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Privatization and Company Restructuring in Poland

Edited by: Barbara Błaszczyk
Richard Woodward

Authors:

Barbara Błaszczyk, Grażyna Gierszewska,
Michał Górzyński, Tytus Kamiński, Wojciech Maliszewski
Richard Woodward, Aleksander Żołnierski

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CASE – Center for Social and Economic Research
ul. Sienkiewicza 12, 00-944 Warsaw, Poland
tel.: (48 22) 622 66 27, 828 61 33
fax (48 22) 828 60 69
e-mail: case@case.com.pl

Barbara Błaszczyk *is a professor of economics and president of the CASE Foundation. Her main research interests are related to the economic transformation of Poland and other post-Communist countries, with a particular focus on the privatization and deregulation of the state sector. In the past she also conducted research on employee participation in enterprise ownership and management. She was one of the founders of CASE in 1991 and has additionally been associated with the Economics Institute of the Polish Academy of Sciences since the early 1980s. Since 1989 she has participated in numerous groups advising the government of Poland and other post-Communist countries concerning economic transformation, and from 1991 to 1996 served as deputy chairperson of the Prime Minister's Council on Ownership Transformation. She is the author of around 100 publications which have appeared in Poland and abroad.*

Richard Woodward *was born in 1967 in the United States and received a master's degree in economics from the Pennsylvania State University in 1992. Since 1994 he has worked with the CASE Foundation in research projects concerning privatization in post-Communist countries, small and medium-sized enterprise support institutions, and the role of local governments in local development and has authored numerous publications, especially in the area of management and employee buyouts in Central and Eastern Europe.*

Foreword

The contents of this volume are the fruit of the research project entitled "Company Adjustment and Restructuring during Economic Transformation in Central and East Europe," financed by the European Commission's ACE-PHARE program. The project was coordinated by Ivan Major of the Institute of Economics of the Hungarian Academy of Sciences and covered four countries: Bulgaria, Estonia, Hungary, and Poland. In Poland, research was carried out by the Center for Social and Economic Research (CASE) in Warsaw and coordinated by CASE's president, Barbara Błaszczyk.

The central question investigated in the project was what happens after privatization – how privatization affects the economic performance of privatized companies, and thereby of transforming economies as a whole. The tasks which the researchers set for themselves included a description of the privatization techniques used in each country, a summary of the results and significance of privatization in the economy as a whole, and analysis of company-level data to examine the factors underlying changes in company performance. We were interested primarily in the changes that various types of privatization bring about in corporate governance and how these are, in turn, correlated with changes in performance.

The contents of this report will appear, in somewhat abbreviated form, in a book to be published in the summer of 1999 under the title *Privatization and Economic Performance in Central and Eastern Europe - Lessons to be Learnt from Western Europe* by Edward Elgar Ltd. (Cheltenham, UK and Brookfield, US). We present the results of the Polish research in this report in order to acquaint our readers with research results which we see as a continuation of previous studies on enterprise restructuring in Poland, including those carried out by the World Bank and the Gdańsk Institute for Market Economics. We believe that these results represent an interesting new contribution to the study of the relationships between enterprise restructuring on the one hand and ownership transformation and other economic factors of post-Communist transformation on the other.

Barbara Błaszczyk
Richard Woodward

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1.1. Introductory Remarks

Together with the stabilization and liberalization of the economy, privatization was one of the underpinning principles of the reform program launched at the end of 1989. Under the program, privatization is to be a tool for increasing the efficiency of enterprises and bringing the ownership structure of the economy into line with market economy norms. In the first privatization program, overly optimistic assumptions were made whereby approximately half of all national assets would be transferred to private owners in the course of the initial three years of the reform [1]. The reality of privatization proved to be much more difficult. From the beginning of the transition the Polish privatization concept was burdened with too many different expectations and important goals competing among each other [2]. It was not immediately evident to all Polish reformers and politicians that some of those privatization goals were partly contradictory and could not be achieved simultaneously (for instance it is impossible to gain high revenues from privatization for the state budget and to maintain a rapid speed of ownership transformation).

On the other hand, privatization was seen as a very controversial political topic by the public. Social mistrust of privatization arose from different reasons. Fears of radical changes were linked with resentments of a historical nature (for example fears of losing working places and of 'selling out' enterprises to foreigners) [3] and strengthened with bad examples of asset stripping by the new-old owners (the so-called 'nomenklatura'). Last but not least, influential groups of the population were interested in keeping the state-owned sector unchanged and felt threatened by privatization [Macieja, 1997]. The consolidation of these groups led to pressures on the government, in order to obtain preferential treatment instead of fast privatization and radical restructuring. The politicians were unable to play against these groups, being anxious about losing large parts of their constituency.

However, during the eight years of reforms public opinion on privatization changed slowly. Experience with privatization taught many people that privatization results in benefits to the enterprises and employees and to the economy as a whole. Moreover, many of the enterprises' managers learned that privatization is an unavoidable step for the future development of their enterprises. Additionally, the public now is much more aware of the necessity of deep restructuring of each enterprise and of the economy as a whole in order to compete on the domestic market and on the future European market. This results in a more positive attitude to foreign investors than at the beginning of reforms.

In this chapter, the privatization of the economy is not regarded as just the privatization of the state sector. The former notion refers to the increase of the private sector share in the economy, whereas the second denotes the transfer of assets from the former state, or public, sector to private owners. Privatization of the economy is not achieved exclusively through the state sector privatization but also – and, in the Polish case, actually to a far greater extent – through the spontaneous emergence of new private companies. Similarly, state policies on the privatization of the economy focus on encouraging new private domestic and foreign businesses to enter the market and establishing an environment which facilitates their development, while policies on public sector

[1] Under the first privatization program (announced in November 1990) 15 per cent of the state assets were to be privatized in 1991 and 20 per cent in each of the subsequent three years. See also 'Podstawowe kierunki...' (1990).

[2] See Ministry of Privatization (1991).

[3] Moreover, in many cases an open hostility against foreign capital investment was expressed. See comparative opinion polls on the attitude toward foreign investments in Poland and Russia in summer 1992. (Błaszczyk and Dąbrowski, 1993), p. 76.

privatization aim at replacing the state as an owner with other entities. Both groups of policies are equally important and closely linked with each other.

1.2. Privatization Concept and Legal Framework

The Act of 13 July, 1990, on the Privatization of State Enterprises constituted a compromise between a number of different concepts. While adopting the flotation of shares (which provides the greatest revenues to the budget) as the primary privatization method, the law also gave substantial privileges to employees and laid the groundwork for a future mass (voucher) privatization program [4]. On the other hand, the law failed to settle the problems of restitution and/or compensation for previous owners whose property had been nationalized by the Communist regime. Two main privatization methods were provided for under the act. The first, called capital (or indirect) privatization, is used for large state enterprises and consists of two stages: first, the enterprise is 'commercialized' (that is, transformed into a joint stock company wholly owned by the State Treasury), and second, shares in the newly established companies are made available to private investors through public offerings, tenders or negotiations following a public invitation. The second method, referred to as liquidation (or direct) privatization, involves transfer of a given enterprise's assets or an organized portion thereof to private investors. Under this method three options are available, namely: (i) sale; (ii) in-kind contribution to a company; and (iii) leasing. The last method is targeted at acquisition of small enterprises by their management and employees. State enterprises in the agriculture sector are privatized according to different principles, provided for under a separate law (The Act of 19 October, 1991, on Management of Agriculture Property of the State Treasury).

These new privatization methods were supplemented by liquidations conducted under the State Enterprise Law of 25 September, 1981 (applicable to enterprises with poor financial standing) as well as bankruptcy and various types of debtor–creditor arrangements. In April 1993, following lengthy discussions, the Act on National Investment Funds (NIF) was finally adopted. This law formed the basis for the mass privatization program, allowing every adult Polish citizen to acquire a portion of national assets for a nominal charge. The NIF program was supposed to accelerate the pace of privatization, at the same time providing for restructuring of enterprises prior to their privatization, facilitated by the expertise of the professional management companies employed by the NIFs. There were 512 enterprises selected for the program, in which 15 NIFs were to participate.

In 1993 two other laws of crucial importance for the privatization process were adopted. The first law referred to financial restructuring of enterprises and state-owned banks and enabled such banks to launch debt reduction proceedings which allowed for conversion of debt into equity (the Act of 3 February, 1993, on Financial Restructuring of Enterprises and Banks). The second exempted a group of enterprises considered to be of strategic importance for the state from privatization based on generally applicable rules (155 enterprises were selected from the coal, power and defense industries, for which special privatization procedures were to be applied).

In the first half of 1993, due to the slow pace of privatization and various constraints hampering the process, work began on amendments to the 1990 Act. In August 1996, lengthy debates were brought to an end and a new privatization law was adopted. This law gives employees a more privileged position with respect to acquisition of shares in their companies and establishes special privatization procedures for indebted enterprises and those of strategic importance [5]. As for so-called direct privatization, the new law allows 'outsiders' to put forward privatization initiatives without the need for seeking approval of the 'insiders'; however, it also reduces the number of enterprises eligible for this type of privatization by introducing very low ceilings on the size of enterprises considered eligible [6]. Additionally, while the employees of the enterprises privatized according to this method do not receive 15 per cent of the shares for free, as in the case of capital privatization, under the new law they may receive the equivalent thereof paid to their accounts in the company's social fund.

The new law, by itself, is in our view not likely to change the privatization practice in any dramatic way. However, on 1 October, 1996, implementation of the reform of the central government administration began which included, among others, important changes in the institutional order in the area of privatization. A new Ministry of the Treasury has been

[4] In cases in which commercial methods were used (referred to in Poland as capital, or indirect, privatization) employees had the right to acquire up to 20 per cent of their company's shares at a preferential price (50 per cent of the issue price). In cases of liquidation, or direct privatization, in which the leasing method was used, employees had the priority over other bidders. In all cases (excluding liquidation on the basis of the 1981 state enterprise law for reasons of poor financial standing), employees and management had the right to veto any privatization proposal.

[5] Employees may acquire up to 15 per cent of the shares in their companies free of charge. A further 15 per cent is available free of charge to farmers and fishermen supplying a given company on a permanent basis. Former employees on retirement and disability pensions also have the right to obtain shares from this pool. The shares acquired free of charge may not be sold for two years following acquisition, and for three years in the case of managerial employees. The law also gives the government the right to extend these periods.

[6] Under the new law only enterprises employing up to 500 persons the annual sales of up to ECU 6 million and own funds of up to ECU 2 million may be privatized using the direct privatization methods.

established, which has assumed the responsibilities of the former Ministry of Privatization. The new Ministry is responsible for the supervision of all state-owned assets and only one of its functions will be privatization. Smaller enterprises will be privatized by the regional governments (voivodes) by the use of direct privatization methods. From the latter change a more efficient privatization may be expected, due to the decentralization of the privatization process [Balcerowicz, Błaszczyk, and Dąbrowski, 1996].

1.3.Privatization Tracks and Their Results

Implementation of the privatization programs in accordance with the principles discussed above started in August 1990. By the end of that year six large enterprises had undergone capital privatization in the form of initial public offerings. The scale of capital privatization operations was broadened in 1991. Nevertheless, every enterprise was privatized on an individual basis, applying lengthy and complicated procedures, which considerably slowed down the entire process. Direct privatization of small and medium-sized enterprises, usually by leasing to employees and management, proved quicker and more effective. The NIF program was designed to speed up the privatization process, but its implementation did not begin until the end of 1995. In the first half of 1997, the NIF program entered a more advanced stage, with shares of the 15 funds being listed on the Warsaw Stock Exchange.

Table 1 depicts proportions between the group of enterprises having initiated privatization processes between the end of 1990 and December 1996 and those in which

Table 1. State enterprises which have initiated ownership transformation procedures, by type of privatization (December 1990–1996)

Number of state enterprises (in parentheses: as % of state enterprises existing on 31 December, 1990)		**Share of completed cases**	
Existing on 31 December, 1990	8,441 (100)	Comments	% of started transformations in the group
Transformed into companies wholly owned by the State Treasury Of which: Transformed into companies under Law on Ownership Transformation of Enterprises of Special Importance	1,227 (14.5) 160 (1.9)	183 privatized; 512 transferred to the NIF Program Temporarily not subject to privatization	14.9 41.7 –
Liquidated under Law on Privatization of State Enterprises (direct privatization)	1,247 (14.7)	1,221 projects completed	97.9
Liquidated under Law on the State Enterprise (liquidation)	1,464 (17.3)	494 projects completed; 441 went into bankruptcy procedures	33.7 30.1
Taken over by the Agency for Agriculture Property of the State Treasury	1,654 (19.5)	Leased, subject to management contract or sold	
Insolvent or in liquidation under the Bankruptcy Law	662 (7.8)	**304** ongoing bankruptcy procedures	
Turned over to local governments under the Law on Municipalization	263 (3.1)	May undergo further transformations	
Total number of enterprises subject to ownership transformations* of which: Privatization completed	5,592 (66.2) 1,898 (22.4)		

Note: From December 1996 (including transfer to local governments and all forms of liquidation)

Sources: Central Statistical Office (1997), Privatization of State Enterprises as of 31 December, 1996, Warsaw, Small Statistical Yearbook 1997, pp. 360–62 and author's calculations privatization has been completed. Out of 1227 enterprises transformed into companies wholly owned by the State Treasury, only 183 have completed the capital privatization process; while 512 of these companies were included in the NIF program, their complete privatization will take a few more years.

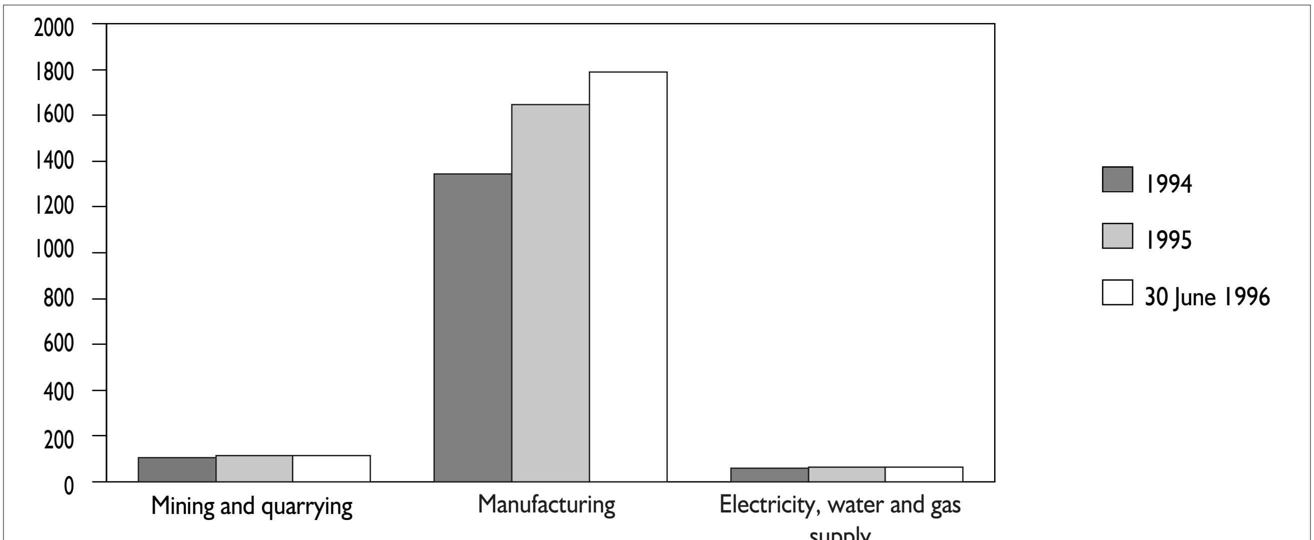
Almost all direct privatization projects have been completed (1221 out of 1247), whereas less than one third (494 out of 1464) of the liquidation projects commenced under the State Enterprise Law have been completed. Thus, between December 1990 and the end of 1996, 5592 (66.2 per cent) of the total of 8441 state enterprises existing at the outset of the process had initiated the transformation processes, but only 1898 (22.4 per cent) had managed to complete it.

With respect to the sectoral breakdown of transformed enterprises from 1990 through June 1996, the relative importance of ownership transformations is much greater in the manufacturing sector than in other segments of the economy. Within the manufacturing sector, in turn, the largest number of transformed enterprises are active in the processing branch, which by far outperforms the other sectors (mining, power, gas and water supply) in terms of transformation pace (Figure 1). As of the end of 1996, the majority of large enterprises in such utilities as power, gas and water supply, as well as in transportation and telecommunications, were excluded from the ownership transformation process. The numerical data illustrating the privatization progress in various parts of the economy need to be supplemented with a brief description of the qualitative effects encountered on the individual paths of privatization.

Capital privatization has been applied in 183 large companies, mostly from food and beverages, tobacco, chemicals, electrical appliances, machinery and the garment industry, moreover a few large banks were included. Though limited in quantitative terms, this type of privatization has been of great importance for the economy in view of the size of the enterprises concerned, their market positions, number of employees and the fact that they represented important branches of the economy. Due to resource limitations of potential domestic investors, around 50 per cent of the capital privatization projects involved foreign capital. The sale of shares in these enterprises facilitated the establishment and development of the Polish capital market and was the main source of privatization proceeds to the state budget. In qualitative terms, the majority of enterprises privatized through capital privatization – in particular those with foreign capital involvement – are showing high growth; they have engaged in deep restructuring [Dąbrowski, 1995]. The high degree of centralization of the administrative procedures applied in capital privatization and its strong sensitivity to political constraints are among the main weaknesses of capital privatization.

Different measures need to be used when assessing the effects of commercialization in cases in which this was not followed by privatization (approximately 400 cases). One has to be extremely cautious in evaluating the significance of this process for the progress of ownership transformations, since commercialization is primarily a formal and legal stage which does not automatically lead to further changes in a given enterprise. In spite of this reservation, it should be added that in our opinion, given the current situation, commercialization – even without subsequent privatization – may have certain disciplining effects due to the increased transparency and improved control mechanisms which follow from the introduction of new accounting rules and standards in the commercialized enterprises as well as the obligation to publish their financial results.

Figure 1. Industrial enterprises in the transformation process by branch



Yet another set of considerations applies to the companies included in the NIF program. After the special Government Selection Committee had selected supervisory board members and managers of the funds, paired the funds with management companies and completed negotiations on the funds' management, the operating phase of the program began in June 1995 with allocation of company shares to the funds. Ultimately, majority stakes in 512 companies wholly owned by the State Treasury were turned over to the 15 National Investment Funds, whose tasks included restructuring and privatizing those companies [7]. The management companies which manage the funds are responsible for improving the financial results of the companies held by the funds, which they may do by directly or indirectly participating in the companies' restructuring or by supporting the privatization process and seeking strategic investors; they may also sell or liquidate the companies. Portfolio investment will be one of the important features of the NIFs' activities.

Certificates for shares in the NIFs were distributed to the public between November 1995 and November 1996 and, according to official data, the vast majority of eligible Poles (25.7 million) purchased the certificates, paying a registration fee which by the end of the distribution period was seven to eight times lower than the market value of the share certificate. A half year later (June 1997) 15 millions of certificates were dematerialized (put into the computerized system of the Warsaw Stock Exchange) [8]. The certificates may be freely traded on the over-the-counter market and the stock exchange. Since the shares in the NIFs have been listed on the Warsaw Stock Exchange since May 1997, every certificate is convertible into 15 shares, one in each NIF. At the end of June 1997, 5 million certificates had been converted already into the NIF shares. The funds started their operations with analyses of their majority holdings in order to prepare restructuring or sale plans. The funds were also obliged to present their consolidated balance sheets for the first year of operation (1995) as well as the adjusted balance sheets of their companies in order for the Securities Commission to approve trading of those companies' shares on the stock exchange. The first year has shown that the funds have been active and varied in the character of their activity, developing restructuring and investment plans adjusted to the unique characteristics of their portfolios. Plans have been made to sell off enterprises with good financial standing while restructuring others which require more profound preparation for privatization. By August 1996, the funds submitted projects which planned the sale of 76 of the 512 companies. One year later, the sale of 21 companies out of 31 prepared transactions was already completed. The stock exchange listing of some 60 to 70 companies was also planned and eight of them entered the Warsaw Stock Exchange. In spring 1996, the sale of minority stakes commenced, in particular those of cement industry companies. On the average, NIF companies are of medium size (200–1000 employees), and operate chiefly in the manufacturing or construction sectors. The manufacturing companies are dominated by machinery and equipment, foods and beverages, and the chemical, construction materials, metallurgy and garment industries.

Over recent years the overall financial standing of NIF companies has deteriorated in comparison with companies not participating in the NIF program, generally due to the following reasons: first, while waiting for implementation of the program, many of the most financially sound companies attracted strategic investors for capital privatization and left the NIF program; second, a large number of enterprises selected for mass privatization spent two or more years in a state of uncertainty and idleness, without any restructuring effort. Finally, the funds, in order to meet the new accounting rules and prudential standards which follow from the 1994 accounting law, introduced high reserves backing every expected kinds of risks, at the enterprises level and at the funds level, which proved to be costly.

Through 31 December, 1996, *direct privatization through liquidation*, designed for small and medium-sized enterprises, had been launched in 1247 enterprises and completed in 1221. The fastest and the most popular method for transfer of ownership rights in Poland, direct privatization, may often be classified as a quasi-sale method due to the payment deferment and the existence of various regulations facilitating purchase on favorable conditions.

Most cases of direct privatization involve leasing of assets to a company established by the employees of the 'liquidated' state enterprise; there have been fewer enterprises sold or contributed in kind to a company [9]. Despite serious concerns about the future of the so-called employee-owned companies, their financial results so far

[7] The shares were allocated in the following manner: 60 per cent of the total shares of each company was entrusted with the funds, 15 per cent given free of charge to the employees and the remaining 25 per cent being temporarily held by the state treasury with a view to later supporting pension funds and compensating holders of various claims on the state treasury. In accordance with the law, the 60 per cent of each company's shares distributed among the 15 funds were divided into majority and minority stakes in order to avoid excessive dispersion of shares. More specifically, 33 per cent of each company's shares was vested in one of the 15 funds, while the other 27 per cent was evenly distributed among the remaining 14. The minority stakes can be freely traded, while the majority stakes can be sold only en bloc.

[8] Central Statistical Office (1997) p. 16.

[9] As of December 1996, 66 per cent of direct privatization transactions were leasing arrangements, 21.6 per cent were direct sales, and only 6.2 per cent cases of in kind contribution to a company (see Ministerstwo Skarbu Państwa, 1996b).

are generally better than expected, although investment volume is still insufficient. The research conducted so far proves that these enterprises currently have very diversified ownership structures, ranging from very concentrated to highly dispersed [Jarosz, 1996]. When negotiation of the State Enterprise Pact began in 1992, the pace of the direct privatization process decreased substantially. While this could possibly be a result of the shrinking of the pool of financially sound small and medium-sized state enterprises, it appears that the overwhelming factor was the decision of enterprises to wait for the adoption of a new privatization law, expected to provide better financial conditions for this type of privatization. It is not yet possible to assess to what extent further direct privatization operations will be impacted by the new (1996) law. One may reasonably assume that the pace of the process will largely depend on the determination of the voivods (to whom the power to privatize most small enterprises has been transferred), the capacity of voivodship institutions and initiatives of the regional offices of the Ministry of the State Treasury. As the results show, privatization slowed down even more in 1997.

Liquidation under the State Enterprise Act is triggered by poor financial standing of the enterprise concerned; privatization should therefore be viewed as a 'byproduct' of the process. Nonetheless, any liquidation under the provisions of article 19 of this law materially supports privatization by enabling small private companies to purchase the assets of the enterprise under liquidation at a relatively low price. Although these enterprises cannot continue to function in their current form, their assets and labor force may be effectively used by others. However, the procedure is much more complex and lengthy than direct privatization. As of December 1996, liquidation had been initiated in 1464 state enterprises, but only 494 (33.7 per cent) of these liquidations had been completed, with the rest still in progress. Another group of 441 enterprises being in liquidation went into bankruptcy procedures.

Since 1990 a large number of SOEs have been declared bankrupt or have had to engage in arrangement proceedings. As of December 1996 around 662 state enterprises had been declared bankrupt or subject to court arrangement proceedings. In some cases creditors took over the enterprises and became their new owners. Moreover, between 1993 and 1996, under the Act on Financial Restructuring of Enterprises and Banks, state banks launched conciliatory proceedings involving 196 indebted state enterprises and companies wholly owned by the State Treasury. The law provided for the following methods of enterprise restructuring: bank conciliatory agreements, public sale of debts owed to banks, conversion of debt into equity and liquidation or receivership. In December 1996 the files maintained by the Ministry of Privatization contained 128 cases of debt-equity conversions. Only 13 bank conciliatory proceedings have been fully completed at that time [10]. The conversion procedures, in addition to reducing financial tension in the firms involved, may lead to partial, and in some cases complete, privatization.

I.4. *De novo* Private Sector Development

De novo privatization, that is, private sector development through the establishment of brand new companies, proved to be of particular importance in Poland. The spontaneous expansion of the private sector has been the most dynamic phenomenon in the entire transition to a market economy. The *de novo* private sector has also been the one with the fastest growth of production, sales and investments. This generated a large number of jobs, thus counteracting the rise in unemployment. If we look at the rates of growth of the numbers of enterprises in the private and public sectors, we note that the fastest growth was in the number of private companies and companies with foreign capital. Between 1989 and 1996 the number of private businesses owned by individuals more than doubled, from 813,000 to 1.95 million [11]. Starting up small private businesses was made relatively easy by the liberal, straightforward registration requirements and commercial regulations as well as the availability for buying, at relatively low prices, assets formerly belonging to state enterprises. This is evidence that effective privatization methods, decentralization of decision-making regarding disposal of state enterprise assets and other favorable systemic solutions were all important factors in private sector revival.

The so-called small privatization process, affecting the retail trade, catering and service sectors, also proved extremely successful in the process of ownership transformation in Poland. During the operation, conducted between 1990 and 1992, approximately 97 per cent of retail and small service outlets and restaurants were privatized [Earle et al., 1994]. As a result of small privatization, by the end of 1992 over 90 per cent of the domestic trade sector labor force worked in private companies, with this share increasing to 94 per cent by the end of 1995. Between 1990 and 1995 the number of private shops doubled (from 223 113 to 419 313), and their sales increased almost tenfold (from PLN 16,926.0 million to PLN

10. Ministerstwo Skarbu Państwa (1996a).

11. See Central Statistical Office, Small Statistical Yearbook, 1994, 1995, 1996, 1997; Central Statistical Office, 'Structural changes in groups of entities in the national economy, 1991, 1992, 1994, 1995 and 1996'.

157,025.5 million in current prices). Today the vast majority of small shops and businesses are private, although most of the real estate on which they are located is owned by the local authorities. A similar development occurred in the wholesale trade sector, where sales increased almost 17 times (from PLN 10,477 million in 1991 to PLN 176,555 million in current prices in 1995).

I.5. Foreign Investment

The ability to attract foreign investment to enter the Polish market was limited in the initial stage of transformation, due to high risk resulting from the high inflation rate, the immense and unsettled foreign debt, the disastrous situation of numerous enterprises following the stabilization shock, and the unpredictable effects of the reforms and prejudices of a part of the society and certain politicians against foreign investors. This changed over time, and in particular after 1993, when the pace of the Polish economy's growth accelerated and the foreign debt had been successfully restructured. The general reception of foreign investors has also gradually improved. These factors encouraged foreign investors to expand their operations on the Polish market. In addition to the incentives associated with the high growth rate, Poland's international treaties (World Trade Organization, European Treaty and other) are an important factor in ensuring economic stability.

The Act of 14 June, 1991, on Companies with Foreign Capital is the legal basis for foreign investment. In adopting this law, the Polish Parliament decided that the same regulations should apply to foreign and domestic investors; tax allowances or other special incentives for foreign investors were therefore dropped, with the exception of large-scale investment projects implemented in regions with high rates of structural unemployment or those of exceptional scientific and technical value. However, the principle of equal treatment of Polish and foreign investors is still not applied consistently. Restrictions affecting land acquisition, remaining following liberalization of relevant legislation in April 1996, still constitute the main legal barrier to foreign investment. On the other hand regulations requiring foreign investors to obtain permits in order to operate in certain business areas were lifted. The introduction of tax exemptions linked with exports and investments and promotion of special economic zones protecting investors were further measures, taken in 1993–94 in order to attract investors – both domestic and foreign. Nevertheless, a general opinion exists that the greatest existing barrier for foreign investments in Poland results from bureaucratic procedures and frequent local hesitance with respect to foreign investments. As for large-scale infrastructure projects, the government has not shown a consistent strategy, no transparent and effective procedures have been put in place and certain areas lack adequate legislation [Carter et al., 1996].

Under the relevant legislation, foreign direct investments may take the form of a capital share in an already existing or newly founded joint-stock or limited liability company. A foreign investor may also extend a long-term loan to a company. The profits on direct investments may be re-invested or transferred outside Poland without restriction. By the end of 1996 roughly 28 000 enterprises with foreign capital participation were operating in Poland. However, according to the data of the State Foreign Investment Agency, only in 492 such enterprises did the value of foreign inputs exceed USD 1 million [12]. By the end of 1995 large scale foreign investments (valued at more than USD 1 million) in Poland totaled USD 6.8 billion (PAIZ, 1996), and smaller scale investments were estimated at USD 1.8 billion. Therefore, the total investment volume totaled USD 8.5 billion. The total value of additional commitments relating to the investments was estimated in 1995 at USD 5.2 billion.

In 1996, there was again a high increase of the foreign investment inflow, reaching more than USD 5 billion. Altogether a total of USD 12,227 billion in foreign direct investments (large scale investments) flowed to Poland between 1990 and 1996, increasing steeply every year. From 1993 through 1996, the inflow of foreign direct investments doubled each year. According to the most recent estimates of the State Foreign Investment Agency, it is expected that in 1997 such investments will grow in a slower pace and their inflow will reach approximately USD 3.5 billion (Rzeczpospolita, 16 April and 9 September, 1997). One may suggest that the reason for this is the slower pace of structural reforms in Poland during the most recent years and in the lack of large privatization projects, especially in infrastructural sectors.

If we consider the largest foreign investments in Poland in terms of branches, the manufacturing sector leads the list, followed by the financial, construction, services and power sectors. 1995 saw a relatively rapid increase in investments in manufacturing, as a result of which this sector accounted for 63.3 per cent of the total value of foreign investments (data from State Foreign Investment Agency). With respect to nationality, the foreign investors' group is led by Americans, followed by multinational companies, Germans, French and Italians. In terms of single investors, the largest amounts in the period were invested by Fiat, the EBRD and the Polish–American Enterprise Fund.

12. See Ministerstwo Skarbu Państwa (1996a). The State Foreign Investment Agency gathers data on the largest investments only (exceeding USD 1 million). However, such projects constitute approximately 80 per cent of total foreign investments.

I.6. Macroeconomic Results and Changes in the Ownership Structure

Following eight years of transformation, the extent of privatization of the economy – in the broad sense – is significant. The private sector share in GDP grew from 30 per cent in 1989 to around 60 per cent in 1995 [13]. By the end of 1996 the private sector's share in total industrial output was 51.7 per cent; corresponding figures for construction and domestic trade were 87.9 and 92.9 per cent respectively. In the transport and communication sector the share of the private output remained at a lower level of 39.5 per cent. The private sector's share in foreign trade amounted to 62.8 per cent of exports and to 75.6 per cent of imports. Additionally, the sector (including agriculture) employed 65 per cent of the entire labor force (Central Statistical Office, Small Statistical Yearbook 1997, pp. 351–6), see Tables 2 and 3.

Together with the changes in the ownership structure, important changes in the physical structure of the economy emerged. The share of the industrial sector in GDP declined from 44.9 per cent in 1990 to 27.5 per cent in 1996. The share of agriculture (together with forestry, fishing and hunting) fell from 7.2 per cent to 5.8 per cent and that of construction from 9.2 to 5.3 per cent. The share of retail trade and repair services was estimated in 1996 at 14.3 per cent (estimates of the Central Statistical Office, Small Statistical Yearbook 1997, p. 341). However, despite these massive changes, from the point of view of GDP production, industry is still the dominant sector [14]. The second most important place belongs to the trade and repair sector. Agriculture, though employing 28 per cent of the total workforce, produces only 5.8 per cent of GDP, which is evidence of very low labor productivity in this sector. It should be noted that the public sector, despite the drop to 35 per cent of the total labor force employed, continues to hold over one half of national assets (59.7 per cent of book value in 1995) and still has a high share in total investment, 55.8 per cent in 1995 (Small Statistical Yearbook 1997, p. 351).

There are substantial differences between the composition of production in the private and public sectors. In the public sector, industry is responsible for the majority of value added, with the remainder produced by services, transportation and a very small share of other sectors. In the private sector it is trade that contributes the most to value added, followed by manufacturing and services; agriculture and construction are less significant. This also means that the private sector performs an important role in modernizing the structure of the economy (through the gradual reduction of the significance of manufacturing). The private sector has become the Polish economy's engine of growth. Between 1991 and 1995 the annual increase in value added in the sector was between 7.0 per cent and 26.7 per cent, whereas in the public sector value added declined continually until 1994, when slight (2.8 per cent) growth was reported [Błaszczyk, Bratkowski, and Dąbrowski, 1996]. For example, in 1995 value added in the private sector increased by 15 per cent compared with only 3 per cent in the public sector.

The growth of private investment was remarkable, too; its share in total investments rose by more than 40 per cent in 1996 [Koniunktura gospodarcza Polski, 1997]. During the

Table 2. The private sector's share in output and employment

Sector of the economy		Dec. 1989	Dec. 1991	Dec. 1992	Dec. 1994	Dec. 1995	Dec. 1996
Industry	a	16.2	24.6	31.0	38.3	44.0	51.7
	b	29.1	35.8	41.4	44.8	50.5	55.2
Construction	a	25.5	62.2	77.7	85.0	87.0	87.9
	b	37.4	59.5	71.8	79.3	80.9	85.0
Transport	a	11.5	25.2	39.3	45.1	45.0	39.5
	b	14.3	26.0	23.1	28.1	26.6	28.8
Domestic trade	a	59.5	NA	86.1	91.5	92.0	92.9
	b	72.7	88.3	90.5	92.0	94.1	94.8

a: private sector share in output, %
b: private sector share in employment in the sector, %
Sources: Central Statistical Office, Statistical Yearbook, 1991, and Small Statistic Yearbook 1994–97

[13] According to official statistics, in 1989 the private sector share in GDP was only 19.2 per cent, and the share of the private non-agricultural sector 9.2 per cent. Cooperatives, then generating approximately 10 per cent of GDP, were not included in the private sector, but rather in the so-called collectivized sector. In order to facilitate comparative analysis we have included cooperatives in the private sector for the entire period; hence the 30 per cent figure. For 1995: OECD estimates. See also, Błaszczyk, Bratkowski and Dąbrowski (1996).

[14] Excluding non-material services, tariffs and taxes, for which the importance of GDP is systematically growing.

Table 3. Employment in the national economy by sectors, in millions

Sectors	1989	1996
Private Sector	4.0	4.2
– non-agricultural	1.8	5.2
Total private sector	5.8	9.4
'Semi-private' sector		
– cooperatives	2.2	0.6
– other ' socialised' entities	0.2	NA
Total non-public sector	8.2	10.0
Public Sector of which:	9.3	5.4
– state ownership	9.3	3.9
– local government ownership	–	1.2
Total employment in the national economy	17.5	15.4

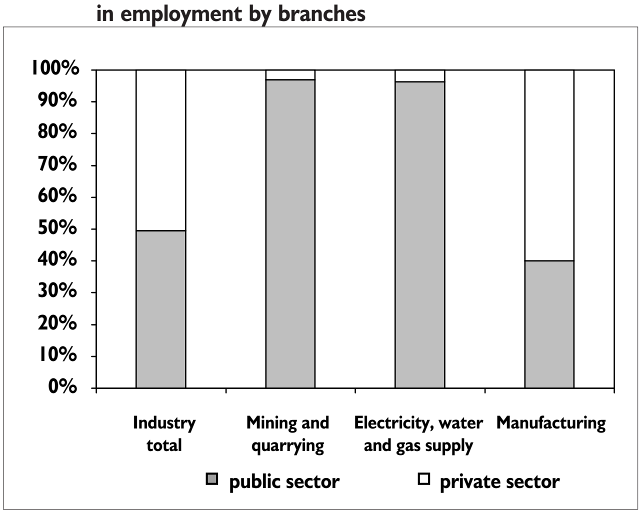
Sources: Central Statistical Office, Statistical Yearbook, 1991, and Small Statistic Yearbook 1994–97.

time under consideration massive shifts in employment among sectors emerged as well. The rising share of employment in the private sector illustrates its scale in the economy. Together with private agriculture, employment in the private sector reached 50 per cent of the total workforce as early as 1990 and at the end of 1996 amounted to 65 per cent. If we look closer at the structure of employment (excluding agriculture) in the private sector in Table 3, we can see other important shifts. Here we can see that employment in the remaining private sector (without cooperatives) rose from 1.8 to 5.2 million between 1989 and 1996. This figure includes persons employed in all private companies and partnerships, but primarily consists of the large number of self-employed. At the same time employment in the cooperative sector shrank from 2.2 to 0.6 million. Altogether employment in the private sector rose from 8.2 to 10.0 million. On the other hand, the workforce in the public sector shrank from 9.3 to 5.4 million, that is by 3.9 million, and total employment in the economy declined from 17.5 to 15.4 million, that is by 2.1 million. This means that the private sector employed a significant number of former public sector employees and also a large number of former employees of the 'socialized' cooperative sector, which became private and underwent serious restructuring.

The share of private employment in different sectors of the economy remains uneven. In industry, this share was 29.1 per cent in 1989 and it rose very gradually, not reaching the threshold of 50 per cent until the end of 1995 and amounting to 53.4 per cent in 1996. In construction it rose very steeply from 37.4 per cent in 1989 to 85 per cent in 1996. In domestic trade as early as 1989 private employment (including cooperatives) accounted for 72.7 per cent, and its share increased to 94.8 per cent by 1996. Among the sectors of material production and trade shown in this table, transportation is the only one where the share of the private sector is still lower than 30 per cent (due to the state-owned railways, ports, airlines, postal service, telecommunication, and so on, belonging to that sector). If we included in this table other infrastructural sectors and showed the structure of industrial employment in more detail, the uneven degree of privatization among sectors and branches would be much more evident.

The share of private employment was over 80 per cent in construction and over 90 per cent in agriculture and trade in 1996. In some kind of services (such as real estate) it amounted to more than 60 per cent, but it was almost absent in some other services, such as education (3.4 per cent) or health and social services (4.5 per cent). In the three main divisions of industry the share of the private sector is very uneven. On average, industry is 55.2 per cent privatized. But as we can see in the table, whereas private employment reached 64.9 per cent in the manufacturing sector, in both remaining sectors of industry (mining and quarrying and electricity, gas and water supply) it stands at 3.3 and 4.5 per cent respectively [15] (Figure 2).

Figure 2. The share of the private and the public sector in employment by branches



It is important to note that the impressive structural shifts between the public and the private sectors described above have not been achieved in the way that was expected at the beginning of the reform process. The explosion of newly-founded private firms was the main driving force behind ownership transformation, followed by the decentralized 'bottom-up', or direct, methods of privatization of state property. The contribution of centralized, 'top-down' privatization methods controlled by the government and

[15] Author's own calculations based on Central Statistical Office, Small Statistical Yearbook 1997, pp. 352–3.

much more under the influence of political fluctuations has been much smaller. An important factor in changing the whole economic structure was also the systematic contraction of the public sector. Evidence for these claims can be found in the fact that former public enterprises comprise only a small part of the private sector with regard to their share in employment and the employed assets.

This is illustrated by the following facts: As of the end of 1996, in the 'privatized' sector (that is, formerly state-owned enterprises) over 400.000 persons were employed, whereas the entire private non-agricultural sector employed over 5 million persons (out of 15 million employed persons in the entire economy, of which 10 million were in the non-agricultural sector). Thus, employment in the 'privatized' sector represented 8 per cent of private sector employment and 2.6 per cent of total employment (see Tables 2 and 3). The entire group of enterprises which had initiated ownership transformation processes (whether completed or not) employed slightly less than 1.5 million persons, or about 10 per cent of the national labor force (and 30 per cent of employment in the private sector). Although this figure indicates that while this group of enterprises constitutes an important element of the Polish economy, it does not alter the fact that the vast bulk of Poland's private sector (in terms of human and productive potential) is made up of *de novo* private enterprises rather than privatized ones. It is the *de novo* private sector which was responsible for the high rate of economic growth in Poland in recent years. The sector's growth can be seen not only in the rapid expansion of the number of enterprises, but also in the rates of growth of production, sales, and investment, which are higher than those for any other sector of the economy. In short, the expansion of the *de novo* private sector has been the most dynamic phenomenon in the entire market transformation of Poland.

We may conclude that, for numerous reasons, the privatization approach in Poland has been pluralistic. Some of the methods used have proved successful, some have failed. Poland is behind other countries in terms of privatization of the largest heavy industrial enterprises and infrastructure. On the other hand, impressive results have been accomplished in development of the *de novo* private sector. The small and direct privatization programs used for small and medium-sized state enterprises and driven by bottom-up initiatives, have also been successful. The rate of inflow of foreign direct investments to Poland is increasing, bringing obvious benefits for the restructuring process. The figures and statistical analyses cited above constitute strong evidence that private sector growth in Poland has to be attributed primarily to the spontaneous development of new firms under liberal systemic conditions, aided by the decline and partial disintegration of the state sector. However, despite this impressive spontaneous private sector development, the extent of privatization of the economy, measured by the private sector's share in GDP, employment and assets, is still unsatisfactory. In reviewing the qualitative effects of privatization we have to admit that only some of the targeted goals have been met.

Through privatization a rapidly developing capital market was established in Poland. Many hold that the Polish securities market is the best organized, most transparent and promising in Central Europe. The State Treasury was strengthened with direct proceeds from privatization, which, though moderate in volume, have been important for the consolidation of the budget [16]. One may expect that in the future the state budget will indirectly benefit from privatization, for example due to reductions in subsidies to the public sector and increasing tax revenues from private enterprises [17]. The eight years of transformation have proven beyond doubt that privatization supported with competition stimulates the increase of enterprise effectiveness. Significant accomplishments have been recorded in the restructuring of large enterprises through commercial procedures, particularly with foreign investors' participation [Kamiński, 1996].

The state sector has diminished, though to a lesser extent than originally planned. The overall result of the privatization process is unsatisfactory due to the continuing large number of state enterprises, the substantial value of assets still within the public sector and the uneven pace of privatization in certain sectors, especially in infrastructure, which so far has been excluded from privatization. Additionally, there is still insufficient popular support for privatization, because many hopes and expectations linked with it have not been fulfilled.

I.7. Results of Previous Research on Enterprise Restructuring in Poland

During the seven years of transformation in Poland described above (1990–96), deep changes occurred in the behavior of enterprises. These changes have been described in numerous empirical and statistical studies. The best known statistical research is the ranking of the 500 largest manufacturing enterprises, led by the Institute of Economics of the Polish Academy of Sciences since the early 1980s. Its scope has been broadened during the 1990s, so that besides the largest manufacturing companies in the public sector, lists have been prepared on the largest companies in the public and private sector and separately on other sectors

[16] The annual volume of these proceeds constituted between 0.8 and 3.2 per cent of total revenues and between 0.2 and 0.9 per cent of GDP.

[17] See: 'Ocena przebiegu procesów gospodarczych w 1995 r. na tle lat 1990–1994', Centralny Urząd Planowania, May 1996, and Antczak (1996).

outside manufacturing. On the basis of the company level data numerous papers and books on different aspects of enterprise restructuring have been published [for instance, Mujżel, 1997].

Among the most important empirical research on enterprise restructuring during the early transition in Poland are studies by Pinto, Belka and Krajewski (1993), followed up in later years with research in a larger group of enterprises [Belka et al., 1995], and empirical research conducted by the Gdańsk Institute of Market Economics since 1990 in both state enterprises and a group of enterprises (starting from 60 and finishing with about 150) undergoing different types of ownership transformation [18]

It is very difficult to compare or to generalize the outcomes of these empirical studies since none of them is based on a representative sample and are related to different groups of enterprises. On the other hand, the statistical research, which is more representative, may not answer many interesting questions because of the massive changes in the statistical methodology which occurred during this period of time. One should also realize that all ranking lists with their rich information include changing samples of enterprises, so that it is not possible to observe

Table 4. Economic relations in companies of different types as of December 31, 1996

Specification	Employment (in thousands)	Cost indicator a)	Net profitability b)	Current ratio c)
Enterprise sector, total d)	4,626.0	97.1	1.6	22.2
Enterprises which have begun ownership transformation e)	1,496.3	97.9	0.9	19.8
Companies wholly owned by the state treasury, of which:	1,064.3	99.0	0.4	16.4
– prepared for individual capital privatization	396.9	97.8	1.8	22.9
– prepared for NIF	358.5	100.2	- 1.6	13.5
- others	308.9	100.2	- 1.4	9.9
Companies in which capital privatization was completed, of which:	175.1	95.6	2.3	31.5
– with foreign capital	68.9	96.4	1.8	24.9
Companies established from liquidated state enterprises, Of which:	58.2	99.7	- 0.9	23.1
– with foreign capital	21.9	99.1	- 1.0	28.9
Employee-owned companies	186.2	94.0	3.4	22.4
State enterprises in liquidation, of which:	12.5	110.1	- 5.8	9.3
– under the state enterprise law	6.3	131.4	- 16.3	8.8
– under the privatization law	6.2	99.0	- 0.3	10.9
State enterprises not having begun ownership transformation	771.6	98.4	0.4	25.2
Public enterprises, total	2,619.9	97.8	1.0	23.1

Notes:
a) Ratio of costs to total revenue
b) Ratio of net profit or loss to total revenue
c) Ratio of current assets to current liabilities
d) All enterprises employing over 50 employees
e) Including those which have completed privatization
Source: Central Statistical Office, 'Financial Results of Economic Entities, January-December 1996,' in Privatization of State Enterprises as of 31 December, 1996, Warsaw 1997

[18] See Ekonomiczne i społeczne efekty prywatyzacji pośredniej i bezpośredniej. Analiza porównawcza kondycji ekonomicznej i działań dostosowawczych przedsiębiorstw objętych przekształceniami własnościowymi w latach 1990-95 (1996), Instytut Badań nad Gospodarką Rynkową, Gdańsk-Warszawa, and Dąbrowski et al. (1991, 1993).

changes in the same sample (an exception is Grosfeld and Nivet, 1998.) In many cases, a large amount of quantitative information is accompanied by a deficit of qualitative information, necessary in order to explain the reasons behind observed changes. Therefore, it is possible to conduct econometric analyses, but it is very difficult to interpret the results of these analyses. However, all these studies and available official statistics allow us to draw a general picture on the adjustment behavior and restructuring effects on enterprises:

1. The adjustment behavior of all types of enterprises has shown many similarities during consecutive stages of transformation. Most authors distinguish two [Belka, 1996] or three such stages [Mączyńska and Zawadzki, 1997].

The first stage (1990–91 or 1990–92) was a period of severe crisis caused by external shocks linked with the systemic change. While in 1990 many enterprises could still allow themselves a 'wait and see approach' because of accumulated financial and other reserves, 1991 was a year of a sharp decline. At that time the enterprises made intensive efforts to find short-time survival strategies, mostly by employment cuts, sale of non-productive assets and so on, and tried to establish new markets for their goods. Production and sales, as well as all other economic indicators, fell sharply. The real indebtedness of enterprises was growing. *The second stage* of adjustment identified in the three-stage approach was in the years 1992–93 when the enterprises tried to halt the decreasing trend of production and sales. In this stage they introduced new sale strategies. The first sign of recovery was the rise of labor productivity in 1992 accompanied by production increase, but the profitability indicators of enterprises were still decreasing investment stagnated. 1993 was the first year when the financial performance of enterprises recovered and when investment rose (although net profitability was still negative). *The third stage* of adjustment, starting in 1994 (or the second stage, beginning in 1993 in the two-stage approach), was characterized by steady production growth, improvement of profitability, rising net profitability and investment spending. In 1996 the overall financial performance of enterprises deteriorated again, but investment and labor productivity continued to rise.

2. A surprising result of research conducted during the first two stages of transition was that privatization seemed to have little influence on the adjustment and restructuring patterns of enterprises.

All enterprises, whether privatized, state-owned or commercialized seemed to react in similar ways to the hardening of budgetary constraints and increasing competition [19]. In the next stages of reforms, especially since 1994, a gradual differentiation between restructuring patterns of enterprises was more and more visible. It is now clear that privatization matters. With respect to deep (strategic) vs. defensive restructuring [Grosfeld and Roland, 1996], most research has shown that the strategic restructuring process, involving large investments and innovative technological changes, was possible only in privatized enterprises, mainly with the participation of a foreign investor. Moreover, the behavior of enterprises of different ownership types in the wage setting process has been investigated. The non-privatized enterprises have a tendency to consume the largest part of labor productivity increases in wages while the privatized enterprises use it for further investment [Grosfeld and Nivet, 1998]. A similar conclusion was made in an international comparative World Bank study [Pohl et al., 1997]. The differences between privatized and state companies measured by the indicators of financial and economic performance are becoming striking (see Table 4 above). The only difference between the conclusions of the World Bank study and most research done in Poland is that, in our view, not only privatization by itself but also the methods of privatization have a strong influence on the quality of the restructuring process.

[19] See Carlin et al., (1995). See also Belka (1995), Pinto (1993) and Mączyńska (1997).

Part 2
A Short Description of the Industrial Branches Represented in the Sample

Here, we provide a comparative background to the analysis of the companies in our sample by investigating economic indicators of the relevant industries. We start from a brief description of production dynamics in manufacturing and in all branches under investigation. Then, changes in average employment and wages are investigated. Finally, aggregated data concerning the financial indicators of enterprises in these branches are presented. These indicators include gross profitability, the investment to revenue ratio, and the quick ratio. Table 5 contains basic statistics for the year 1995 on production, employment, wages, and investment for the branches represented by the companies in our sample.

2.1. Production in the Manufacturing Sector, 1990–96

Production in the centrally planned economy was not governed by market demand but determined by supply conditions. Relative prices were distorted by the widespread control and persistent shortages resulted in forced substitution. Moreover, the administrative allocation of capital and labor was inefficient, magnifying distortions in the production structure. Heavy industry was overdeveloped, mostly for political reasons. Transformation to the market economy required fundamental changes in the structure of industrial production. The first two years of transformation (1990–91) were characterized by a severe recession. Industrial production fell by ~20 per cent in 1990 and by ~10 per cent in 1991. The reduction was caused by the shock therapy necessary for macroeconomic stabilization, but also by the process of production restructuring in response to market signals. The dynamics of sold production of manufacturing branches (NACE Divisions) are reported in Figures 3 and 4.

The initial decrease was not identical across the branches. Figure 3 shows that the production of 'consumer goods' fell significantly less than the manufacturing average. It is obvious that initially repressed demand gave way to relatively higher consumption and less output fall. The opposite is true for producers of 'investment goods'

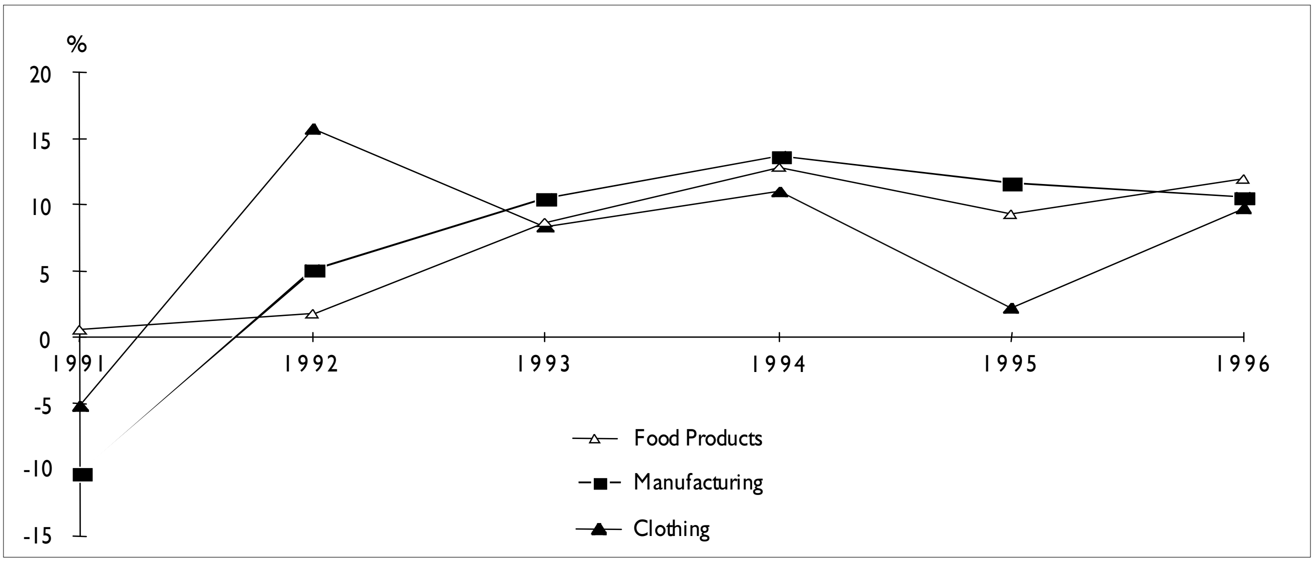
Table 5. Basic 1995 statistics for branches represented in sample

Branch	Production sold (million PLN)	Average employment (thousand)	Average monthly wage (PLN)	Investment outlays (millions of PLN)
Manufacturing	211533.1	2616.0	699.27	11732.7
Apparel, Dressing and Dyeing of Fur	6338.5	240.0	499.56	232.5
Food Products	51629.7	452.0	683.81	2694.6
Machinery and Equipment	13689.3	292.0	682.93	584.4
Electrical Machinery and Apparatus	6179.4	87.0	747.51	381.4
Fabricated Metal Products	9367.5	87.0	683.89	325.8
Radio, Television and Communication Equipment	3348.0	43.0	754.68	151.2

Source: Central Statistical Office, Monthly Statistical Bulletin (with the exception of one branch). A clear-cut difference between the decrease in 'investment' and 'consumer' goods production may be difficult to establish because the latter did not necessarily reflect consumer needs. The opening up of the Polish economy and large-scale import of consumer goods extended consumer choice and allowed for substitution of unwanted products. On the other hand, the decrease in production caused by the process of restructuring was 'cushioned' by the initial devaluation of zloty, which made Polish imports expensive and exports highly competitive in 1990. In mid-1991 domestic prices adjusted and true competitiveness began to determine trade flows.

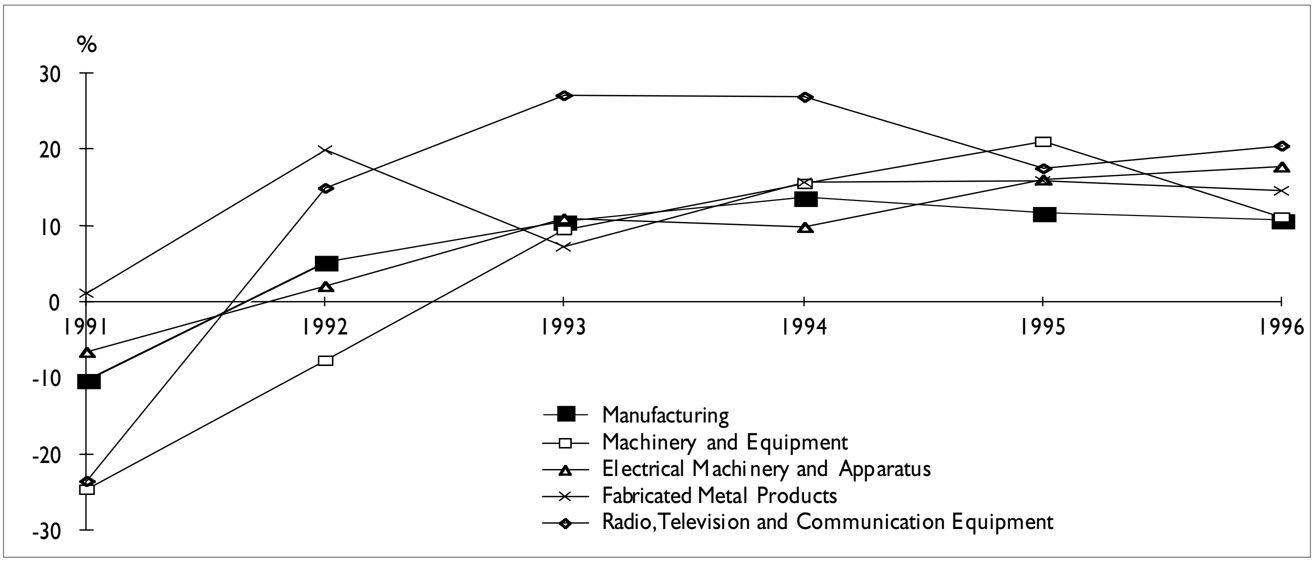
In 1991 the dissolution of the CMEA produced another large negative demand shock. Trade with the USSR and other countries of the Eastern block dropped significantly. Economic links with Western countries were not established yet and the shock exerted considerable influence on the Polish economy. Production in branches exporting to the CMEA countries decreased. Recession ended in 1992, which was the first year of production growth. Since 1993 production has been increasing by 10 per cent per year. Enterprises began to adapt to the new, market environment. The expanding private sector constituted a considerable part of the economy. Initially, increasing exports to the European Union (especially to Germany) boosted demand.

Figure 3. Dynamics of sold production – 'consumer goods'



Source: Central Statistical Office

Figure 4. Dynamics of sold production – 'producer goods'



Source: Central Statistical Office

Then, the domestic demand recovered and the production growth was fuelled mainly by domestic absorption. It is important to note that the structure of production growth in manufacturing has changed in last two years. Figures 3 and 4 indicate that the dynamics of the 'consumer goods' sectors declined, while the production growth in the 'investment' branches increased relative to average growth in manufacturing. Thus, the process of restructuring seems to positively affect investment demand, which is fairly obvious in transforming economy.

Lipowski (1998), discussing changes in structure of the manufacturing sector in 1990–1995, observes that pre-transformation manufacturing production in Poland was extremely material intensive and its competitiveness was relatively low. It follows that the production of raw materials and low-processed goods should gradually fall with the progress in restructuring and adopting new technologies. There is only one division producing low-processed goods in the sample under investigation, namely Manufacture of Fabricated Metal Products. This is one of the fastest growing branches so the data do not seem to confirm this supposition.

2.2. Employment Dynamics and Average Salaries

In 1990–94 average employment in industry was continuously falling. The exact estimation of employment dynamics is impossible because of changes in industrial classification but it is justifiable to use the available figures for rough comparison. In 1990 average employment in industry (KGN classification) was 4,620,000 while in 1994 it dropped to 3,641,000 (NACE classification). Enterprises in the pre-transformation period were plagued by a substantial overmanning. The process of adjustment was painful and labor hoarding remained a considerable problem even after four years of reforms. Results from a broad survey of Polish enterprises indicate that the issue of overmanning was certainly unsolved in 1993 [Belka et al., 1995]. The last year of employment decline was 1994, followed by growth in 1995.

The dynamics of employment showed a declining trend both in the consumer goods and in the investment goods production between 1993 and 1996. It is clear from the data on employment that the average employment growth differs across branches. The most noticeable 'outlier' is very high employment growth in the clothing industry in 1993 but growth in the food industry is also substantial. As was already shown, the food industry did not experience production decline at the beginning of the transformation. A decrease in the production of clothing was lower than the manufacturing average. These observations seem to confirm the supposition that the consumer goods sector was less influenced by the stabilization shock and demand contraction. The pressure on restructuring might have been lower than in other branches. However, the food industry experienced decline in employment in 1994, indicating that employment was excessive.

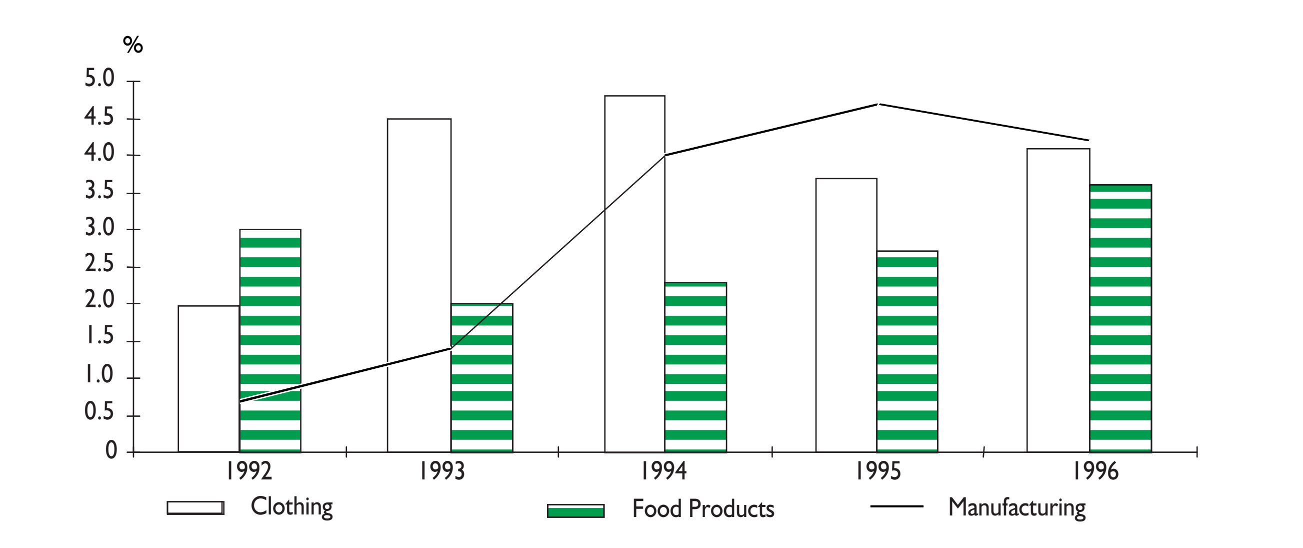
A situation in the investment goods sector was different although one branch had also experienced high employment growth already in 1993 (Production of Fabricated Metal Products). In other branches employment was significantly reduced at the beginning of the transformation. Two branches were capable to increase employment in 1994–95 (Fabricated Metal Products and Electrical Machinery and Apparatus). The Production of Radio, Television and Communication Equipment experienced persistent decline in employment. These results confirm that the pressure on restructuring was stronger in the investment goods sector due to demand contraction. The situation of the consumer goods sector was better at the initial stage of transformation since demand for these products was repressed in the planned economy and the demand contraction due to transformation was less severe. To fully assess the employment decisions of the firms, we also analyzed the salaries in branches under investigation relative to the manufacturing average.

Salaries in the food and clothing industry were generally below the manufacturing average (although close to average and, in 1992, higher in the food industry). Moreover, salaries in the clothing industry are declining relative to the average in manufacturing. Two branches in the investment sector had considerably higher salaries than the manufacturing average – Production of Electrical Machinery and Apparatus and Production of Radio, Television and Communication Equipment. These branches (especially Production of Radio, Television and Communication Equipment) are certainly the most human-capital intensive in the sample. The positive difference between salaries in these branches and the manufacturing average may be explained by the fact that highly skilled labor is employed in both industries. On the other hand, severe and persistent employment decline in Production of Radio, Television and Communication Equipment may suggest that the average salaries paid in this branch is too high, making the manufacturing of high-tech products too expensive.

2.3. Enterprise Profitability and Liquidity

In the previous two sections it was shown that the enterprises restructuring in manufacturing, combined with demand contraction, resulted in a substantial decline in production and in employment. In this section an influence of these factors on profitability will be investigated. Figures 5 and 6 compare gross profitability of branches with gross profitability in manufacturing. Gross profitability in the consumer goods sector was higher than the manufacturing average in the 1992–93 period and lower afterwards. The profitability of the food industry is gradually increasing after itive in 1994 and higher than the manufacturing average in 1996. Production of Radio, Television and Communication Equipment generated losses and became profitable only in 1996. These facts confirm our hypothesis that the situation of the consumer goods sector was relatively better at the

Figure 5. Gross profitability – Consumer goods



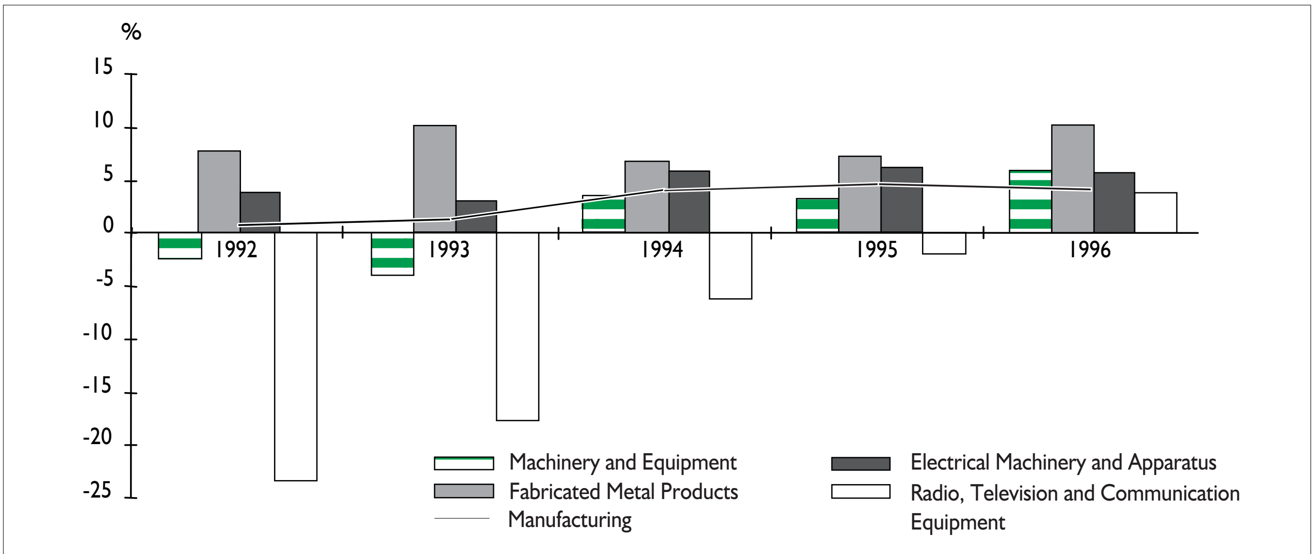
Source: Central Statistical Office

a decline in 1993. The clothing sector obtained the highest profitability in 1993–94.

In the investment goods sector gross profitability was continuously above the manufacturing average in two branches: Production of Fabricated Metal Products and Production of Electrical Machinery and Apparatus. In Production of Machinery and Equipment, profitability became pos- beginning of the transformation process. The profitability of the investment goods sector gradually improved, although in some branches it was very high from the beginning of the period.

In further investigations of the financial situation in manufacturing we analyze liquidity in enterprises. Quick

Figure 6. Gross profitability – Investment goods

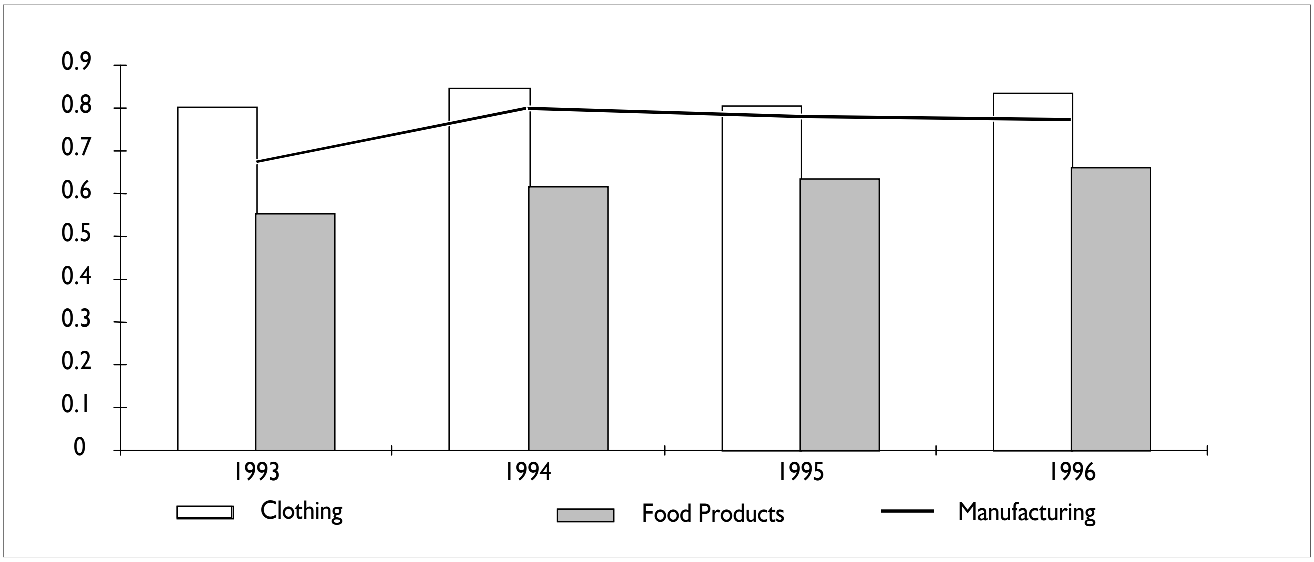


Source: Central Statistical Office

ratio indicators largely differed between the consumer goods and the investment goods sectors. The figures do not reveal any clear patterns in changes in liquidity or in differences between the groups. Liquidity remained roughly constant in the consumer goods sector and was slightly increasing in the investment goods sector. Within the consumer goods sector, clothing had an above-average indicator with 0.8, while food production showed a below-average liquidity with 0.5–0.6 cent between 1993 and 1996. Within the investment goods sector, it was only machinery and equipment production, plus the telecommunications equipment production that had a below-average quick ratio, with 0.6–0.7, and 0.45–0.55, respectively. The quick ratio of fabricated metal products, manufacturing and electrical machinery amounted to 1.0–1.2, 0.9–1.0 and 0.65–0.8, respectively.

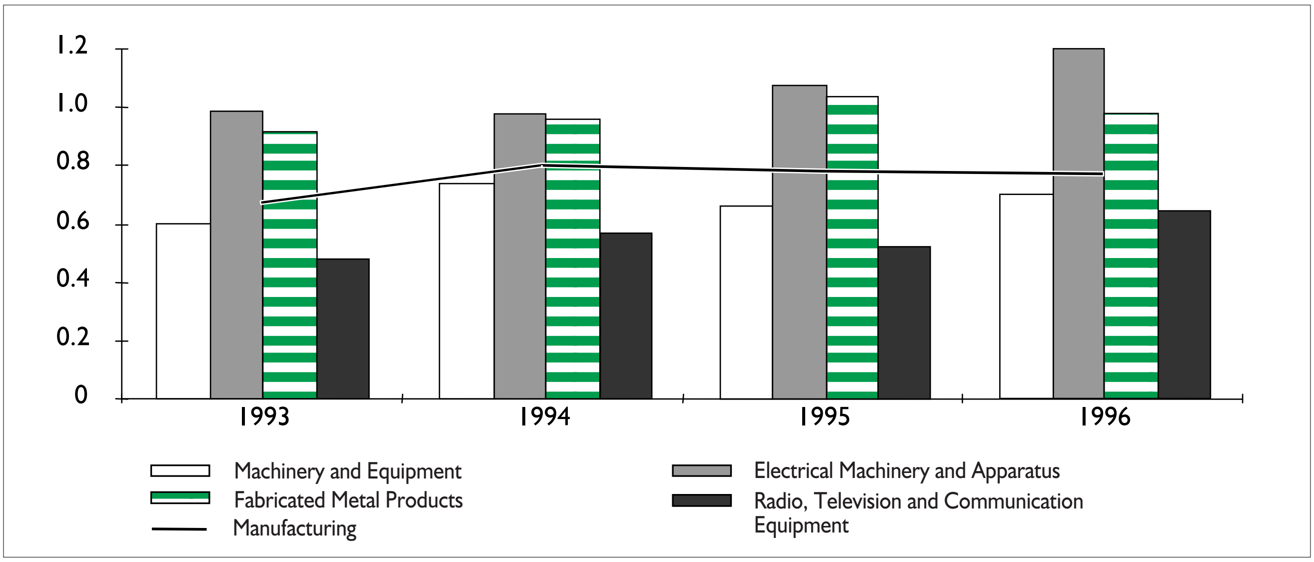
The differences between branches seem to be caused by persistent branch-specific effects, that is, differences in the 'normal' liquidity level for branches. Figures 9 and 10 present investment to revenue ratios for the branches under investigation. Investment patterns reflect the current situation of the enterprises but also expectations concerning future demand for products and profitability of the industries.

Figure 7. Quick Ratio – Consumer goods



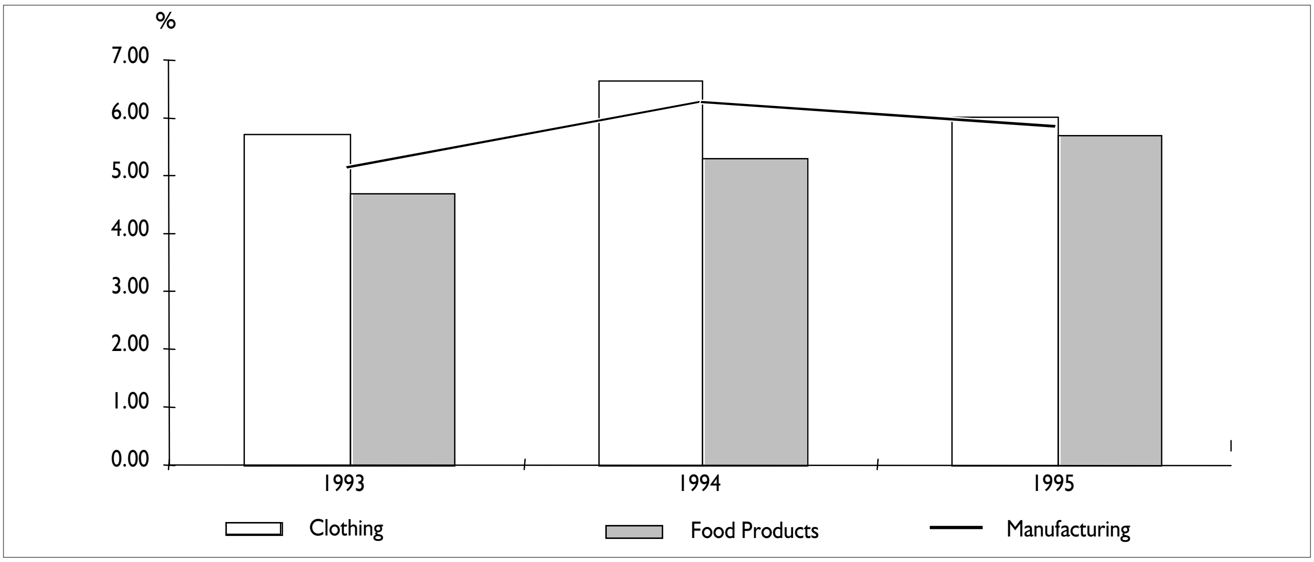
Source: Central Statistical Office

Figure 8. Quick Ratio – Investment goods



Source: Central Statistical Office

Figure 9. Investment to Revenue Ratio – Consumer goods

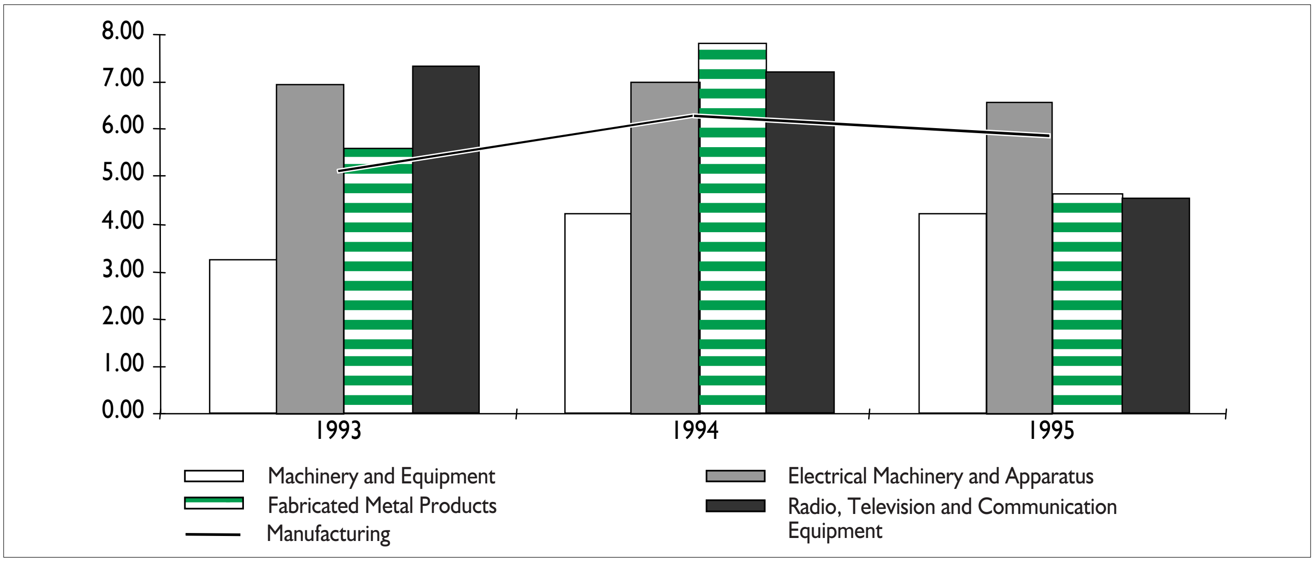


Source: Central Statistical Office

Investment outlays (as percentage of revenue) were increasing in the Manufacturing of Food Products and remained constant (and higher than manufacturing average) in Clothing Production. In the investment goods sector the investment to revenue ratio decreased in almost all branches except Production of Machinery and Equipment. The reduction of investments may indicate a gradual decline in the initial growth potential in these industries.

The main conclusion from our investigation is that the branches producing consumer goods faced less demand contraction at the beginning of the transformation process than the industries producing investment goods. The less severe initial conditions were reflected in lower output and employment decline, as well as in higher profitability in the consumer goods sector. After the initial restructuring, the situation in the investment goods sector improved and the economic performance of these branches became better than the manufacturing average. However, the other financial indicator – liquidity – does not follow this pattern and seems to be determined by branch-specific characteristics. Investment outlays recently decreased in the investment goods sector, which may indicate a decline in the growth potential of these industries.

Figure 10. Investment to Revenue Ratio – Investment goods



Source: Central Statistical Office

Part 3
Ownership Transformation and Organizational Transformation

The purpose of this section is to paint a fairly detailed picture of the various types of ownership transformation processes which all the firms in our sample have undergone, and then to examine the results of restructuring in order to determine whether there is any relationship between such restructuring processes on the one hand, and the nature of the ownership transformation process or the branch in which the enterprise operates on the other.

3.1. Description of the Sample

The firms are divided into two broad groups: those producing consumer goods and those producing investment-type goods (one firm producing household appliances has been included in the group of investment goods' producers due to the nature of the production technology). Our sample of 24 firms includes 11 enterprises producing mostly investment goods and 13 consumer goods' producers. Companies in the consumer group represent the food and clothing industries. Enterprises in the investment group are more diversified but most of them may be classified in the machinery industry. The sample contains only six firms that have not been fully privatized: three state treasury companies – that is, companies which have undergone so-called 'commercialization' but have not advanced beyond wholly state-owned status – and three companies participating in the National Investment Fund (NIF) program. One firm in the sample is also treated as a privatized firm although it is still majority owned by the state treasury and its strategic investor is also a state agency. The vast majority of privatized firms in our sample were privatized on the basis of conventional methods (for example, initial public offerings and trade sales) referred to in Poland as 'capital' or 'indirect' privatization; only three were privatized on the basis of employee leasing (the most popular of so-called 'liquidation' or 'direct' privatization). One very interesting and exceptional case is that of an employee-owned company which was created by being separated from a company which had earlier been commercialized and then sold to a foreign investor. All the enterprises in the sample but three (employee-owned) underwent commercialization. The timing of the commercialization does not seem to be correlated with the size of firm and does not differ significantly across the two industrial groups.

3.2. Initiators of, and Motives for, Transformation

In most cases, when we asked respondents who had initiated the ownership transformation process, they named the director (sometimes jointly with the employees' council; in one case, a third party – the Solidarity trade union – was mentioned). In three cases – a state treasury company, an NIF company, and a privatized firm with a large foreign shareholder – the initiator named was an outsider (the ministry). Another state treasury company named the state treasury, insiders and a bank as initiators. The founding organ (voivode) was named in one case as an initiator. Four companies provided no answer.

As regards the motives, seven firms provided no answer. The firm which had still not been privatized five years after commercialization stated that it had chosen commercialization in order to avoid the dywidenda tax [20]. Motives of commercialization were named in five other cases. The most popular motive was making privatization possible (commercialization being the necessary first step of 'capital' privatization). This motive was named by four companies (all privatized), although one of them also mentioned the desire to avoid the *popiwek* tax [21]. One company stated that its motive for commercialization was the ability to cre-

[20] This was a tax paid by state enterprises based on the book value of their assets.

[21] This was a tax paid for wage increases exceeding centrally-set norms.

ate a holding company and carry out other organizational changes and improve decision-making process.

The most popular motive of privatization named by the companies was the desire to acquire investment capital. There were two variants of this motive. One was the acquisition of a strategic investor who would provide these funds (named by three firms, all owned by strategic investors – two foreign and one a Polish individual). In the other variant the strategic investor does not appear as a source of funds. This variant was named by five firms (Interestingly, all of them but one have strategic investors).

3.3. Ownership Structure Past and Present; Employment Restructuring

All firms in the sample were still 100 per cent state-owned as of the end of 1990. By definition, all state treasury companies continue to be 100 per cent state-owned. The NIF firms in the sample still have a relatively uniform ownership structure: in each of them 33 per cent of the shares belong to the leading fund and 27 per cent to the other 14 funds. As two of the firms are food processing firms, both employees and farmers supplying the firms are entitle to free shares, giving these two groups a combined share of close to 30 per cent in both firms; the remaining approximate 10 per cent is held by the state treasury. In the other firm, employees hold 15 per cent, and the state treasury holds 25 per cent.

If we turn to other firms acquired by Polish owners but not employees we note, first, that only in one case out of seven was the purchaser an individual. In all cases (four) in which there is a strategic investor (holding 30 per cent or more of the shares), it is an institutional investor – in two cases a financial investor (bank) and in two cases a non-financial investor (a holding company and a state-owned agency).

A question often posed in discussions about the role of privileges for employees in the privatization process concerns the shares which employees acquired at preferential prices or even for free (in the case of 'indirect' privatization, the employees are given such privileges): Have they simply sold them to make a quick and very large profit, or do they appear to be genuinely interested in being co-owners of the firms in which they work? In cases of publicly traded companies, it is often very difficult, if not impossible, to determine how many shares are held by employees (five companies were unable to provide data on what percentage of shares was held by employees – although one of these was not publicly traded), but the information provided by our respondents concerning the number of shares held by employees in firms privatized by so-called indirect methods (in which employees acquired shares at half their face value or for free) indicates that employee shares in those companies were between 1 and 7.5 per cent in 1996. Given the fact that in all these companies 20 per cent of the shares were originally reserved for the employees on preferential conditions, it seems that employees have in fact generally been quick to dispose of their shares, often realizing impressive gains. Another important issue is the state share maintained in companies privatized by indirect methods. This share was generally low in the companies in our sample. In seven companies the state treasury held no shares whatsoever; in the others, the state shares – as of 1996 – ranged from 0.2 per cent to a majority share. All three of the firms in the sample privatized by employee leasing have undergone further ownership transformation, becoming non-leasing firms before the expiration of the leasing contract. This is indicative of a trend occurring throughout the economy with respect to better-performing companies privatized by this method. In one case, all shares were sold to a foreign owner; in two other cases, additional capital has been obtained by means of quotation on the Warsaw Stock Exchange.

Some of the most important questions surrounding the influence of ownership transformation processes on employment are: Does privatization (commercialization) change the pace of employment reduction? Or does employment reduction follow industrial patterns irrespective of ownership form? Or does it vary from case to case, depending solely on the financial health of the firm? Does the type of ownership matter (for example, are firms owned by strategic investors more willing to cut employment than firms owned by employees)?

Before examining the evidence from our sample, it is worth noting two things. First, in the state and former state sector in 1990 and 1991 – in the depths of the transformation recession (which ended in 1992) – the pace of employment reduction was much slower than the rate of production decline; however, this pace continued relatively unabated (or even accelerated) into the period of recovery. Second, a belief very widely held in Poland is that privatization is followed by accelerated employment reduction, despite the fact that several empirical studies have concluded that this is not the case and that employment reduction generally begins well before privatization. Does the evidence from our sample shed any light on these problems?

First, we must note the unfortunate number of companies (seven) in our sample for which we have no data on employment or for which the data are only from a single year, not allowing for an analysis of employment dynamics. In addition, there are six companies for which there are no data from recession years and seven firms for which there are no data before privatization/commercialization.

Having noted that, we can state what we found in those companies for which we have data. We might start with the good news: three enterprises had no significant drops in employment during the period for which we have data. Turning to the worst news, the most drastic drops in employment during the entire period of the 1990s were found in four companies. In the first two cases, the biggest drops occurred after privatization, whereas in the second two (commercialized, EO), they occurred before privatization. Looking at the best and worst cases, there is certainly no obvious correlation between type of ownership and employment policy. As for less extreme cases: for three companies (an NIF company, a publicly-traded company, and a state treasury company), the largest drops occurred in the same period (covering more than one year) as privatization, and we cannot determine whether this was before or after actual privatization. Finally, in four companies (an NIF company, a publicly-traded company, a foreign-owned company, and a company owned by a Polish strategic investor) the most dramatic drops occurred after privatization.

Three companies experienced their most dramatic drops in employment during the recession. Four companies' most dramatic drops occurred after the recession. It is interesting to note that we observe companies from the same branch (clothing) and ownership groups (NIF, publicly traded) in both categories (employment drops before and after recession).

Clearly, the evidence here is very mixed. The size of the sample and the gaps in the data suggest the utmost caution, but there is certainly no evidence in our data that ownership transformation is related in any deterministic way to employment policy: we can find companies with identical ownership forms and very different employment patterns. There may be a certain branch relationship: the three companies that managed to avoid large employment drops were all food producers and the four companies which shrank drastically were all machine producers.

3.4. Labor Costs and Changes in Pay and Other Motivation Systems

Following the analysis of employment, the next task is to analyze the extent to which employment rationalization affected labor costs and the relationship between labor cost growth and ownership transformation vs. other factors (for example, branch) dealt with above in the employment analysis. Once again, we must begin by noting the fairly large gaps in the data. No data at all were received from seven firms. No data on recession years were received from eight firms, and five firms failed to provide data from the period preceding privatization (Additionally, data for five firms prior to privatization is lacking because they were privatized so early).

The first observation seems to be that in the recession years firms tended to keep the growth of their wage bills well below the growth in the producer price index. Seven firms showed an increasing trend following privatization; two firms did not. In the end, six firms (from every ownership category except publicly traded firms) had wage bill growth lower than the growth in the producer price index during the entire period for which they provided data. Two of these six provided no data on employment, but the other four showed the biggest employment reductions in the sample.

As a sort of check on the comparison between employment data and wage bill data, we gathered information on average monthly wages in the firms (Here too there are large gaps in the data). An interesting contrast to the data on the total wage bills is noted here: while total wage bill growth tended to stay well below producer price index growth during 1991 and 1992 (as the recession was coming to an end), average monthly wage growth in this period exceeded consumer price index growth with only one exception. In the first year of growth, wage growth in the foreign-owned firms was – with one exception – above consumer price index growth, while in the other firms the situation varied. In the following years, characterized by steady growth, wage growth has been consistently above consumer price index growth. However, the large gaps in the data suggest great caution in the interpretation of these results.

Changes in pay systems, especially if they are designed to increase the motivation of employees, often constitute an important aspect of organizational change. Close links between performance and pay are often considered especially important for management. We therefore sought information on changes in pay systems, with an emphasis on motivational elements – both for managerial and non-managerial employees. It should be noted, however, that in some cases it is difficult to determine the nature of the motivational element of pay for non-managerial employees. In many cases a bonus is referred to, but in some cases this is a bonus linked to the financial performance of the company and thus having the incentive effects of a profit-sharing arrangement; in other cases, it is simply a fixed bonus which is withheld in cases of absenteeism or discipline problems and therefore has a more disciplinary than motivational character. We are not always certain to which type of bonus a given correspondent was referring.

Four firms (one NIF firm, one employee-owned firm, and two with Polish strategic investors) reported no changes in their pay systems. Eight companies, from all ownership types and branches, reported using a bonus system for their employees. However, the direction of developments with respect to bonuses is not the same throughout the sample. While three firms noted that the weight of the performance-related component of pay had increased, and one reported a planned increase, three firms (all foreign-owned) reported a decrease in the weight of the performance-related component of pay.

The principles determining base pay also differ quite widely. For example, while six firms reported using fixed daily or monthly rates (and two of them had switched from piece rates), four reported the use of piece rate wage systems for production workers, and two others reported the use of both (although one of these is gradually shifting from a piece rate system to daily rates). Here too there appear to be no patterns with respect to ownership type, although there seems to be a shift away from piece rate systems in companies producing investment goods.

3.5. Training and Organizational Changes

Firms generally provided little information about training activity. Aside from health and safety training, which is required by the law, our evidence seems to indicate that Polish firms generally tend to underestimate the importance of investment in human capital regardless of their ownership status, unless they are owned by foreign investors or have introduced an ISO certification program.

In the area of organizational changes, three firms reported that no changes worth mentioning had occurred. Five companies reported that the only change had been the creation of one department or division; in two cases, this was a marketing department (Creation of a marketing department was one of a number of changes made in five other firms). The development of two or more new departments and divisions was mentioned by four firms.

Spatial expansion of various kinds was reported by six companies. In contrast, spatial concentration was mentioned by six companies. Plant closings occurred in two firms, and one plant was sold by another. Apartments, holiday camps, and other employee service facilities were sold by four firms, and other real estate (buildings and land) by three others. Strictly organizational measures took place in five firms. Employment restructuring was mentioned by two firms. A holding structure was created by another. An employee-owned firm introduced cost and profit centers, meaning that the firm's six plants (corresponding to six product groups) are highly autonomous, with each having its own design, sales, marketing, quality control, personnel management, and accounting. Divisions were reorganized by two firms.

3.6. Company Presidents, Directors and Supervisory Board Members: Where Do They Come From, Who Chooses Them and How Much Are They Paid?

Managerial continuity is observed very generally in our sample and seems to be independent of the mode of ownership transformation. Our data indicate that there have only been eight cases of management shake-ups in the 1990s. Six of these were cases with strategic investors (five of them foreign, the other a case in which the owner took over the position of president shortly before our research was conducted), and two employee-owned companies. Generally, however, today's managers were also the managers of yesterday's state-owned enterprises under socialism.

Asked who determines membership of the board of directors and the supervisory board, most respondents simply answered in accordance with the commercial code that the membership of the board of directors is determined by the supervisory board and that of the supervisory board by the shareholders' assembly. Only a few companies went into more detail about the 'politics' behind these personnel decisions, providing some insights into how these decisions are made in reality, 'behind the scenes'. A number of responses indicate that while the president is chosen by the supervisory board, the other members of the board of directors are usually hand-picked by the president.

Who sets the remuneration for members of the two boards? Eleven firms reported that management's pay is determined by the supervisory board. Seven firms reported that supervisory board members' pay is determined by the shareholders. One NIF firm said that the NIF determines pay for both boards, and two firms with strategic owners (one domestic, one foreign) said that the owner determines pay for both boards. In two foreign-owned companies, representatives of the owners on the supervisory boards are not paid. A respondent from one publicly-traded firm said that management base pay was set not by the supervisory board but by the shareholders' assembly, and that the supervisory board set the bonuses for management. Finally, eight firms provided no information on this subject.

Possibly the two most interesting observations concerning supervisory board membership in our sample are that the boards of firms owned by strategic investors tend to include employee representatives and that there is a strong outsider presence on employee-owned firms (in at least two cases representing a source of technology transfer). Thus, it seems that insider-dominated firms often appreciate the contributions that outsiders can make, and that outsider-owners often continue to find value in the employee representation which originated before they acquired their firms. In firms owned by Polish strategic investors, representatives of the owners dominate the supervisory boards but are not the exclusive members. By contrast, three foreign-owned companies' boards consist exclusively of representatives of the strategic investors (The same situation exists in the former employee-owned company which is now foreign-owned). The boards of the other four all include employee representatives, and the board of one in which the state treasury still maintains a significant stake also has one member representing the state treasury.

There is wide variation in the frequency of supervisory board meetings. The frequency named by the largest number of firms (11) is once a month. In five firms, the board meets every two to three months; in four (all foreign-owned), every three months, in two, two to three times a year, and in one (foreign-owned), once a year. Only in one foreign-owned company do meetings occur once a month; in all other foreign companies, they occur every three months at best. Apart from this, however, we do not observe any correlation between the type of ownership and the frequency of board meetings. Even more interestingly, frequency does not appear to be very strongly linked to whether or not the board in a firm is involved in strategy formulation, as one of the three firms meeting less than once every quarter is described as a strategy-maker, and two of the four boards meeting once every quarter are strategy-makers (although the board that meets only once a year is also the only one described as a passive organ). There does, however, appear to be a strong connection between frequency and whether a board is described by the respondents as an active one. Of the eleven boards described as active, only two have boards which meet less than once a month.

In evaluating the role of supervisory board in Polish companies, one must first be careful to distinguish between the role of this organ in the European two-tier management system and the role of the board of directors in the Anglo-Saxon system, where corporate executives sit beside outside monitors on one body. Generally speaking, the role of the supervisory board in the European system is to monitor the performance of management – and, when the need arises, to discipline or even replace management – and not to manage the company. Of course, in practice, the actual range of activities in which the supervisory board engages may span a wide spectrum, depending on numerous factors, of which the ownership structure is undoubtedly one. But it would certainly be a misunderstanding to judge a supervisory board to be unduly passive if it evaluates plans developed by the board of directors without, for example, developing alternative plans of its own. The need for caution is further underlined by the highly subjective, and therefore often vague, nature of the respondents' evaluations of the supervisory boards' role in the decision-making process.

Respondents tended not to express negative opinions concerning the role of the supervisory board. There were only two cases of unambiguously negative evaluations of the supervisory boards' performance. In one firm owned by a Polish individual investor, the supervisory board (which meets every two to three months) was described as playing no role in the decision-making process (Accordingly, the owner was named as the only strategy maker in this firm). Furthermore, we asked respondents whether the supervisory board was a passive or active organ, and in only one case – that of a foreign-owned firm – was passivity indicated (This was also a firm in which the board of directors alone was named as the strategy-maker and the one in which the board meets least frequently – only once a year). Turning to more indirect measures, we asked whether the board was rather a consultative or a decision-making organ. These were not necessarily seen as mutually exclusive categories, as two boards (in an NIF company and an employee-owned company) were described as both.

Just as a decision-making character and a consultative character are not mutually exclusive, neither is an active role necessarily associated with a decision-making, or strategic, role. While boards of a decision-making or strategic character are described as active, the reverse is not necessarily the case. Most descriptions (16) of the supervisory boards' activities listed those which are statutorily required: the boards of four companies of diverse ownership types, including two foreign-owned companies, were described as consultative organs, those of five companies as monitors and advisors to the board of directors, and those of seven were described as both (the latter two groups were also of diverse ownership structures, although neither included foreign-owned companies). While seven boards described as active were described as having monitoring and advisory roles, only four were described as decision-making organs, and two were described as strategy-makers.

We asked the respondents to identify the most active members of the supervisory board. Although we received very few answers (five), they indicate an interesting diversity. In four companies (two foreign-owned, one NIF, and one in which the state and a state agency hold the majority of shares) whose supervisory boards include employee representatives, the representatives of the owners were said to be the most active, whereas in one company owned by a Polish individual, the employee representative was the most active.

3.7. Who Determines the Company Strategy?

Respondents were asked who formulates the company strategy. Four companies (all foreign-owned) provided no answer. The answers received indicate that the board of directors usually plays the crucial role here, with the supervisory board usually taking the back seat. Interestingly, there seems to be no correlation between the type of ownership and the location of strategy-making responsibility, as all ownership types are represented both in the group of firms in which supervisory boards play a small role in strategy-making and in the group where they play a greater role (Neither is there a correlation between branch and the location of strategy-making responsibility). Another interesting observation is that owners – even in cases of strategic investors – seldom play a direct role (although the lack of answers from four foreign-owned companies may distort this picture). Six companies indicated that the board of directors alone determined strategy. Two (an NIF company and one with a Polish institutional strategic investor) indicated that the owner and the board of directors did so together, and one owned by a Polish individual investor indicated that the owner alone determined company strategy. Four indicated that strategy was formulated by the board of directors, with review and advice by the supervisory board. Six respondents stated that their firms' strategies were worked out by the board of directors and supervisory board together. Finally, in one foreign-owned firm, strategy is developed by the owner's representatives on the supervisory board.

3.8. Views on Corporate Governance and How to Improve it

The response rate to this question was quite good; only one firm failed to provide an answer. Nineteen companies' respondents said that there were no problems in relations between the two boards. Conflicts between the boards were only mentioned in two cases. In an NIF company, disagreement arose because the supervisory board did not agree to a share issue intended by the board of directors to increase investment funds, due to the fact that the NIF wants to maximize the price of the company's shares. In a state treasury company, the respondent state that the first supervisory board had tried to force a certain strategy on management, but that the second supervisory board works 'better' with management and problems have been eliminated.

In keeping with the generally positive evaluation of relations between the two boards, a large number (11) of respondents saw the corporate governance structure seen as adequate and did not mention any changes they believed would be desirable. Four firms did not indicate whether they saw the governance structure as adequate or in need of change.

Only five respondents commented on the role of trade unions in corporate governance. One of these did so only indirectly by saying that there were no bodies beside the two boards which had any influence on governance. Another (from a foreign-owned firm which experienced drastic employment reduction) said that trade unions in the firm had dissolved themselves in 1995. Two others (in an employee-owned company and one in which the state treasury and a state agency have controlling shares) said that trade union representatives were pragmatic and did not cause any conflicts with management. Only in one company (an NIF company) did the respondent remark that the role of trade unions was excessive and should be reduced.

Nine respondents either stated what they thought should be done to improve corporate governance or reported what was being done to improve it. One managing director of an NIF firm said that he believed the company would be better off without a supervisory board. As mentioned above, in another NIF firm, the respondent felt that the role of trade unions should be decreased. One state treasury company representative said that in his opinion supervisory board members should have capital links to the company to increase motivation. The managing director of a publicly traded company said that he was considering adding a new member to the board of directors (which had three members at the time of the interview). The director of an employee-owned company said that the decision-making process would be improved if share ownership were concentrated, with a controlling package of shares in the hands of a small group of people; he also said he would like to expand the board of directors from 2 to 3 persons. The respondent from the company owned by a Polish individual investor said that the company needs a 'new, intelligent investor' with a different development vision than the current owner's. One employee-owned company representative said that control over the firm's wholly-owned subsidiaries is to be tightened. Another respondent from an employee-owned company said that there should be an advisory body for production/quality control matters and market research. Finally, a representative of a foreign-owned company reported that corporate governance was to be improved by the introduction of computerized information systems, which should improve information flow.

3.9. Respondents' Overall Evaluation of Restructuring and Challenges for the Future

We asked the respondents to evaluate restructuring efforts in their companies to date by identifying the most important successes in restructuring, the deciding factors in those successes, and the problems that had not yet been addressed in the restructuring process. Eight firms provided no answer to this group of questions. In general, producers of consumer goods stressed market-oriented and production measures, while investment goods producers were more strongly represented in the groups emphasizing organizational and cost-reducing measures, as well as those emphasizing ownership transformation itself. As for restructuring problems not yet dealt with, two noteworthy observations are that companies are generally satisfied with their market-oriented measures of the past and seem to want to concentrate on production issues – especially investment – in the future and that employee-owned companies are interested in further ownership transformation.

We asked the respondents to identify the biggest challenges facing their firms in the future. Six firms provided no answer to this question. Three respondents saw their biggest challenges in the area of cost reduction, seven mentioned market-oriented measures, six mentioned production-oriented measures, and four mentioned ownership transformation itself (six provided no answer). It is interesting to note that while some employee-owned companies indicated their desire for further ownership transformation, none indicated that this area would be the most important challenge in the future.

Part 4
Investment and Transformation of the Production Process

The research presented in this section is concentrated on the following issues:

(1) Changes in the product range accomplished over the last six years, including main and secondary items manufactured by the enterprise. (2) Changes in the market position of enterprises measured by the share in the market. (3) Industrial adjustments of enterprises to customers' expectations and market requirements involved with the shortening of life cycles of products. (4) Methods of modernization of production. (5) Transformation of production processes, including changes to production cycles, productivity, production capacities in enterprises and their utilization over the last six years. (6) Changes in the composition of suppliers.

4.1. Production

Changes in the product range

Changes in the basic and secondary product range are of very different nature and scope depending on the ownership form of the analyzed firm and the branch in which it operates. Very substantial changes were found in nine enterprises, of which four were privatized firms with a majority stake held by foreign owners, four were privatized firms with a majority stake held by Polish owners, and one is an NIF company. Small changes in the product range were introduced in five enterprises, of which three were privatized firms with a majority stake held by Polish owners, one was a privatized firm with a majority stake held by foreign owners and one was an NIF company. No changes were introduced to the basic product range in nine of the analyzed enterprises, of which two were NIF companies, one was a state treasury company, two were privatized firms with a majority stake held by foreign owners and four were privatized firms with a majority stake held by Polish owners. Privatized enterprises having introduced no changes to their product range explained that in terms of continued requirement for items manufactured by them the problem was not the product range but product quality. Consequently, these enterprises, following their privatization, concentrated on modernization and improvement of product quality. The changes in the structure of production in surveyed enterprises were aimed at: launching new products, limiting the output or discontinuing the production of previously produced items, and increasing the production of supplementary items.

The share of newly-launched products in surveyed enterprises can be estimated at 10 to 45 per cent in most firms. The furthest-reaching changes were found in two firms having replaced as much as 90 per cent of the assortment of production (interestingly, both these enterprises are manufacturers of capital goods). The data concerning the share of new products in total production are estimates, as such records are rarely kept by companies themselves. In many cases the problem lies in classifying a product as 'novelty'. It is justified when new products require introduction of completely new technologies, different from those applied so far. The launching of new products was accompanied by the withdrawal of unprofitable and hardly marketable items from the market. Most enterprises which have not implemented any major changes to their product range embarked on product quality improvements (these issues are to be discussed later on).

Changes in the market position of enterprises

It is difficult to evaluate the market position of enterprises due to lack of complete data concerning market shares of an enterprise and its major competitors at two points in time, that is, in 1990 and 1996. Five enterprises failed to provide any data on their and their main competitors' market positions in 1990 and 1996, and four respondents were unable to specify market shares in 1990. The analyzed sample included three firms currently holding monopolistic position on the market – manufacturers of capital goods, and one food-processing firm having lost its monopolistic position to foreign competitors.

The market position of the remaining surveyed enterprises for which data were available is considerably diversified. Some firms formerly held monopolistic positions and have lost them. We observe other firms with market shares as low as 0.7 per cent. Four firms dominate in their sectors over their main competitors in terms of the value of sales, although their market shares do not exceed 30 per cent. These are sectors of the engineering industry, in which the pattern of competition changed over the last six years due to the entry of foreign firms either with their finished products (imports) or through capital investment in Polish enterprises.

Two surveyed firms (both of them NIF companies) compete on local markets, with their shares in the value of sales reaching 50 per cent and showing sustained growth over the past six years. For the near future, these enterprises do not plan to undertake actions towards a substantial expansion and are still going to consolidate their position exclusively on the local market. Their long-term strategy assumes penetration of markets of the former Soviet Union.

Industrial adjustments of enterprises to customers' expectations

Industrial adjustments in the surveyed enterprises were aimed at: launching new products and new assortments of goods, introducing new products and new assortments of goods to new market segments, modification of products manufactured so far involving their modernization, improvement of quality, user's features, appearance, and so on. In addition, firms targeted the expansion of production capacities – construction of new production plants, purchase of technology lines, purchase of state-of-the-art machinery and equipment. In only 5 out of 23 surveyed enterprises were no new products introduced to the market. In the remaining firms the changes were the following: in 10 enterprises the scale of changes was very large – new production was started and products were introduced to the market, in three enterprises the scale of changes in the portfolio of goods was limited – the so-far assortments were supplemented with new items, and in two enterprises product changes were manifested by an improved appearance of products or packaging.

The already mentioned candy sector provides a good example here. These firms managed to enhance their productivity and to increase their capacities in view of a soaring market demand for their products. Polish manufacturers managed to maintain or even strengthen their position on this difficult, highly competitive and open to foreign companies market. Undoubtedly, the standing of privatized firms with a majority stake held by foreign owners is the best. Small firms operating on this market chose a strategy of copying the already established, well-selling products. Large firms in this sector stepped up their exports to the difficult markets of the European Union, the US and the former Soviet Union. Small firms enjoyed the booming market and based their exports on cross-border deals.

Engineering industry enterprises, manufacturing capital goods and so-called consumer durables did not restrict their industrial restructuring to the widening of the product range by the introduction of new products based on state-of-the-art technologies, adding new functions to their products, modification of technical and quality specifications, as well as modernization of the already manufactured products. Market changes in this sector have also resulted in undertaking new follow-up services, the extension and improvement of the maintenance network and offering financial assistance to customers. Foreign-owned firms gained competitive advantages thanks to making special offers to customers, that is offering products closely following customers' specifications and satisfying particular requirements.

Market adjustments in surveyed enterprises also covered such activities as: improvement of product quality, improved appearance of goods and packaging, new patterns (clothing sector), implementation of ISO 9000 quality standards, extension of products' storage life (foodstuffs). They also aimed at the introduction of new standards in the field of production preparation, product adjustments to individual tastes of customers, filling in market niches, the implementation of new production technologies, outward processing traffic, the creation of new enterprise structures aimed at vertical and horizontal integration, reconciling interests of suppliers and producers in achieving better quality of final goods, and channeling production to higher market segments (better product quality, higher price, more well-off but at the same time more demanding customer).

Methods of production modernization

The main ways of modernizing production by the surveyed enterprises included:

- working out their own research and development (R&D) base – in 19 surveyed enterprises,
- know-how transfer – in 17 surveyed enterprises,
- studies provided by research institutes or specialized R&D units operating in some sectors – in 5 surveyed enterprises,
- cooperation with suppliers in the field of improving the quality of final goods, in two surveyed enterprises.

Undoubtedly, the own research and development (R&D) base is of crucial significance in the product modernization in surveyed enterprises. In recent years, many firms operating on highly competitive markets have established their R&D departments, scientific laboratories and design departments. Fierce rivalry results in innovativeness, while catching up with technological and organizational progress requires regular implementation of new solutions not only in production, but also in company management processes. In some enterprises the strengthening of R&D departments brought about original patents. Know-how transfer takes various forms, including new technologies of production, new products, state-of-the-art organization and management techniques. This was the case in both the food sector and the engineering industry.

In the clothing sector, more significance is attached to the experience gained by Polish enterprises within the framework of the so-called outward processing traffic (OPT). This form of cooperation has been developed by some firms for more than ten years. Two surveyed enterprises producing finished clothing employ foreign designers. These firms argue it is a very efficient way of improving the quality of products, expanding the product range and working out features distinguishing the firm among its market competitors.

Transformations in production processes of enterprises

The modernization of production, introduction of new products and changes in the assortment structure find their consequences in changes to labor productivity and to the life cycle of products. In some of the surveyed enterprises (five firms) no relevant information was obtained, while in three firms it was stated that productivity changes and life cycle duration had not been monitored. In one enterprise the life cycle was extended by some 30 per cent, and labor productivity declined, as the output had been reduced. Fourteen surveyed enterprises saw various changes to labor productivity and to the production cycle.

Labor productivity soared (in one enterprise it went up ten-fold). The level of capacity utilization increased, also a consequence of the sale of non-productive fixed assets (In some of the surveyed enterprises, transformations in production processes adversely affected capacity utilization. Usually, the production of unprofitable assortments was cancelled, closing down entire production lines, while fixed assets remained, as their sale was not easy).

Transformations in production processes often result from the more effective utilization of working time in firms characterized by attractive wages coupled with new work discipline standards. This refers, in particular, to enterprises privatized with a majority stake held by foreign owners, in which foreign strategic investors introduced new organization and different patterns of employee attitudes. As a result of industrial restructuring, production capacity increased in 10 enterprises, remained unchanged in seven firms, and fell in three; three enterprises failed to provide explicit information (for example, seasonal fluctuations of production and difficulties with specifying the level of capacity utilization were stressed, the scale of plant modernization was too large to compare 1990 with 1996).

Privatized firms, both those with a majority stake held by foreign owners and those with a majority stake held by Polish owners, associate changes in production process with ownership transformations. The problem lies not only in the fact of production modernization, launching new products, the acquisition of know-how, but also in genuine interest of employees in labor productivity growth (the distribution of company shares among employees contributed to improvement of the quality of work according to one respondent).

Changes in cost structure and cost management policy

We asked respondents about changes in cost structure; that is, changes in the share of various items in total costs. One firm (a foreign one) provided no information at all on this subject. There were six firms whose cost structures were fairly stable in all categories (that is, for which all changes in the shares of various items were less than 10 percentage points). These included three employee-owned firms, a firm owned by a Polish investor, and two publicly traded clothing firms.

The most frequently cited change in the cost structure was a rise in the share of materials and/or energy costs (noted in 16 firms). Eleven firms from all ownership categories except NIF noted a rise in materials and energy costs. Three firms noted a rise in materials costs alone, and two firms noted a rise in energy but not in materials costs. By way of contrast, four firms (three of which were NIF or state treasury companies) noted a fall in the share of materials and/or energy costs. There did not seem to be any patterns with respect to industrial branch.

The firms in our sample seemed to have greater success in controlling labor costs, since of the thirteen firms mentioning a change in their share, six reported a drop. Here, too, we fail to observe a pattern with respect to type of ownership. Privatized firms with dispersed shareholding – that is, employee-owned and publicly-traded companies – seem to exhibit a relatively high degree of stability in their cost structures. Privatized firms with strategic investors seem to have experienced greater increases in materials and energy costs than state treasury and NIF companies. Generally, firms appeared to be more successful at limiting the share of labor costs than the share of materials and energy. This may be due to the greater ease of simply reducing the overmanning typically inherited from the socialist era as opposed to altering the production process to make it more efficient, but also to increased quality of inputs in the production process – especially through use of Western imports. Having asked respondents about changes in the structure of costs and the reasons behind those changes, we asked them what sort of cost management policy had been implemented. Seven firms provided no information on this subject. One firm admitted openly to having no cost policy, and the answers of two others indicated indirectly that they had no policy.

We have divided cost management policies into three categories: attempts to limit costs by using inputs more sparingly; investments in technology which would reduce costs, and a strategy which was intimately linked to fundamental organizational change. The first type of policy – saving by making various kinds of cuts – was found in six firms from various branches, none of which had a strategic investor. The second cost management strategy, based on investment, was applied in four firms (two with strategic investors – one foreign and one Polish). The final type of cost management strategy, based on fundamental organizational change, was demonstrated by four firms, three of them foreign-owned. In general, NIF firms seem particularly weak on cost strategy (two had none) and foreign-owned firms seem to be strongest. With the exception of one employee-owned company which has introduced cost and profit centers, privatized firms with highly dispersed shareholding have tended to focus their cost management strategies on savings in the use of inputs, rather than on deeper changes such as investment in new technology or fundamental organizational change.

Changes in the composition of suppliers

The composition of suppliers changed in 17 surveyed enterprises, while in three it remained unchanged (three firms did not provide data). In most enterprises, the problem lies not only in the change of the composition of suppliers, but also in forging new relationships between suppliers and receivers. Changes in the structure of suppliers are often caused by transformation in the sector of suppliers themselves, for example changes resulting from privatization and restructuring, closing of many firms, inability to catch up with quality requirements, obsolete structure of production by suppliers, and so on. Such changes also result from changes in wholesale trade and in turnover in some goods. The liquidation of many intermediary levels, especially in foreign trade, required from many firms to create new links with suppliers, to look for new, better sources of raw and base materials, as well as components.

In many surveyed enterprises, especially foreign-owned firms which made sizeable investment in modernization of production and quality improvements, the share of imported materials and components has increased. This was often due to the fact that growing market competition required from many enterprises, especially in the food and clothing sectors, a major boost of their products' quality, which in turn necessitated finding suppliers of better quality raw materials. For many enterprises, know-how transfer or purchase of modern technologies from foreign firms meant establishment of advantageous relationships or even capital links. This referred to privatized firms with a majority stake held by foreign owners, and also to engineering industry firms covered by our survey, which changed their product strategy and became specialized in the execution of orders placed by particular customers. However, technology transfer seems to occur quite frequently as a result of normal licensing arrangements, without ownership ties.

In the analyzed food-processing and engineering industries sectors, the bargaining power of suppliers declined substantially. This fact is associated by the surveyed enterprises with privatization of the economy and its opening to foreign competition. The manufacturing and financial potential of producers of both capital and consumer goods increased so markedly that in the present situation they may impose their conditions on suppliers, and the accessibility of foreign markets adds to their bargaining power.

4.2. Investment Processes

The investment decisions of surveyed enterprises reflect well the overall economic climate and the assessment of future demand. The completion of investment projects in a given year reflects the expectations and financial opportunities two or three years back. The necessity to invest depends mostly on the competitiveness of markets on which the enterprise operates, and on the toughness of the financial system in the economy. Our research has also tackled investment processes in enterprises, in particular the structure of expenditures on development in real and financial terms in 1990–96 and investment objectives.

Structure of expenditures on development in real and financial terms in 1990–96

In all the surveyed enterprises, the level of investment outlays has been increasing. In most firms these outlays account for 20–40 per cent of revenues. In some enterprises, investment outlays account for 5–7 per cent of total revenues, and in only one case the expenditures were insignificant and involved purchases of computer equipment, tools and protective clothing (a NIF company). Enterprises purchase production lines, machinery and technology and set up R&D departments to introduce new products or to modernize the already produced ones. Many enterprises spend considerable amounts of their financial assets on development of their distribution networks, purchases of transport equipment, new forms of marketing, promotion and product advertising.

Sizeable outlays of privatized firms in the clothing and engineering industries have been spent on improving the quality of production, as well as on research and development. These outlays were the highest in firms implementing ISO 9000 standards. Large outlays are also spent on buildings. Such investments usually involve modernization and adjustment of old factories. There are also new projects being carried out in this field, including construction of new warehouses, new production departments and complete plants. Such investments are mostly undertaken by foreign strategic investors in the food-processing industry. The investment in equity or stakes of other firms is insignificant. In only two surveyed enterprises are such endeavors aimed at the establishment of new relationships with suppliers of raw materials and sub-components. There is still very little room for joint undertakings of enterprises competing against each other, such as joint development of a product, creation of a common distribution network, development of new technologies or entering new markets.

Investment objectives and sources of investment financing

Investment objectives of surveyed enterprises are very convergent and not differentiated by either the ownership form or branch association. The analysis shows that the major objectives of investment projects undertaken by enterprises were improvement of the enterprise's market position, improvement of product quality and creating a new image of the enterprise and product. These objectives are equally important for both privatized firms and state treasury companies. The improvement of the market position is the key issue for most surveyed enterprises, due to increased competitiveness in the sectors in which they conduct their activities. Cash flow on current activities, issuing of shares, and commerciality are of key significance for investment financing. In all privatized firms with a majority stake held by foreign owners, funds provided by the strategic investor account for a sizeable share of investment outlays.

4.3. Market Adjustments

Before starting the analyses of the market adjustment, the investigated companies should be divided into two groups. As both the markets have different profiles, a clear division into the companies operating on the investment goods markets (firms from the machine industry) and on the consumer goods markets (companies from the clothing and food sector) is necessary to appropriately estimate the intensity of the market adjustments in the investigated companies. The contrasting profile of the markets results from the different characteristics of the offered products and the final consumers, as well as the different structure of competition on the two markets. These two markets are also characterized by different key factors determining strong market position of the companies in the long run – so-called key success factors (KSF). In addition, it should be noted that in referring to types of ownership in this chapter, firms have been divided into three categories: state-owned companies (NIF and state treasury companies), foreign-owned companies and companies privatized by Polish capital.

The respondents from the companies from the machine industry, asked to list the KSF, most frequently listed advanced technologies (seven answers among nine respondents). Next in importance, the respondents listed the quality of offered products (five answers) and production costs (four answers). Only two respondents mentioned the importance of the marketing and the well-developed distribution network.

The respondents from the food and clothing industry gave opposite responses. All respondents enumerated marketing (understood as promotion activity – sales and product and trademark promotion) as one of the KSF. In the second place, they listed distribution network and quality of the offered goods (six answers among nine respondents). Only two respondents included advanced technology as the KSF in this sector. Taking into account the above observations it should be said that the companies from the food and clothing industry make the strong market position dependent mainly on the market adjustments. According to the respondents, in the companies from the machine industry, the product adjustments play a much more important role than market adaptations. Thus, we observed a larger intensity of market adjustments in the companies from the food and clothing industry than in the investment goods group.

Turnover and sales trends

If we analyze the output in 1990s in the investigated companies in comparison with 1980s, it appears that in the most cases the production volume has decreased or remained on the same level since 1980s.

Companies from the machine industry experienced a more significant decrease of turnover than the companies from the food and clothing industries. There is only one company from the machine industry which has increased its production capacity since the 1980s. In four companies out of the nine which gave us data about the turnover in the 1980s and 1990s, manufacturing has remained on the same level. Among these companies there are two companies privatized by foreign capital, one company privatized by domestic capital and one state-owned company. The remaining four companies (three state-owned companies and one privatized by domestic capital) have decreased production in comparison with the 1980s. It is worth mentioning that the state-owned companies have decreased their output by 50–70 per cent while the company privatized by domestic capital has decreased production only by 12–15 per cent.

In the case of the companies from the food and clothing industries, we can clearly separate the group of the companies which increased their output in the 1990s in comparison with the 1980s. There are six companies in this group – four companies privatized by foreign investors and one privatized by domestic capital and one state-owned company. It should be said that this group contains the whole population of the companies privatized by foreign capital in these industries. It also observed the largest increase of output in this group in relation with the two other firms. The remaining seven companies (four privatized by domestic capital and three state-owned) have decreased the production since 1980s.

In the 1980s export was very important for the companies from the machine industry. Among ten companies which gave us data about sales directions in 1980s, half of them placed over 40 per cent of their output on the foreign markets. The percentage share of export in relation with the total production, in some cases exceeded even 75 per cent. It is worth mentioning that the companies from the machine industry exported mainly to the former CMEA countries. Export to the Western countries was marginal. Among the investigated population, in the 1980s only three companies placed more than 90 per cent of their output on the domestic market. It should also be underlined that among five companies which exported over 40 per cent of their output in the 1980s, three companies have not been privatized yet.

The companies from the machine industry were forced to look for new customers after the collapse of the markets of former CMEA countries. It resulted in increasing interest in the domestic market as well as the export reorientation to the Western markets. Therefore in the case of the companies from the machine industry in the 1990s export does not play such a significant role as it played in the 1980s. At present there are only two companies, from the investigated population, exporting more than 40 per cent of the total output – one state-owned company and one firm privatized by foreign capital. At the same time five companies place their production mainly on the domestic market – two privatized by domestic capital, and two state-owned, and one privatized by foreign investor. In contrast to the 1980s companies from machine industry export their products mainly to the Western markets. There are only two cases – a company privatized by domestic capital and a company privatized by foreign capital – where export to the former CMEA countries exceeds export to the Western countries. Additionally, there is only one company where export to the Eastern markets amounts to 20 per cent of its total output (at the same time exports of that company to the Western countries exceeds 45 per cent of its total production). However, according to the respondents, the eastern markets have increased their attractiveness for approximately two years. It is connected with the gradual increase of demand on these markets for investment goods, and larger profitability of these markets as well as the larger credibility of the Eastern contracting parties. It is worth mentioning that the companies privatized by domestic as well as foreign capital express the largest interest in the Eastern markets.

In the case of the companies from the food and clothing industry the situation seems to be different. The companies from the food and clothing industry in the 1980s were more dependent on the domestic market than the companies from the machine industry. Among the eleven companies which gave the data about the sales directions in the 1980s, five operated mainly on the domestic market (two companies did not export at all). There were only three companies exporting over 40 per cent of their total production. It is worth mentioning that all these three companies manufacture clothing products as subcontractors of Western companies. The export in the third group of companies, exporting from 10 to 40 per cent of their total output, usually did not exceed 15–20 per cent of the total production. The most important difference of sale directions between companies from the food and clothing industries and the machine industry resulted from the export orientation. Companies from the food and clothing industries in contrast to the companies from the machine industry were not so dependent on the markets of the former CMEA countries. These companies exported their products mainly to the Western countries. It was a positive heritage of the 1980s for companies from the food and clothing industries in comparison to the machine companies. In the case of companies producing investment goods, large dependence on the eastern markets in the 1980s was the main obstacle to adapting to the new economic environment at the beginning of the 1990s. According to the respondents, the export activity of the companies from the food and clothing industries in the 1980s, operating mainly on the western markets helped them, after economic transformation, to adjust their activity to the requirements of the market economy.

In the 1990s, in the case of the companies from the food and clothing industries we cannot observe such rapid shift of sales directions as in the case of companies from machine industry. This results from the much smaller earlier dependence on the eastern markets. At present, there are four companies exporting over 40 per cent of their output. Among them there are three above-mentioned clothing companies and one food company. In the case of two clothing companies the percentage of exports in relation to the total output has even increased since the 1980s. These three clothing companies still export mainly to the western markets as in the 1980s. The food company included in this group, which exported little to the west in the 1980s and nothing to the east, now exports 60 per cent of its production to the eastern markets. In the 1990s the companies from the food and clothing industries are also more interested in the domestic market than in the 1980s. Six companies among 13 companies sell over 90 per cent of their output on the domestic market. This focus on the domestic market is shared by foreign-owned firms. The attraction of the Polish market results from its size, its present and potential high rate of growth, and its high profitability. Additionally these companies were privatized mainly by international companies, which are not interested in exporting to the markets where they already operate. In the case of the food and clothing industries we can observe the gradual domination of companies privatized by foreign investors on the Polish market (especially in the case of food companies). As these companies start to squeeze out the state-owned companies and companies privatized by domestic capital from the domestic market, the latter are forced to place their products abroad or to strengthen their position on the local markets. Among the remaining nine companies, six firms started placing their surplus output on the eastern markets in the 1990s. According to the respondents, export to the eastern markets is a large opportunity for them because it is much easier to place the products there than on the more competitive domestic and foreign markets.

In contrast to the companies privatized by foreign investors, state-owned and domestically-owned private companies (with some exceptions, especially clothing companies) operate rather as local producers. Only two companies from the food industry from the remaining two groups could be consider as producers operating on the national market – one state-owned company producing vegetable oil and one company privatized by domestic capital producing food concentrates. The rest of the companies operate as local producers.

Profitability

The increased attractiveness of the Eastern markets in the last two years for companies from the machine industry mainly results from the increased profitability of these markets in comparison with the early 1990s. In the 1980s the markets of the former CMEA countries were more profitable than the domestic market. According to the respondents, in the 1980s Western markets were the most profitable but at that time the companies from the machine industry practically did not operate on them. In the early 1990s the Eastern markets become less profitable. For many companies from the machine industry export to the markets of the former CMEA countries was very often unprofitable, and many of them were forced to give up these markets. Companies had to turn their attention to the domestic, more profitable market. The strongest and the best companies from this sector started to export to the Western, most profitable markets. In the 1980s for the companies from the food and clothing industry, in contrast to the machine industry, the CMEA markets were the least profitable. At that time the domestic and western markets were much more profitable. However, respondents said that in the 1990s the domestic market was the most profitable; the western market became less profitable mainly because of the increase of production and labor costs in comparison with the 1980s.

Distribution

The types of distribution in the two investigated groups – companies from the machine industry and the food and clothing industries – are different. This results from two factors. First, the products in both sectors are aimed at different kind of final customers. The companies from the machine industry usually meet the needs of identified final individual customers. The companies from the food and clothing industries meet the demand of anonymous mass clients. Secondly, the different profiles of products require a different approach to the distribution process (in the case of the companies from the machine industry distribution of the products is connected with their assembly).

In the case of the companies from the machine industry direct sale is the most popular way of distribution. Only in two cases was the distribution system designed differently. In addition, the distribution systems in the companies privatized by domestic as well as by foreign capital should be characterized as *uniform systems*. *Mixed systems* are noted only in the case of state-owned companies. This is due to the fact that the collapse of demand after 1990 (mainly because of the breakdown of the eastern markets) more strongly affected the companies which still remain in the state hands. These companies were forced to develop secondary product lines in order to survive on the market. However, selling on new markets very often requires the establishment of the new distribution network. Without financial support and the knowledge of market conditions, these companies were forced to pass the distribution process to the wholesalers. This process was observed with different intensity among the three companies having mixed distribution systems.

If we analyze the intensity of the distribution adjustments in the investigated companies from the machine industry, we can affirm that the most advanced adjustments are observed in the companies privatized by the foreign investors. They are more aggressive in the area of direct contacts with the final customers. The companies privatized by foreign strategic investors also spend more funds and pay more attention to the organization of distribution networks and professional training on the field of product sale, and contacts with customers.

If we consider the distribution adjustments in the remaining two groups of investigated companies, we can affirm that the adjustments in the state-owned companies are more advanced than the adjustments in the companies privatized by domestic capital. This is due to the fact that the state-owned companies have had to look for new markets to place their output more aggressively than companies privatized by domestic capital. In contrast to the state-owned companies, companies privatized by domestic capital, especially companies privatized by MEBO, usually had a good economic and financial standing in the early 1990s. These companies were not so dependent on the eastern markets in the 1980s and at present usually keep the share of the domestic market that they had in the 1980s. Consequently distribution adjustments have a very limited scope.

The distribution adjustments in the companies from the food and clothing industries are much more intensive than in the case of companies from the machine industry. This results from the fact that a well-developed and well-organized distribution system is one of the most important factors determining the company's competitive position on the market (KSF). The intensive distribution adjustments play a much more important role in the food and clothing industries than in the machine industry.

As in the case of the group of companies from the machine industry, the most advanced distribution adjustments can be observed among the companies privatized by foreign strategic investors. These companies base their distribution systems mainly on the distribution channels of their owners. We also observed that these companies separated the distribution process from the organizational structure, usually by creating trade companies responsible for distribution. This allows for decentralizing the distribution process as well as increasing its efficiency.

The distribution adjustments in the case of the companies privatized by domestic capital are less advanced than in the companies privatized by foreign investors. They distribute their products mainly through the wholesalers. At the same time they are developing their own distribution channels. The least advanced distribution adjustments are observed in the state-owned companies. The distribution process in these companies is based mainly on direct sale to the wholesalers. At the same time, the state-owned companies are developing their own distribution networks to a smaller extent than the companies privatized by domestic capital.

Sales promotion and price policy

Before starting the analysis of the intensity of the sales promotion in the investigated companies once again the different profile of the two sectors should be pointed out. Promotion adjustments – like distribution adjustments – play a much more important role, according to the respondents, in the case of the companies from food and clothing industry.

The promotion activity of the companies from the machine industry is mainly aimed at public relations activity (PR) and direct contact (direct sales) with the final clients. Among the most frequent PR activities are specialist seminars and publications in trade magazines. Among the most frequent tools of direct sales are participation in trade fairs and organization of shows and travelling displays. In the companies from the food and clothing industries the situation is different. These companies mainly focus on advertisement activity (press, TV, radio, billboards, caisson) and promotion activity (competitions, tasting). PR activity and direct sales were observed only in the companies where the sale promotion adjustments are the most advanced.

The most advanced sales promotion adjustments among the companies from the food and clothing industry can be observed as in the companies privatized by foreign capital. These companies spend the largest funds on sales promotion. They also engage in much more PR and direct sales activity than the state-owned companies and companies privatized by domestic capital. Analyzing the sale promotion adjustments we can divide the examined companies from food and clothing industry into two groups. We observe a clear division, taking into account the intensity of sales promotion adjustments, between the group of companies privatized by foreign investors and the group including state-owned companies and companies privatized by domestic capital. Here, the gap between domestically-owned private companies and state-owned companies is much smaller than that between foreign-owned companies and all the others. In the machine industry we observed a similar division between privatized companies and state-owned companies. However, here the gap between foreign-owned companies (again the best performers) and domestically-owned companies is much smaller than between foreign-owned companies and state-owned companies.

With respect to the formulation of the price policy in the examined companies, we observed a clear division between privatized companies and state-owned companies. This tendency is very clear in the companies from the machine industry as well as in those from the food and clothing industries. The privatized companies formulate the price policy adopting the market price as the base price. We noticed such behavior among almost the whole population of privatized companies. There is only one exception – the company privatized by MEBO from the machine industry, having an almost monopolistic position on its market. The state-owned companies are much less advanced in the field of price policy adjustments. Among eight such companies which gave us data about the formulation of the price policy, five companies formulate the price policy adopting as the base price the production cost of the offered products.

Part 5
Financial Aspects of Restructuring

While analyzing financial matters one should bear in mind the problems enterprises encountered in the transformation period. In the early years of this period, the recession obviously contributed to the fall in profitability and to the deterioration of financial liquidity in the enterprise sector. Systemic solutions, such as tax regulations, exchange rates and customs tariffs also had their impact on the financial standing of enterprises. Moreover, intensive restructuring may lead to a temporary deterioration of financial results, which should be taken into account while analyzing efficiency ratios and financial liquidity. With this in mind, we analyze the impact of ownership status and branch association of firms on their finance, concentrating on their initial position, sources of financing, financial standing, indebtedness and problems in the field of financial management.

5.1. The Outset of Transformation

The situation at the starting point of the transformation was quite important. The analyses indicate differentiated initial positions at the beginning of transformation. Most enterprises were free of the troublesome 'legacy' of the past affecting their operation and financial standing. However, in nine enterprises adverse circumstances affected their situation later on.

The burden of the former system's legacy was experienced, first of all, by three groups of enterprises: all enterprises covered by the NIF program (irrespective of branch) and privatized manufacturers of capital goods. The most difficult situation was found in the NIF companies and foreign-owned electro-engineering companies. The former group's problems were due to the long-year delay in the field of ownership, economic and organization transformations, during which time they retained their status as companies owned by the state treasury. The two foreign-owned companies reported the heaviest burden of the legacy of the past and the most difficult situation at the starting point. One was a telecommunication components manufacturer producing obsolete, non-competitive products. The other had been hit by arrears in customer payments and the loss of the eastern market, which accounted for 60 per cent of sales. Less serious troubles were faced by two engineering industry enterprises privatized with the participation of Polish investors.

The analysis of the starting point position of the surveyed firms allows two groups of problems to be distinguished depending on their sources: external and internal, depending on the enterprise. The first group includes the loss of markets (the eastern market and some segments of the domestic market, for example, the falling demand of the mining industry). The problems caused by strategic errors made at the beginning of the transformation period include lack of industrial-commercial and organizational adjustments, wrong investment policy and inefficiency in settling inter-company debts. The troublesome legacy of the past resulted in the deterioration of the financial position. Negligence in the field of adjustment strategies, mounting balance-sheet losses and indebtedness resulted in the necessity of raising restructuring funds. On the other hand, thanks to export adjustments embarked on earlier, some firms in the analyzed sample reported good economic and financial standing. This group included clothing industry enterprises and major exporters to the European Union countries, as well as firms operating on particularly attractive markets (in the brewery or candy branches). Strengthening positive trends in the financial indicators of these enterprises was a priority target of their privatization.

Summing up, many enterprises entered the period of transformation with a legacy adversely affecting their financial position. In some firms these factors were external, in others they were enterprise-dependent (for example, negligence in the field of adjustment strategies). The financial position of NIF companies and manufacturers of final goods in the group with foreign investors gave rise to particular concern. Hence, their new owners have been faced with considerable challenges as regards restructuring and development of these firms.

5.2. Financing of Activity

Despite different approaches to the role of borrowing, it should be stated that credits were not the major source of investment financing, while current activity was supported with credits, especially when it was required by the features of activity (for example, seasonal fluctuations of production). The analysis of the entire group of enterprises points to striving at self-reliance given the high interest rate on credits. This tendency was particularly strong in privatized enterprises with good economic and financial standing, although it was present in the entire group of surveyed enterprises. However, it can be seen from the analysis of surveys that changes have occurred in the field of supporting investment programs with bank credits.

Another source of financing is the liquidation of over-expanded organization and assets, for example, through sales or lease of fixed assets, and/or changes in the profile of activities. This phenomenon was recorded in eight enterprises, both state-owned and privatized. Financial operations were also of significance in some companies. They were conducted in half of the monitored enterprises, but only in six were they a major source of financing. Privatized enterprises invested their cash flow in stakes in other firms, usually enterprises operating in the same branch and/or companies dealing with marketing and distribution of these firms' products, as well as in the shares of publicly traded companies, other securities, and time deposits.

Activity financing by borrowing

Credit was not a popular source of activity financing in our enterprises. State treasury and NIF companies reported the largest needs in the field of borrowing funds for their activity. Despite their already mentioned reluctance to borrow from banks, all these groups of firms benefited from both working-capital and investment credits. Four state treasury companies avoided credits for investment activity, but lack of external financing turned out to be a barrier to development. For several years enterprises covered by the NIF program were deprived of restructuring capital due to postponements of the program implementation. Consequently, these enterprises faced a particularly hard financial barrier to development. On the one hand, boards were forced to take credits and, on the other hand, they were afraid of being dependent on banks, and of problems with repayments. Consequently, only indispensable working-capital credits were drawn, together with loans for solving financial problems. Privatized enterprises usually experienced neither the need for borrowing funds for their activity, nor the financial barrier to development, thanks to their equity capital. This referred, first of all, to firms privatized with the participation of foreign investors. The financial potential of investors allowed firms threatened with bankruptcy to survive, and speeded up the development of enterprises enjoying good financial standing. Borrowing was limited here to small working-capital credits, while investment credits were taken only occasionally. Despite its lack of popularity, in most monitored enterprises the accessibility of bank credit was evaluated positively (they could get loans if they wanted them).

Summing up, the surveyed enterprises were cautious about resorting to credits. State-owned firms were forced to take investment credits as they run into the financial barrier of development. Private companies relying on their equity usually did not take investment credit, but supported their current operation with working-capital credits. Despite the improvement of relations with banks following privatization, bank credit remained a secondary source of activity financing.

Sale and lease of assets

The restructuring of organization and assets resulted in the intensification of getting rid of assets through sale or lease. This was most important for the manufacturers of capital goods, relatively badly hit by the recession of the early years of the transformation. In state treasury companies the sale and lease of assets were a major source of revenues. Firms from this group were characterized by the extent of their over-expanded assets. Restructuring of a defensive, austere nature was accompanied by processes from the sales of assets. Among companies in this group, only one neither sold nor leased its assets. In one firm owned by an NIF, sale (and to a smaller extent also lease) of assets was also a major source of revenue (above 10 per cent of the value of sales). In the case of companies from the foreign privatization group, the sale and lease of assets meant 'paving the way' for expansive strategies. In general, unlike some state treasury and NIF companies, privatized enterprises treated revenue from the sale of assets as a short-term consequence of regular defensive activities ('paving the way' for strategic transformations). In the former groups of firms, where radical changes had not taken place, the gradual selling out of parts of assets aging both economically and materially was seen as an additional source of financing the activity throughout a period longer than in private companies, where the funds contributed by investors allow them to speed up the restructuring.

Financial operations

Financial operations were not a significant field of activity for the monitored firms. Less than half of the analyzed companies were involved in major financial operations, and in only some of them were these operations regarded as a significant source of activity financing. In the group of state treasury companies and NIF only one enterprise (a state treasury company) conducted financial operations on a significant scale. More intensive activity in this field was conducted by some privatized enterprises. Examples include: equity investments by a brewing company, a well-known listed company operating in the textile branch, and an engineering industry company, and investment in time deposits and securities by the candy enterprise from the 'foreign privatization' group.

5.3. Financial Standing

Ability to generate profits

The analysis of gross profitability reveals an interesting and differentiated picture. The indicators for the first half of 1996 are not surprising. Privatized enterprises have better abilities to generate profits than state treasury companies and enterprises covered by the NIF program. A look at firms from the 'state' group (state treasury and NIF companies) shows similar (low) levels of profitability. On the other hand, the generally higher profitability of private companies is differentiated, as firms from the Polish privatization group record the highest profitability in the entire population, exceeding as much as three times the average indicator for the foreign privatization group. In 1995–96, the latter was the lowest in the entire sample, but has been recording a very fast growth rate since 1993.

State treasury companies are characterized by a high and increasing growth rate in 1992–94. The analysis of these companies reveals opportunities in the field of restructuring rooted in defensive adjustment strategies. State treasury companies reorganized their structures by getting rid of over-expanded assets, controlled their costs by introducing internal cost accounting and eliminated market inertia by developing marketing structures. Industrial adjustments and modernization of the productive potential were also of relevance in this context. The restructuring of state-owned enterprises stabilized at a fairly high level. This was the period of consuming the austerity effects of (largely) defensive strategies. In 1996, gross profitability declined almost threefold. State-owned enterprises deprived of external financing faced the consequences of capital barriers. A diminishing ability to generate profits is the result of a shortage of restructuring capital, as well as the exhaustion of positive effects of utilization of the existing potential.

The situation of NIF companies was different. The postponement of the program's implementation resulted in the halting of restructuring undertakings for several years. Gross profitability, low in 1992, declined below zero a year later. The implementation of the NIF program at the end of 1995 did not bring any improvement of efficiency ratios. Gross profitability dropped by 1.5 percentage points in 1995 and another 2 percentage points in the first half of 1996, when it reached the level of 5.3 per cent. If NIF and state treasury companies are taken as one group, which is justified given their long-time operation as state-owned enterprises, we shall see a gradual increase in the ability to generate profits until 1994, when gross profitability peaked, followed by a decline through the end of 1996 caused by lack of external financing.

Firms from the Polish privatization group showed, as a rule, favorable and stable profitability indicators. Interesting conclusions can be drawn from the comparison of the indicator for this group between 1994 and June 1996 and that for state treasury companies. In privatized firms profitability declined only insignificantly, while in state-owned enterprises it plummeted as much as threefold. Moreover, in the case of the Polish privatization group the decline in the average profitability ratio is caused by the diminishing ability to generate profit in only one firm (in 1995 it recorded a balance-sheet loss). There are several reasons for the high profitability of the analyzed firms in this group. Six of these firms are publicly traded companies, whose finances were solid at the time of their initial public offerings. Following their privatization, these firms enjoyed financing (issues of shares, contributions made by foreign partners) as well as promotion effects connected with their status as public companies. Generally, firms from this group recorded the highest and at the same time the most stable gross profitability in the whole sample (However, these enterprises also had the best starting point).

A more differentiated situation was found in the group of enterprises privatized with the participation of foreign investors. On average, they recorded the lowest profitability in the first half of 1996, and by far the fastest growth rate in the whole analyzed sample (the increase in the average value of the indicator for the group was almost 20 percentage points). However, the 'foreign privatization' group was not homogeneous. Two firms found themselves on the verge of bankruptcy in 1993. In both cases, profitability dropped to disastrous levels (-68.8 per cent and -79.4 per cent, respectively). Restructuring capital contributed by the foreign investor allowed them to recover from the deep collapse.

The remaining firms from this group were characterized by their stable ability to generate profits; however, apart from the above-mentioned 'convalescing' firms and one candy enterprise, their profitability declined in the first half of 1996 compared to the same period of 1995. Foreign investors interested in high rates of return in the long run were pursuing their development strategies, which incurred high costs. This phenomenon also occurred in the Polish privatization group, but on a smaller scale.

The analysis of net profitability confirms the above conclusions and findings concerning gross profitability. Better performance of 'foreign privatization' than in the case of the gross indicator results from tax incentives for firms privatized with the participation of foreign investors. In addition, the value of profitability ratios in the analyzed sample was dependent on branch affiliation of a given firm. Three manufacturers of capital goods recorded negative profitability. The improved ability to generate profits by privatized enterprises is also indicated by the return on their assets. In most firms analyzed, the return on assets declined in 1994 compared to the previous year. That year of favorable business trends encouraged optimistic forecasts, which were another incentive for modernization and expansion of the productive potential. The improvement of enterprises' financial results allowed for increased purchases of capital goods. With the growth rate of productive assets outpacing that of profits, the rates of return on assets were declining in that period.

The sharpest drop was recorded in the foreign privatization group where, despite an improvement, the return on assets was negative as recently as in 1994. External contributions made by investors were the main source of financing of the growing assets. After 1994, the return on assets in the group of foreign privatization had been growing steadily by the end of the period covered by our analysis. In the Polish privatization group, a drop in the return on sales caused by growing investment expenditures occurred in 1995. However, the average value of the indicator for all privatized firms has been growing (thanks to its fast increase in the foreign group). The indicators for NIF and state treasury companies were stable in the whole period of 1992–95. At the end of the analyzed period, the tendencies in the field of return on assets became divergent, as the ability to generate profit is quickly declining in state treasury companies, while improving in firms covered by the NIF program.

In privatized firms, the return on assets for the entire group had been growing since 1994 and for both sub-groups since 1995, which might be an indication of this favorable trend becoming permanent. Another factor of this indicator's growth was the already mentioned sale of assets, decreasing the value of the denominator of the return on assets ratio (particularly in the case of firms from the foreign group). Considerable sales of assets were also recorded in state treasury companies, although they did not affect significantly the value of the return on assets, due to the stronger downward tendency of profitability.

The analysis of return on equity confirms the higher ability to generate profits by private companies. In this regard, enterprises from the Polish privatization group turned out to be the most stable ones, as they managed to maintain high profitability and a high return on equity throughout the whole analyzed period. Favorable ratios recorded by state treasury companies deteriorated after 1995, while those of NIF companies became more favorable in 1996, which might be an indication of early symptoms of transformation. The most substantial improvement of efficiency ratios was shown by firms from the foreign privatization group due to financing from external sources and strategic adjustments made by investors. It should also be noted that the value of return on assets and equity ratios was, as in the case of profitability, branch-dependent. The most serious difficulties were experienced here by firms from the electro-engineering branch (in the foreign privatization group).

Financial liquidity

In the analyzed group of companies, financial liquidity indicators were relatively favorable. Taking into account average values for the entire sample it can be argued that they were 'model' figures. Differences were found between various groups of firms and between individual enterprises. The overall liquidity ratio was more favorable in privatized firms, being 1.5 times higher than in state treasury and NIF companies. The former recorded an increase in the overall liquidity ratio in 1995, when the value of this ratio was the most favorable in the entire period. In 1995, the current ratio in the group of state treasury companies amounted to 2.0 [22]. The decline in 1996 was to a small extent caused by the rise in short-term liabilities supporting current operations (in the case of lack of external financing). The main reason for the fall in this liquidity ratio was the decline in stocks of finished products and in available funds.

If we look at individual enterprises, the picture is less favorable. In 1995 one engineering industry enterprise had a liquidity ratio of 4.2. This figure indicates irrational management of enterprise's assets, leading to a rise in inventories and in unutilized cash flow. The later decline in the level of the liquidity ratio in the enterprise (to 2.6 in the middle of 1996) points to an improvement in working assets management. In the remaining enterprises, in 1995 the value of the analyzed ratio did not exceed 1.5 and improved in only one case.

The current ratio reached, on average, a higher level in firms covered by the NIF program. This ratio had been growing since 1992, reaching its (irrational) maximum level of 4.0 in 1994. Then it declined to 1.8 in the middle of 1996. This rise in the current ratio must be interpreted as an unwelcome development, and its later decline indicated

[22] In the literature it is assumed that the minimum value for this ratio is 2.0. See Heddenich (1988).

an improvement in assets management. The improvement recorded in 1995 was the consequence of better marketing techniques and reduced stocks of finished products. In the middle of 1996, however, the ratio fell, on average, below its welcome level. One firm still recorded a very high ratio (although it fell from 5.8 in 1994 to 3.2 in the middle of 1996), while in another firm this ratio was low (1.0), as a consequence of short-term liabilities.

Generally, privatized enterprises have the better liquidity indicators. Companies from the Polish privatization group showed the highest and most stable average liquidity ratios. Their level was particularly high in the case of publicly traded companies operating in the clothing branch, which in order to cope with competition would accumulate large stocks of finished products before the start of the season. In the Polish group, manufacturers of capital goods recorded stable levels of liquidity. One of them was characterized by excess liquidity (with the current ratio ranging from 4.2 to 5.2).

The foreign group was characterized by favorable (on average) financial liquidity. The level of the quick ratio confirms the above findings concerning better liquidity of privatized companies. The quick ratio clearly shows some slight excess liquidity of the Polish group, pointing to imperfections in managing the assets of enterprises.

5.4. The Structure of the Debt

Enterprises were cautious about borrowing, with short-term credits clearly dominating. Investment projects were financed mostly with own funds or contributions made by foreign investors. Despite the positive evaluation of the banking system mentioned in sub-section 5.3 and the availability of credits, enterprises were afraid of long-term indebtedness (due to high interest costs), and privatized firms clearly preferred relying on investors' contributions equity. The common application of working-capital credits, and their substantial share in the structure of liabilities, resulted from the specific features of branches.

The analysis of liabilities and receivables points to the diminishing role of inter-company debts. In all the monitored enterprises inter-company debts had no significant impact on their financial position in 1995–96. The most frequently repeated declaration of our respondents, confirmed by the analysis of their financial records, was that inter-company debts had been a problem in the early 1990s, but their significance had since dwindled.

Another problem here was the collection of overdue debts. Enterprises resorted to virtually all legal methods of debt collection. The most popular ones were contracts with debtors. When all other possibilities are exhausted, debtors are taken to court. Problems with overdue debts have led to the establishment of departments and teams in charge of debt collection. There is no apparent relationship between the ownership status or branch and the efficiency of solving this problem, which has lost importance over the course of the decade.

5.5. Financial Restructuring

Our analysis of financial restructuring allows us to divide the firms into three clearly distinct groups. The first of them is made up of state treasury and NIF companies. Most firms from this group concluded agreements with creditors, some with and some without debt-equity swaps. Two enterprises from this group were not taking any steps towards restructuring of their debts, which they are managing to repay without recourse to agreements with creditors.

In the Polish privatization group, the needs in the field of financial restructuring were less conspicuous. On the one hand, this was due to financing by owners, and, on the other hand, most firms from this group were publicly traded companies with good financial standing both prior to and after privatization. Among firms from the Polish privatization group only one was a party to an agreement with debtors.

In the foreign privatization group, improvement of the financial situation was secured by financing from external sources (all enterprises have been re-capitalized) and by comprehensive organizational, industrial and commercial restructuring, as well as debt reduction in firms characterized by poor financial standing.

5.6. Conclusions

In addition to the impact of initial conditions in the early transformation period on the financial situation of the entire analyzed group of enterprises, ownership status is the most important factor differentiating the sample, followed by branch affiliation. Our research has confirmed the most general conclusion outlined in other studies, namely that the best financial standing or the fastest growth rate was recorded by privatized enterprises, especially foreign-owned ones. Equity capital leads to positive qualitative changes in the operation and structure of enterprises. The condition and dynamics of financial indicators constitute a composite measure for evaluating adjustment strategies. Ownership effects are apparent in the companies' profitability and liquidity measures. Financial transfers by investors and/or new issues of shares contributed to a positive change in efficiency ratios of restructured firms or financial stabilization of viable firms, especially those which have been operating for a relatively long time as privatized companies. The indicators for state treasury companies and firms from the Polish privatization group were similar through 1995, at which point these tendencies became divergent: privatized firms have stabilized, while state-owned firms have been hit by a dramatic decline caused by the capital shortage barrier. NIF companies were in decline during several years of 'privatization limbo', but showed an improvement in 1994 – a period of economic revival. However, the following years again brought some deterioration, though it may be too early for the effects of the program to crop up in the form of improved financial results. Firms from the foreign privatization group showed a fast growth rate thanks to financial contributions from foreign investors, while the fall in efficiency ratios at the end of the analyzed period points to an increase in costs of adjustment to growing competition. Privatized firms also showed better debt-servicing ability.

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