign owner was often more difficult than expected. An MNC found that some managers carried over from the SOE, or newly hired, were reluctant to make decisions, to take responsibility, to delegate authority to subordinates, and to use leadership and teamwork rather than operating hierarchically. Thus, considerable on-the-job learning and formal training were needed (Estrin and others, 1997, p. 221).

Foreign-owned FSOEs usually proceeded cautiously in shedding excess *labor*. In some cases, they were constrained by explicit or implicit employment guarantees in privatization contracts. In others, they were concerned about hostile public opinion concerning foreigners' purchases of SOEs. Foreign-controlled firms were able to recruit easily because they paid above-average wages (though expecting above-average productivity), offered good working conditions, and provided extensive training opportunities. Yet expatriate managers sent by the parent to the FSOE were often disappointed by workers' attitudes, for example about the importance of quality and their responsibility for it (Estrin and others, 1997, pp. 222-223). Sometimes the "corporate

culture" of the MNC clashed with that of the workers and managers of the FSOE. For instance, a study of the U.S. General Electric Company's acquisition of the Hungarian firm Tungsram found wide differences between the GE culture and the Tungsram culture regarding such characteristics as individualism, self-confidence, codes of conduct, empowerment, response to uncertainty, the ambitiousness of targets, and the importance of time (Marer and Mabert, 1996, pp. 169-175).

Foreign direct investors have strong advantages over domestic outsider and insider owners in modernizing and expanding an FSOE's *capital* stock and transferring new, up-to-date technology in production processes and products.[18] However, MNCs often demanded preferential investment incentives, such as tax holidays, accelerated depreciation, exemption from VAT and duties on imported equipment, and the possibility to carry losses forward to future tax periods (Mah and Tamulaitis, 2000). Also, technology transfer by an MNC was frequently accompanied by a reduction in the FSOE's own research and development, because the parent preferred to concentrate this function abroad (Farkas, 1997).

FDI improved the quality of *output*, of both exports and import-substitutes, and provided marketing links abroad, bringing FSOEs into networks of international business (Meyer, 2000). On the other hand, foreign investors acquiring FSOEs producing for the domestic market often wanted to buy established monopolistic positions and to preserve or strengthen them by government protection against imports (Carlin and others, 1995, p. 448).

In addition to these effects concerning specific elements of restructuring, there are more general issues in the assessment of foreign investors' transformation of FSOEs. First, the state privatization agency and/or foreign investors usually chose for acquisition by foreigners stronger SOEs with better management and technology, fewer restructuring needs, and brighter prospects than the typical firm (Ewa Balcerowicz and others, 1998, pp. 106-108). Foreign investors tended to avoid enterprises in branches requiring extensive restructuring, such as steel, heavy machinery, and chemicals. This selection bias complicates the evaluation of the ownership-corporate governance-performance chain (Carlin and others, 1999, p. 15).

Also, foreign-controlled firms are commonly larger than domestic enterprises, and the size differential can help explain the superiority of the former in restructuring, for example through new investment and the associated technology transfer (Rojec, 2000, p. 144).

Finally, one should consider the spillover effects of FDI on domestic firms (Estrin and others, 1997, pp. 229-236). All types of foreign-controlled companies trained managers and workers who later moved to domestic enterprises. However, spillovers of technology transfer and quality improvement into domestic supplier and customer firms were greater from foreign-controlled enterprises producing for the national market than from export-oriented assembly operations with a high share of intra-firm trade.[19]

Despite these qualifications, foreign strategic investors were superior to domestic investors in restructuring FSOEs. FDI contributed to the preparation of Central European economies for entry into the European Union. In turn, EU accession will provide new opportunities for foreign acquisitions of FSOEs (as well as greenfield projects), speeding the integration of these countries into the world economy (Hunya 2000, pp. 18-25; Carlin and others, 1999, p. 9).

5. CONCLUSIONS

Restructuring of FSOEs encompasses both short-run or "defensive" actions and long-run or "strategic" measures.

The main elements of restructuring firms include changes in corporate governance, organizational structure, management personnel and compensation, labor inputs and remuneration, the capital stock, technology, and the composition, quality, and sale of output.

The results of restructuring may be measured by employment, sales, productivity, and profitability, but care is required in the selection and interpretation of performance indicators.

In the restructuring of FSOEs, foreign strategic investors have many advantages over domestic investors. Foreign acquisitions of SOEs, and other types of FDI, play an important role in expanding transition economies' participation in the globalization of production.

Table 1

Principal Performance Indicators Used in Selected Studies of
Post-Privatization Enterprise Restructuring in
The Czech Republic, Hungary, and/or Poland

Performance Indicator	Study No.
Costs	
Employment [number of workers]	3
(Labor + materials costs)/sales	3
Revenues	
Sales	3
Net export sales/total sales	4
Productivity	
Sales per employee	3, 4
Value-added [sales – materials costs] per employee	2, 3, 4
Value-added [sales – materials costs] per worker-hour	5
Total factor productivity	1, 5
Profitability	
Profits/sales	2, 4
Profits/shareholders' equity	4
Profits/total assets	4

Key to study numbers:

1. Claessens and Djankov (1998).
2. Claessens and Djankov (1999).
3. Frydman and others (1999).
4. Major and others (1999).
5. Pohl and others (1997).

Notes

1. Conventionally, an enterprise is considered to be privatized when ownership of more than 50 percent of its shares is nonstate, though the government may retain a significant minority of the shares, perhaps even a "golden" share with veto power over certain decisions such as mergers. However, a privatization agreement may provide that a strategic investor acquiring less than 50 percent of the shares nevertheless shall make key decisions affecting the operation and expansion of the firm (Frydman and others, 1999, p. 1157). In both cases, the government can continue to influence a firm by legislation, taxes and subsidies, and measures affecting foreign economic relations.

2. On pre-privatization restructuring, see Aghion and others (1994), and Carlin and others (1995, pp. 430-442).

3. Private startups are discussed, for instance, by Ewa Balcerowicz and others (1999) and Bratkowski and others (2000).

4. Restructuring in agriculture is examined, for instance, by Turnock (1998) and Wegren (1998).

5. On bank restructuring and related issues, see Anderson and Kegels (1998), Bonin and others (1998), and Hawkins and Turner (1999). On bankruptcy, see Leszek Balcerowicz and others (1998).

6. Post-privatization enterprise restructuring in other countries of Central and Eastern Europe or the former Soviet Union is discussed by Djankov and Pohl (1997), Pankow and others (1999), Aukutsionek and others (1998), and Djankov (1999).

7. This conception of corporate governance is common in the literature on post-privatization enterprise restructuring in transition economies. For example, see Frydman and others (1996) and Brada and Singh (1999). Shleifer and Vishny (1997) present another view from the perspective of corporate finance.

8. Mejstrík (1997) furnishes a comprehensive account of privatization in the Czech Republic, including other methods of privatization.

9. In these auctions, the state set and adjusted the prices (in investment points) and the buyers bid the quantities (of shares) they wanted at those prices – the reverse of the usual auction procedure in which the seller specifies the quantity and the buyer the price.

10. The forms of asset-stripping include the following (Coffee, 1998, p. 113): (1) The controlling shareholder subcontracts to buy part or all of the firm's output at or below cost and then resells it to the firm's former customers at a profit. (2) The controlling shareholder requires the firm to repay the bank loan with which the investor acquired its shares. (3) The firm sells or leases valuable assets to the controlling shareholder (or its affiliates) at low prices.

11. Blaszczyk and others (1999) present a comprehensive review of privatization in Poland, including other methods of privatization.

12. Canning and Hare (1999) provide a broad survey of privatization in Hungary.

13. The company thus moved from a Unitary form to a Multidivisional form in the classification of Oliver E. Williamson (1986, pp. 54-80).

14. A study of Czech firms during 1993-1997 found that the appointment of new general directors in privatized enterprises was associated with improvements in labor productivity and profit margins (Claessens and Djankov, 1999).

15. However, the implementation of competition policy has been weak in some countries (Dutz and Vagliasindi, 2000).

16. Other issues in the choice, calculation, and interpretation of indicators to measure restructuring performance are discussed by Szalavetz (1996, 1997).

17. See, for example, EBRD (1999, pp. 173-174). An exception to this consensus is Frydman and others (1999). Their survey of 506 midsize manufacturing firms in the Czech Republic, Hungary, and Poland during 1990-1993 found that the restructuring performance of foreign strategic investors was not significantly better than that of domestic "outsider" owners. The authors speculated that the period studied was too short to observe the results of the foreign owners' transfer of managerial know-how and technology (p. 1172).

18. Djankov and Hoekman (1999) found that in the Czech Republic in 1992-1996 the growth of total factor productivity, taken as an indirect measure of technology transfer, was greater in foreign-controlled firms than in JVs or domestic enterprises.

19. Szanyi (2000) discusses other issues concerning FDI (including not only acquisitions of SOEs but also JVs and greenfield projects), such as investor and host country motivations, links to international trade flows, and transfer pricing and profit repatriation.

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