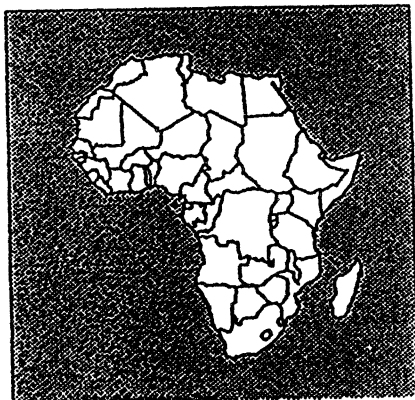


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RESTRUCTURING AND PRIVATIZATION OF PUBLIC ENTERPRISES

Edo Pirkmajer
International Center for
Public Enterprises
Ljubljana, Slovenia



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RESTRUCTURING AND PRIVATIZATION OF PUBLIC ENTERPRISES

Issues, experiences and needs for further studies

Introduction.

There is agreement among policy-makers, experts, and practitioners that the public enterprise sector has in general not performed according to the expectations which were vested into it.

The low efficiency of the public enterprises, their accumulated debts and other adverse effects on the national economy led to the conclusion that the sector needs restructuring and, in general, reduction by divestiture and privatization.

A survey of the reasons of establishing the PE's shows, that the rationale behind was manifold. Among the arguments for establishments of the state owned enterprises, or parastatals, some could be mentioned specifically:

- the need to bring the industrial and trade potential (which was owned in the time of independence of new countries by foreign companies) under national control;
- the intention to secure better and more just utilization of the national resources;
- the influence of the government on production and sale of goods essential for development of other activities;
- to secure employment and upgrade the skills of the population;
- to trigger and sustain economic development without producing socially unacceptable differences in the population and contribute to a "just" income distribution;

- to channel foreign aid and donations in equipment and plants, mainly offered by governments, to the general benefit.

Some of the above reasons were also given a militant ideological connotation, especially in countries where establishment of the so called socialist society was the dominant ratio and ultimate goal, but aside of these considerations, the above listed reasons have even today its legitimacy and form parts of the declared development policy in many countries.

It is known from experience of the last decades, that governments have only in a limited number of cases succeeded to utilize their PE sector as an effective development tool, and that the overall balance of success is doubtful, nevertheless in any reform of the PE system, the legitimate development objectives that led to its establishment should not be neglected.

2. Goals and objectives of privatization.

As an attempt to enumerate the developmental objectives of privatization the following list is suggested:

- (i) To individualize ownership

With a large number of owners, making their own decisions on their capital, be it in form of shares or complete enterprises, independent of other subjects, helps create a capital market not dominated by a too powerful, or only investor, like the state in the centrally planned economies.

It should be mentioned here that cooperatives and ESOP schemes, with rigid internal structures do not contribute to this objective.

(ii) To secure mobility of capital

The rigidity of the PE system, which prevented entering of new and exiting of old entities into and from the business world, has certainly to be considered as a main deficiency of the industrial PE system.

(iii) To introduce Profit Motivation

There is seldom a profit motivation in a public enterprise. Even in enterprises that bring revenue to the government, profitability was examined only in rare cases. In most PEs a zero profit, or a profit which could be distributed as an incentive to the management and employees was considered a success.

(iv) To mobilize savings of the population

In most countries with a strong PE sector, and definitively in "socialist" economies, there was little motivation for the population to invest in any business, and certainly not in shares of larger companies, where the ownership and management function were separated.

(v) To introduce new projects

An efficient economy is a dynamic one, where new business ideas get their opportunities to be realized. It is believed that the existence of a capital market and availability of mobile capital increases the chances for new business.

(vi) Management accountability

The accountability of public enterprise managers is often not well defined. They are accountable to the board, if one exists, to one or more ministers and governmental departments, sometimes to the political

party, or group in power, to trade unions and to general public. Each of these groups sets its own criteria for evaluation, derived from its expectations and stakes in the public enterprise. This defused accountability provides the PE manager with more freedom for his manouvering, than sound business practices would allow, or restricts him in his decisions and limits his motivation.

In addition to the above goals an analysis of the benefits of privatization should take into consideration also macroeconomic aspects, such as purchasing power of the population, foreign debts, size of the public spending etc.

The above summary should not be considered as evidence of benefits that privatization brings in each particular case, but rather as a check list against which other possibilities of restructuring in the public enterprise sector could be evaluated.

It should be added, that privatizations of the enterprises calls also for profound changes in the public administration, especially if privatization of the enterprises that enjoy a monopoly position in the market is concerned. Privatization of infrastructure such as telecommunication, for instance, requires a well trained public administration and development of sophisticated methods, by which the government could inforce the quality standards and protect the costumer.

Even in the fields, where there is no monopoly, governments have to assume new responsibilities. Public enterprises were often entrusted with task of developmental nature, such as promotion of new methods in agriculture, training of the population, housing, certain social services and similar. It can not be assumed, that this activities be fully taken over by a privatized enterprise, unles the government pays for it, as for any other service rendered by a private enterprise. It is more likely, that the government will have to develop a special service to take care for such aspects.

3. Some issues on privatization techniques

Attention will be drawn to some aspects which are present in Central and Eastern European countries in connection with the privatization techniques, and which might have relevance also for other countries where privatization is practised on a less massive scale. They will be mentioned only briefly and interested experts are invited to consult other sources. The author and ICPE would be glad to provide reference.

(i) Compensation of previous owners.

Some of present public enterprises originate in nationalized private industry. The question arises, to what extent the previous owners should be compensated in the privatization process. Different solutions have been designed and implemented.

(ii) The supply - demand issue.

If the market supply of capital in form of enterprises or their shares to be sold by the government exceeds the demand in form of available cash by the domestic population, the possibility of low price sales is evident. A particular issue in this connection are foreign potential buyers. The question arises to what extent should the government dump on the market its capital and to what extent and for what period of time should it retain its ownership. Solutions with free distribution of capital to the population, management buy-outs, ESOP schemes, preferred shares retained by the government etc. are being practised.

(iii) Business valuation.

How to set price to a business on sale. Dynamic methods of business evaluation and valuation of assets are practised. It is believed that business valuation is important also from the point of view of

performance evaluation of an enterprise in public as well as private sector. A report on a conference on these issues prepared by D. Mramor is annexed. (Annex 1)

(iv) What method of sale should be applied?

Direct negotiations, public bidding, sales over the stock market, ESOP and MBO schemes are being considered. Conditions on investing fresh capital into the business, strategic alliances and retaining the work force are often part of the deal. No single method is applicable to all cases, an adequate combination is essential to take care of all economic and political implications.

(v) How to prevent illegitimate gains of individuals and groups?

Issues of the so called "black" or "wild" privatizations where individuals or groups divert business from the public enterprises into their private business, provoke bankruptcies of public enterprises, manipulate the valuation to gain as buyers etc. are in focus of several countries in Eastern and Central Europe.

4. Assistance to enterprise restructuring

In this chapter some issues on assistance that could be provided to the public and privately owned enterprises to meet the challenges of the competitive world are mentioned. The interested readers are referred to papers that are given as annexes to this contribution.

- (i) Entrepreneurship development as a part of the restructuring process.

In 1991 a conference was organized by ICPE, ILO and INTAN in Kuala Lumpur on New Initiatives in Entrepreneurship Development. The papers presented dealt with entrepreneurship support systems provided by governmental and nongovernmental organizations. They were published by ICPE in Public Enterprise (Vol. 12. Nos. 1-2). The Editorial Introduction by I. Pavlin, giving the summary of the findings is reproduced as Annex 2.

Issues on spin offs, ancillarization, contracting out and similar are important in connection with restructuring of the public sector.

- (ii) Franchising as a tool to entrepreneurship development.

Franchising as "entrepreneurship by imitation" has come into the focus of attention in connection with upgrading the business in the service sector.

An activity brief for an international seminar on Franchising and Entrepreneurship in Transitional Economies to be held in June 1993 is reproduced as Annex 3.

- (iii) Revitalization of enterprises for greater competitiveness

The lack of adaptability to the challenges of the changing market environment has been for a long time identified as one of the weaknesses of the public enterprises. The change in the ownership structure alone, does not guarantee any improvement in the competitiveness. The experience on a project carried out in Slovenia, together with the experience from some other countries has shown, that mechanisms to

trigger turn around processes, could be designed and implemented. Annex 4 is a reproduction of a short and preliminary project proposal to this effect prepared by. T. Petrin for this conference.

The above three examples of possible assistance to the restructuring processes suggest, that privatization of the economy is not necessarily limited to privatization of the existing public enterprises, but includes also providing stimulation for new private enterprises to be set up.

5. Conclusions and proposals

The analysis of the reasons for establishing a dominant public enterprise sector in African and other countries, as well as consideration of the failure of this sector to achieve objectives for which it was established suggest that the decision of the governments to reform it has to be followed.

The solution to the problems of the public enterprise sector is not a single one and governments have to develop their own strategies how to tackle them. Privatization is among the important options, however, it has to be accompanied by measures that would enable the government, the private enterprises and the entrepreneurs to assume their responsibility for economic success of their operations and benefit of the population.

There is definitely a need for joint efforts of the African and world community to speed up the economic development of African countries. Issues connected with the present public enterprise sector are certainly of vital importance in this connection.

An activity plan will have to be drawn up and the community of experts interested in research, designing models and their implementation has to assume its share in the efforts.

Several joint projects could be envisaged that could provide a mechanism for transfer of experience among the countries concerned. The attention of the governments could be called to the potential which exists in the African and other experts, willing to assume responsibilities. African countries could profit from the knowledge accumulated in other regions, the solutions to the typical problems experienced in Africa and particular countries however will have to be designed on a case by case basis, to meet the particular requirements of the environment for which they are intended.

It is expected that Conference identifies some topics for possible research projects and modalities for their implementation.

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R E P O R T

PREPARING ENTERPRISES FOR PRIVATIZATION: BUSINESS APPRAISAL

(Workshop: Bratislava, October 25-26, 1991)¹

This workshop was held in Bratislava, Czechoslovakia, on October 25 and 26, 1991 with 40 participants from 14 countries (Eastern and Central European, Turkey, France and U.S.A.) and 10 observers from Slovakia. Participants were mainly representatives of agencies or ministries for privatization and representatives of consulting firms and research teams with experience in business valuation in former socialist countries.

The workshop was divided into four sessions. In the first session the question whether business appraisal is necessary and desirable in the process of privatization of state or social capital, was discussed. The second session focused on ways in which a consistent institutional and regulatory framework for business appraisal for the purpose of privatization can be set up on a national level. The third session was devoted to the exchange of experiences on the problems, solutions and lessons arising from practical applications of business appraisal in the region. And in the fourth session, an action plan was proposed concerning regional cooperation in the areas of training, licensing and

¹Names mentioned in the main text of this report (not in footnotes) are those of the authors of papers prepared for this workshop.

business appraisal practices (information, data, problems and solutions).

In the first session it was stressed that there are several advantages of applying a rigorous, clear and open business appraisal in the privatization process. At the national level it offers a control mechanism permitting a regulated but decentralized privatization process while ensuring its transparency, propriety and legitimacy.

Beside value, a consistent appraisal process provides at the enterprise level (in most cases for the first time) a set of data and information on past performance, current position and future prospects of the firm, necessary for its informed decision making in the emerging new economic environment. It also provides the managers of firms with a first encounter with "the managing for value" philosophy that prevails in market economies. A large majority of managers from these countries engaging in market transformation have inadequate knowledge and experience in operating in a market environment. For this reason, a strong involvement in the process of business appraisal, lead by professional appraisers, is the first thorough learning experience of these managers in analyzing their company, estimating future business prospects and determining the influence of their business decisions from the perspective of a new market environment and new goal of the company - maximization of its market value. These aspects are analyzed in Dr. Kenneth Zapp's paper.

On the other hand, the discussion led to a general consensus that the application of rigorous business appraisal has serious constraints that threaten to postpone the privatization process. The data and information on enterprises to be privatized are either not available or unreliable and inadequate to allow direct use of standard business appraisal approaches, methods and procedures. Moreover, there is a serious lack of local appraisal skills

and know-how, while foreign appraisal firms are expensive, lack understanding of the regional specifics and cannot meet the enormous demand in the region. Depending on the seriousness of the problem, the countries have opted for different approaches, which range from accepting book values as the basis for the privatization transaction to enforcing rigorous valuation principles. Some models of privatization (i.e., free distribution of shares) postpone, for the sake of fast privatization, the problem of business appraisal to the period after the privatization is done.

The discussion by the representative of Treuhandanstalt (a German Agency for Privatization), Mr. Eberhard Sinnecker, distinguished the East German situation from the rest of the countries. He emphasized two major differences. First, experienced managers are available in the western part of Germany which reduces the need for thorough independent business appraisal for the purpose of preparing the ground for a turnaround of companies (assessing business position and perspectives as well as educating managers). The clear point was made that contrary to the general notion that available capital makes the case of former East Germany different from other former socialist countries, available management skills are even more important. Second, the political decision was made that the speed of a "turnaround" is much more important than the issue of (unfair) redistribution of wealth. Therefore, enormous decision making power concerning privatization process was granted to Treuhandanstalt, which is not a case in other countries.

In his paper² and the discussion, Dr. David Young stressed that the problem of business appraisal cannot be avoided, as the concept of value is an element of the core logic of market economy. In his opinion it would be beneficial for the turnaround process of privatization if

²The second half of his paper refers to session three.

business appraisal was done when enterprises are being prepared for privatization. In this way, the turnaround process would have a much better basis and therefore better prospects for success.

On the other hand, Dr. David Ellerman warned that privatization should be done quickly and a thorough business appraisal may postpone this process. Namely, the deteriorating economic situation in these countries is partially a consequence of "wild" privatization. Managers of the state (social) companies are redirecting income from the state into their private companies (pockets), they are leading state companies to bankruptcy to buy them cheaply later, etc.. He suggested that a preliminary business appraisal should be done before privatization. Thus, the first basis for value would be established, and it would be corrected later on the basis of actual business performance ("Variable Pricing"). In this way business appraisal could be done faster and also the privatization transaction could be achieved quicker as the risks concerning the inappropriate price of a privatization deal would be lower.³

It was a general consensus of the first session that business appraisal is needed in the process of privatization. As dr. Church Lewis (moderator of this session) stated, it is not necessary only for the reason to sell the equity share of state or socially-owned enterprises (outside view), but also to answer the questions for the management - what is the business position of the company and what are its prospects (inside view). This view does not completely apply to former East German companies.

³Dr. Gultekin and dr. Mramor supported the general idea of "Variable Pricing". However, dr. Gultekin suggested the use of special financial instruments in its implementation and dr. Mramor suggested that the price should change only if certain events occur that are of an important and external nature for the management of an enterprise.

On the basis of this conclusion participants discussed in the second session issues concerning the development of an efficient and highly professional institutional and regulatory frameworks for business appraisal on the national levels. The first part of this session was devoted to an overview of the present situation in the U.S.A., Germany, Slovenia and other countries.

Presentations of the present business appraisal institutional and regulatory framework in the U.S.A by dr. Shannon Pratt and in Germany by dr. Burkhard Hense revealed basic differences. While in the U.S.A appraisal practice has been developing as an independent profession, in Germany it is a constituent part of the auditing profession. This difference has a big impact on the past approaches and methods used in business appraisal in the U.S.A. and Germany. While the U.S.A business appraisers are more market oriented, German appraisers are more inclined to an asset-based approach. At present German practice is quickly converging to the U.S.A. practice.

In the case of Slovenia, dr. Marko Simoneti explained how the Agency for Privatization of Slovenia recognized that for the purpose of privatization no one (simple) method can be prescribed as adequate for business appraisal of all companies. Also, it was obvious to the Agency that in many cases the seller of social capital has the same goal as the buyer or has no motivation or resources (not enough qualified professionals or not enough money for foreign consultants) to act as an opposing party in the privatization transaction. Therefore, the Agency decided to develop a business appraisal profession in Slovenia⁴ with training and regulating it through standards and principles of business appraisal practice, valuation commission and licensing. High standards are set for obtaining the license,

⁴It is actually developing the real estate and machinery and equipment appraisal profession as well.

and help and support of the American Society of Appraisers (ASA) is in this respect very important.

In the discussion, representatives of all other countries expressed almost the same need for the development of a business appraisal profession in their countries to ensure a smoother process of privatization. At present, most of the countries have no institutional or regulatory framework of this kind (except Germany). Croatia, Poland and Slovakia have certain regulations/guidelines concerning valuation methods while most of the countries rely heavily on big foreign consulting firms to transfer their knowledge and experience to local business appraisers. In most countries a growing number of private local consulting firms offer appraisal services for the purpose of privatization (in Hungary over 200 local firms) but the course of events suggests that the quality of service of many of these firms is questionable. A rigorous system of training and licensing would help to raise the quality and distinguish between these firms, as well as foster the development of country specific solutions in this field.

In the third session it was a common view, that no special approaches to business valuation for privatization in the former socialist countries should be invented. Namely, for the purpose of privatization the main logic of business valuation is in these reforming countries the same as in the developed market economies. Therefore the income based approach should be the basic one⁵. However, because of the great uncertainty about the future political and economic environment, nonexisting capital markets, lack of adequate information and data etc., there can be only a limited use of the many methods available and used in developed market economies.

⁵There are many ways in which this general approach is named: dynamic, prospective, income, earnings, cash flow etc.

One can summarize the paper and discussion of dr. Dušan Mramor in the following way. Because of the different economic system in the former socialist countries, existing data and information are not directly applicable in business appraisal which is to be prepared from the perspective of a future private owner. Therefore, the task of a business appraiser is to extract data and information needed (as many and as reliable as possible) while using standard business appraisal methods developed in the market economies. Extensive original research into the specifics of these economies and their influence on the performance of the companies (from the perspective of equity investors) is needed for the best possible results. This approach is presented in his paper using the case of business appraisal of a Slovenian foreign trade company.

Some other cases were also presented (Hungary, Czechoslovakia, Poland) and they all followed the same logic as explained above, although the problems encountered in different countries were to a certain extent different. From the perspective of developed market economies these problems concerning business valuation in former socialist countries (no capital market, no labour market, no free market for goods and services, nonapplicable accounting system, etc.) are sometimes so big that "no secure and reliable figure of value can be obtained" as stated dr. Burkhard Hense, but as he continued "there is no alternative".⁶ Problems have to be solved in the process of business valuation to the biggest extend, while some of the remaining problems could be dealt with in a form of "Variable Pricing".

In the fourth session participants agreed that the governments of Central/Eastern European countries are confronted with a double task of setting up adequate

⁶In his paper he explained what problems German auditors encountered when preparing an opening balance for all former East German companies according to International Accounting Standards.

institutional and regulatory frameworks for business appraisal as well as of promoting R&D on the regional specifics of business appraisal along with training a sufficient number of local appraisers. Therefore, it would be a big help to these governments if a mechanism within a region would be established which would enable them to share experience and know-how and to undertake regional programs on business appraisal training and licensing. As a first step it was agreed that a special training seminar will be organized in Ljubljana, Slovenia at the beginning of 1992 for specialists in business appraisal of these countries, who could then further train their local appraisers. In the process of obtaining internationally recognized designations for Central/Eastern European local business appraisers, ASA offered its support by organizing its chapter(s) in Central/Eastern Europe.

Dr. Dušan Mramor
Workshop Coordinator

EDITORIAL INTRODUCTION

In 1989, the thematic edition of the ICPE journal on **Leadership and Motivation** presented the whole range of issues of entrepreneurial organization structure and entrepreneurial leadership on the public-private enterprise continuum. The ILO/ICPE publication on **Entrepreneurship Development in Public Enterprises** studied cases of successful public entrepreneurs and of selected forms of entrepreneurship development, such as management and employee buy-outs, and reflected upon regional and enterprise-based incubators for the development of small businesses.

(1) The current volume of PUBLIC ENTERPRISE is devoted to **support mechanisms for entrepreneurship development** from the perspective of greater or lesser involvement of the Government and the public sector. It studies the following phenomena:

- legal and macroeconomic conditions and ownership structures conducive to entrepreneurship development;
- industrial restructuring, employment policies and entrepreneurship development strategies through spin-off, contracting out, etc.;
- small business in the turbulent environments of developing and post-socialist countries;
- the phenomenology of success stories of socialist entrepreneurs, or the *modus vivendi* of entrepreneurs in socialist economies,
- forms of entrepreneurship support mechanisms introduced through legal and regulative frameworks, institutional setups, funding services, information, training and consulting assistance for small business development;
- the role of the State, large enterprises and public-private partnerships in the development of small and medium-sized business.

Many of the above issues were discussed at the workshop on New Initiatives in Entrepreneurship Development organized jointly by ICPE, ILO and INTAN (National Institute of Public Administration, Malaysia), from 19 to 22 August 1991 in Kuala Lumpur.

The workshop participants were senior officials from public sector agencies and ministries involved in entrepreneurship development and industrial restructuring. The participants came from Canada, China, the Czech and Slovak Federal Republic, India, the Republic of Korea, Laos, Malaysia, Mongolia, Singapore, Sri Lanka, Thailand, Vietnam and Slovenia, from the ILO offices in Geneva and Bangkok, from ICPE in Ljubljana and from ESCAP in Bangkok. The workshop contributed towards international networking in terms of sharing resource expertise in research and training and exchange of information on the subject. This is also an objective of this thematic edition of PUBLIC ENTERPRISE, which includes papers presented

at the workshop. In addition, we commissioned or selected a number of other articles to complement the material presented at the workshop.

The reader will note that there is a comprehensive chapter with contributions from several authors on entrepreneurship development in Slovenia. Slovenia is a tiny state, the host country to ICPE. In the recent past it has witnessed most of the dramatic historic changes which are taking place in other parts of Europe. After a political revolution and democratic elections, Slovenia declared its independence last year. This was followed by a short war with the Yugoslav army, and finally by full international recognition and membership in the United Nations. The heritage of the former Yugoslavia was added to the tradition of Slovenia's association with the Austro-Hungarian empire. Of all former socialist countries Slovenia occupies the most western position. Its economic and cultural windows have been wide open to the West since the fifties. Slovenia has had entrepreneurial experience of trading and business links with Western countries for decades.

(2) How were business ventures able to **succeed** within the socialist system, in terms of strategic position, long-term profitability and growth? The **monopoly** position that a "successful" enterprise achieved was supported by the political power of its management, which operated a socialist mastership style of management, easy access to subsidies, protection from foreign competition by import barriers, relative freedom for exporting firms, which also had the benefit of being able to learn to do business abroad, absence of strict anti-monopoly and disclosure regulations, absence of strict accounting standards, a soft approach to cost reduction, and increase of productivity. All of this led to a reluctance to embark on innovation (Vácha, Pavlin).

For example, Slušovice, one of the showpieces of the Czechoslovak economic system, which had somehow escaped the rigidity of the centrally planned economy, is now fighting for its life. Based on the local industrial tradition, and operating on principles of modern management and a simulated internal market of production factors, Slušovice had become a controversial success. Since all economic activity in the socialist system had to be undertaken against the current, this was also so in the case of Slušovice. The result had led to gains all round, gains for the employees and even more gains for the managers (Vácha), who have now been accused of fraud and corruption. As members of the former communist party, many of them are considered unsuitable for future managerial positions.

In the transition from socialism the basic premises of the privatization process were definition of legitimate ownership, introduction of a legal system based on market principles and mobilization of entrepreneurial and intrapreneurial behaviour among the newly established domestic owners and the public at large – citizens, employees, and managers. In large enterprises there is now a political struggle between those who are clinging to power and who want to continue with old-style management, and the people who have ventured to become new owners, either through restitution or by appropriating state, social or nobody's property (Vácha, Pavlin).

One of the difficulties in the transition process in many socialist countries is that the managers, who had been appointed by the communist party, played

a key role in the privatization process. In the preparatory stage before privatization **managers** were able to use the **power of their position** to select the method of privatization and the future owners, and often they selected themselves. They have been able to retain their influence through dispersed ownership, transitional public or state ownership with the benefit of subsidies, or they have found foreign speculative owners who helped them to achieve ownership of the company, or shielded them against political supervision of the privatization process (Vácha).

Thus often the managers are only formally accountable to inexperienced provisional boards and they tend to make full use of the status of newly acquired ownership coupled with technical, managerial or only positional power.

The views of the participants of the Malaysian workshop on the subject of foreign direct investment or joint ventures with foreign companies as one of the possible strategies for promoting entrepreneurship development are shared by the Government of Czecho-Slovakia, which invited the world's best companies to join in projects for privatization, which speeded up the attainment of western standards of production as well as management know-how and know-who.

Post-socialist entrepreneurship can be analyzed using the concepts and models of developed market economies, but the outcome will not be the same as in market-based economies. Large-scale enterprises that have been transformed and privatized and enterprises in transition would have to change in terms of decentralization and the adaption of their organizational structures, human and financial capital to market signals. However, there is a danger that they will become stuck in a permanent transitional stage because of macro-economic turbulences and persisting rivalries (Vácha, Pavlin, Deškovič).

The real trap threatening such transitional enterprises is an inability to follow market signals when these indicate that labour is too expensive, that production and administration costs are too high and productivity is too low.

A case that could serve as an alternative model for restructuring and entrepreneurship development in developing and post-socialist countries is that of the TAM truck factory in Maribor, Slovenia. Here a **spin-off strategy** was adopted to create autonomous entrepreneurial "satellites" – new enterprises whose diversified activities and more flexible management will enable them to survive and to prosper under the new conditions. This relieved the core business of activities which required more effort to maintain than their services were worth to the company. The activities were contracted out to private entrepreneurs who have so far been able to operate the new businesses without a massive layoff of labour (Deškovič).

(3) In socialist countries, but also in many developing countries, the public sector touches every aspect of life. This tended to lead to a dampening of its sense of responsibility and the public sector enterprises often became inefficient giants, government control was constrained by rampant corruption, which lubricated the wheels of allocation, distribution and licensing. At the

same time the psychology of scarcity was sustained by the politicians. In this situation, calls for denationalization and restructuring of public enterprises finally moved the sector to seek ways and means to meet competition (Juneja).

With regard to the entrepreneurial aspects of public enterprise, it is generally agreed that although public enterprises should be run like private businesses, losses should be permitted in exceptional cases where the need to subsidize a particular sector, e.g. the provision of public transport, housing, etc., is clearly indicated in advance. In such cases losses should be anticipated and minimized and subsidies should not be considered only after the losses are incurred.

The case of the privatization of public transport in Sri Lanka revealed that the contract went to the company which requested the lowest subsidy, which is one way to retain the competitive element in subsidized activities. Subsidies can also be given at a declining rate.

In the case of Singapore, the fact that a company had received a start-up grant did not imply that it could continue to make losses. In the public health sector losses were minimal, as they were balanced by paying patients. In the housing sector, those who qualified for larger homes subsidized the cost of lower-priced housing. The same was also true for the public transport system, although the Government set a price ceiling.

In many Asian countries governments have tried to manage joint ventures by negotiating a compulsory domestic content and invariably "forced" the foreign companies to work with local sub-contractors. In the case of Singapore, only multinational companies (MNCs) with knowledge and technologies useful to Singapore were given incentives to set up shop there. At the same time, workers were sent overseas for training so that these equally skilled locals could be offered to the MNCs at lower prices. MNCs were encouraged to make profit, for this in turn helped to raise the incomes of local workers.

Furthermore, instead of establishing new facilities, the Singapore Government has also identified and is financing, from funds specially collected for this purpose from enterprises, the development and extension of existing capability at training institutions.

The main reason for the MNC investments in South-East Asia was the availability of skilled labour, and not generosity in providing training for the locals. MNCs were interested in utilizing entrepreneurial talent, and not in developing it. MNCs avoided training at all costs, but if governments identified areas of interest to MNCs and made staff training a requisite, then these MNCs could be committed to HRD, as in the cases of Singapore, Malaysia and Indonesia. In fact, MNCs were also willing to help small and medium industries which served their interests. Following a special scheme MNCs helped upgrade the skills and managerial know-how of medium and small industries, to make them more efficient in supplying quality products to the MNCs. In fact, MNCs invested in Singapore because of the existence

of supporting industries. It was suggested that there should be no compulsion for the MNCs to use local inputs at the initial stages; local content could be introduced gradually.

Other criteria applied by MNCs were political stability, the existence of an appropriate infrastructure and tax incentives – cheap labour is no longer a criterion unless it is available in combination with the factors mentioned above.

For the emergence and functioning of small businesses in post-socialist economies the same holds true as for the privatization of many large businesses: changes often do not come in a manner regulated and prescribed by the State, but spontaneously. Slovenia is a typical example, entrepreneurial reform emerged more as a political project than as an economic option or a business decision.

The awareness of the need to create an appropriate economic and psychological environment for the development of small and medium-sized business (SME) is now widespread in countries like Vietnam and Mongolia. The policy makers in these countries are fully aware of the fact that there is no sense in introducing entrepreneurs into a non-market environment. The question is what comes first. How can the capital for start-ups be accumulated and how can entrepreneurs using domestic raw materials be given the advantage of public assistance? The idea of building a nucleus of SME entrepreneurs has become common in many post-socialist and other countries.

Among the key questions that are being asked in connection with the promotion of SME sectors in more advanced developing countries such as Malaysia are: What are the competitive advantages of the sector and how can they be achieved? Can they be achieved through better absorption of the best available technology, use of contemporary management approaches and international marketing?

SME development support systems can be either consciously directed towards **different segments** of small entrepreneurs or, depending on the nature of the supporter, specialized. They may also be quite unconsciously biased towards one particular group. In countries which at one time in their past already had an entrepreneurial tradition we sometimes meet the idea of the entrepreneurial class as a **Sleeping Beauty** – all that needs to be done is to awaken her, give her some tools, and her business will flourish. This idea is close to the western tradition of focusing on and glorifying “hero entrepreneurs”. However, the hectic reality of inadequate value systems and inadequate legal and macroeconomic environments has shown that everywhere in the world there are different situations and different groups of entrepreneurs which require differentiated treatment by different subjects (Pavlin).

In post-socialist countries **craftsmen**, who often play a specific cultural role, are the survivors of the only legalized private business sector, besides the omnipotent social or public sector. They often have a different view of business and growth than the new class of rapidly emerging **educated**

entrepreneurs. Another category are the former managers of restructured and privatized businesses or technological and organizational innovators, small traders and financial dealers (Tibor, Pavlin).

When speaking of the transitional economies, one of the critical differentiations which should be made, but is often neglected, is between **start-ups** and already **established businesses**. The fact that the former predominate in post-socialist countries calls for specific policies, which cannot be the same as those for start-ups in well-run market-based economies. There should also be a differentiation between **small firms with growth potential** or already growing firms, such as for example Lestro (Pavlin) and **livelihood entrepreneurship**, which is often linked to the informal sector. There are also specific groups of entrepreneurs requiring tailor-made policies, for example innovators, those requiring a **technological base, export-oriented small firms, and imitative entrepreneurs**, such as franchisees. This wide variety will obviously involve different segments of government and calls for different approaches to entrepreneurship development in terms of training, consulting, financial, informational and other types of support (Pavlin, Thomas, Hashim, Juneja).

Those people who welcomed the transplantation of the *laissez-faire* approach to entrepreneurship development from the developed market systems of the liberal economies to post-socialist environments may not be impressed by the need to design a redeployment strategy for restructured public enterprises. The case from India, where various entrepreneurial opportunities for reemployment of laid off labour and management are considered, may be interesting also for other countries undertaking massive restructuring and ownership changes of public enterprises (Juneja).

The basic difference in orientation between employment objectives and profit objectives may not be controversial, as growth potential and employment generation capability may not be mutually exclusive. Nevertheless, today we are confronted with situations where a large portion, sometimes the majority of a generation of young school leavers, on top of the 15 to 30 % of the adult unemployed population, cannot find employment in the industrial or other sectors in the area in which they live. In such situations the simple hero entrepreneur development approach may not be the only paradigm of entrepreneurship development. Small business development and the development of self-employment skills may indeed be given impetus by the need to generate employment (Pavlin, Tibor, Smole-Grobovšek).

The perspective of regional and community development is another aspect which is often related to the discussion of entrepreneurship development, and specifically to the development of small businesses. Government support systems may not always reach those for whom they were designed. Due to inherent weaknesses, SMEs are often unable to take full advantage of government assistance schemes. To avoid this the SMEs in Singapore cooperate through self-help intra-industries communities which help them to become more competitive (Chong, Thomas).

It can be concluded that a comprehensive national strategy for entrepreneurship development from the perspective of government would have to integrate:

- the involvement of government, its institutions and government-established specialized non-governmental agencies for entrepreneurship development at the national, regional and local levels,
- the entrepreneurial revitalization of public enterprises and their support to entrepreneurship development through ancillarization, contracting out, spin-offs and other approaches, and
- public-private partnerships and networks to support and develop small businesses.

Igor Pavlin
Guest Editor

Ljubljana, 16 December 1992

**International Center for Public Enterprises (ICPE)
the European Franchise Federation(EFF)**

**INTERNATIONAL SEMINAR ON
FRANCHISING AND ENTREPRENEURSHIP IN
TRANSITIONAL ECONOMIES**

Ljubljana, June 14-16, 1993

ACTIVITY BRIEF

1. Background

Entrepreneur is not a brave lone rider on a white horse, although he has learnt how to use opportunity, cope with risk, innovate. He cannot achieve his objective without knowledge, even if he has stamina and capability to overcome obstacles. Would-be entrepreneurs and development bureaucrats from transitional economies may have to learn from success and failure stories of developed countries and in their own environments.

An intermediary multi-functional tool to assist local entrepreneurs, both franchisers and franchisees, to solve problems of economic adjustment of post-socialist countries can be franchising business concept:

- Entrepreneur may get support where he faces obstacles;
- Productive employment can be found for hundreds of managers and skilled persons who are perceived as redundant;
- Existing industrial and trade companies with known brand name, facing programmes of rehabilitation, restructuring, and privatisation may be acquainted with an alternative strategy, i. e. franchising;
- International business cooperation may develop;
- Vital injections of managerial skill and world tested business practices under well known brand names may become a spearhead of local business in many areas;
- National and export income can be increased.

There is a growing realisation of efficiency and high survival nature of franchising business. Governments of post-socialist countries have gradually realised that it can be used as an element of their economic development policy. It can promote rapid growth of small businesses, raise the overall level of business practice at a fast pace. As such, it is well suited to the economies in the process of economic adjustment, ownership transformation, industrial restructuring with scarce managerial and capital resources. This applies both to development of local franchises as well as to import of foreign franchises.

ICPE has devoted a major part of its activities to the subject of entrepreneurship development, including the work which resulted in the ICPE - ILO publication on Entrepreneurship Development in Public Enterprises (1991), followed by the thematic edition of ICPE journal on Entrepreneurship Support Systems (1992). A series of policy-level seminars related to entrepreneurship development have been initiated.

A major event in this field was the International Seminar on Franchising and Entrepreneurship in Asia and Europe. It took place in New Delhi, October 14-16, 1992. Experts from countries with rich experience in franchising business were invited to share information with other government officials and businessmen from post-socialist and developing countries. Members of the European Franchise Federation, international consultants specialised in entrepreneurship development and franchising and practitioners in franchising business were among participants. Several interesting cases were presented from the perspective of national economy, individual business practice, and perspective of advertising specific franchising offers.

Most post-socialist countries have acquired limited experience in franchising. Faster pace of introduction of franchising would require building of proper business environment. This includes development of suitable macroeconomic and policy conditions and development of legal, regulatory and institutional framework. Prior to that, policy makers, local businessmen, entrepreneurs and public at large may have to be properly acquainted with the concept, philosophy and achievements of franchising practice.

As in the area of privatisation, there are cases of successes and failures. Failures arise mainly from inappropriate environment, misunderstanding of the concept of franchising and starting "quasi" systems of franchising.

Central and East European countries have shown interest in organising a seminar on franchising tailored to the needs of transitional economies. Responding to this an international Seminar on Franchising and Entrepreneurship in Transitional Economies is being organised at Ljubljana, Slovenia, from June 14 to 16, 1993.

2. Seminar Objectives

- o Contribute to dissemination of knowledge on franchising;
- o Building awareness of the potential of franchising for local entrepreneurship development, employment generation, raising standards of production, improvement of channels for distribution of consumer goods and services, and safe/rewarding investments;
- o Exchange of experience through analysis of current practice;
- o Review of Government strategies, legal and institutional arrangements;
- o Propose recommendations for Governments;
- o Provide opportunity for business offers of franchisers;
- o Provide facility for franchising consultants and legal experts to meet respective business and Government partners;

3. Contents

The seminar will discuss the following subjects:

1. Introductory part

- o What is franchising: franchiser, franchisee, consumer;
- o Franchising in developed countries: European focus;
- o Franchising, entrepreneurship, innovation and employment in selected newly industrialised and developing countries;
- o Franchising in transitional economies and related phenomena.

2. Presentation of national experience:

- Franchising systems, major areas, experience related to positive arrangements and deficiencies in the environment, problems of franchiser-franchisee relationship, new projects;
- National objectives and policies related to franchising (entrepreneurship, employment, income generation, transfer of know how and technology etc.) and local, import/export franchising systems;
- Legal framework applicable to franchising;
- Institutional component of support to franchising development (promotional and consulting and technical assistance institutions, associations, financial institutions) and their specific arrangements;
- SWOT analysis of promotional activities of franchising;
- Projection of future development in this field.

3. Case studies of individual franchising systems/franchises:

- Profile, basic information on franchiser and franchisees;
- Cases of "fake franchising";
- Brief historical overview;
- Franchiser - franchisee relationship - agreement, prospectus;
- Major achievements, strengths and weaknesses;
- Development prospects.

4. Concluding part

- o Referral service and clearing house arrangements on franchising in transitional economies at ICPE and EFF: bank of documentation and case studies, occasional meetings of various actors in the franchising processes, and promotional activities;
- o "Franchising exchange".

Conceptual and analytical papers national and individual business case studies will be prepared as indicated in this Activity Brief.

4. Participants

Participants will be franchisers, entrepreneurs involved in franchising arrangements, franchising consultants, Government officials and financial/banking specialists connected with franchising, representatives of respective international organisations, franchising associations, and small business development experts.

5. List of potential co-sponsors of the seminar:

- International Labour Organisation
- World Bank
- Economic Development Institute of the World Bank
- French Franchising Federation
- Dutch Franchising Federation
- Italian Franchising Association
- Hungarian Franchising Association
- Hungarian Franchising Institute
- Chamber of Economy of Slovenia
- Austrian Franchising Association
- International Trade Centre

6. Organisational and financial arrangement

Basic organisational work will be undertaken by ICPE in consultation with EFF. Funding support will be sought from international and local organisations, and business concerns.

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Prof. Dr. Tea Petrin
Faculty of Economics
University of Ljubljana

REVITALIZATION OF ENTERPRISES FOR GREATER COMPETITIVENESS
INDUSTRIAL RESTRUCTURING AND INDUSTRIAL POLICY
PROJECT PROPOSAL

March 1993

1. INTRODUCTION

As the relatively stable macroeconomic conditions cannot, in themselves, engender the economic transformation essential to the long-run competitiveness of the economy, the proposed project aims at establishing conditions which will enhance the restructuring process that will bring about the necessary change within the real sector of the economy.

2. OBJECTIVES

Mid-Term Objective:

To increase the competitiveness of the economy by facilitating the restructuring process and transition towards the world class manufacturing, the competitive mix of industrial activities, and new attractive industries and/or services.

Short-Term Objectives:

To transfer knowledge how to manage turnaround and knowledge concerning the principles of world class, customer-driven performance (world class manufacturing); to initiate the revitalization of key enterprises;

To develop competitive analysis and competitive benchmarking as a vital information enabling the transformation into a world class enterprise;

To outline developmental and regulatory industrial strategy for achieving dynamic efficiency.

Outcomes

Both the strategic sector analyses and restructuring of pilot enterprises provide **practical tangible results** which are easily implemented in the enterprises to immediately improve their competitiveness as well as useful guidelines for industrial policy recommendations :

- recommendations for improvement in enterprise organization, performance and marketability, including cost reduction and efficiency improvements all over the value added chain leading to world class manufacturing;
- evaluating economy's current ability to penetrate successfully and serve international markets by competing at international standards;
- introducing a series of strategic and structural measures (industrial strategy) to strengthen the industry performance and increase international competitiveness on the basis of information provided by detailed studies of the selected enterprises and contrasting the performance of selected enterprises with world class enterprises.

3. METHOD OF APPROACH

Achieving the goals will require:

- a/ Conduct a strategic sector analyses in major manufacturing industries (electrical, chemical, wood processing, metal, non/metal, food processing) with the purpose of analyzing the strengths and weaknesses, challenges and opportunities facing enterprises by an individual with knowledge of sources of competitive advantages of the world's leading firms and regions;
- b/ Develop benchmark analyses for individual selected pilot enterprises;
- c/ Establish business plans or basic building blocks for turnaround in enough detail to guide successful action, step by step in selected pilot enterprises;
- d/ Develop the management tool kit for achieving the principles of world class, customer-driven performance (world class manufacturing);
- e/ Disseminate the fundamentals of turnaround to other enterprises in the sector;
- f/ Disseminate the management tool kit for achieving the world class manufacturing to other enterprises in the sector;
- g/ Develop performance indicators to track the progress of individual pilot enterprises;
- h/ Implementation of action plans in pilot enterprises;
- i/ Extension of the project to other industries.