

**STATE ENTERPRISE  
RESTRUCTURING IN BULGARIA,  
ROMANIA AND ALBANIA**

**edited by Mitko Dimitrov**

**GorexPress**

**Sofia, 1997**

# **STATE ENTERPRISE RESTRUCTURING IN BULGARIA, ROMANIA AND ALBANIA**

Edited by Mitko Dimitrov

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## Preface

This book gives the results from the international research project State Enterprises Restructuring in Bulgaria, Romania and Albania, financed by ACE Programme of European Union. This research project focuses on the process of restructuring of state-owned enterprises. The research covers firms from three countries from South Eastern Europe - Bulgaria, Romania and Albania for which enough information is still missing in comparison for instance with the countries of Central Europe. A common research methodology was applied to each of the countries and a comparable sample of enterprises was taken.

The comparative analysis of the process of restructuring as well as the main conclusions of the research are given in the beginning of the book. Further the contents is divided into three parts which analyse the restructuring of the state enterprises in each of three studied countries.

The study of each country - Bulgaria, Romania and Albania, includes five general questions which determine the contents of the five parts of our countries studies.

The first of them concerns the initial conditions at the start of the reform period and includes a study of ownership structure, organisation and size structure, management principles and economic independence by the end of 1980s.

Second, the macroeconomic changes since 1990 and the subsequent creation of market environment for the functioning of enterprises are revealed. The main stages of the economic reform are analysed along with some basic problems related to financial stabilisation, opening of the economy, development of the private sector, etc.

Third, the national policy and institutional framework of state enterprises restructuring is analysed. In the final chapter of this part, the structural changes in the system of state enterprises are studied as resulting from the on-going economic reforms. To this end, the same indicators are used as those characterising the economic structure by the end of 1980s.

The fifth part of the project presents the results of 19 case studies of enterprises (7 case studies in Bulgaria and Romania each, and 5 case studies in Albania). Each of the reports comprises a short summary of the characteristics of the studied enterprise, determination of the intensity and importance of the main shocks accompanying the macroeconomic changes, and analysis of the short- and long-term responses of enterprises to the shock effects.

The research project was carried out by a team of scientists from research institutes from five countries from Eastern and Western Europe. Coordinator was the

Institute of Economics at the Bulgarian Academy of Sciences (Sofia) but in working out the methodological part as well as in comparative analysis a very active participation had the partners from LBS - Prof. Saul Estrin and ROSES (Paris) - Prof. Xavier Richet. The studies were made by teams which included researchers from the partner institutes from the relevant countries - the Institute of Economics - Sofia (Mitko Dimitrov, Evgeni Peev, Roska Petkova and Vesselin Mintchev), the Institute of National Economy - Bucharest (Gheorghe Zaman, Ioan Bratu) and the Economic Faculty of the University of Tirana (Iilir Gadeshi, Hecuran Mara and Vladimir Misja).

This research can be treated also as a part of a wider activity which is undertaken in the last years for investigation of the enterprises in the transitional economies from Central and Eastern Europe. The questionnaire used here is very closed to this of the research project of the World Bank Enterprise Behaviour and Economic Reforms: a Comparative Study in Central and Eastern Europe, coordinated by Saul Estrin. That is why the results could be used for a comparative analysis of the processes of restructuring and adjustment of the enterprises in a wider region including the countries of Central and South Eastern Europe.

Except to the main participants in the research project we should like to thank specially Mrs. Maria Georgieva and Miss Diana Dimitrova for their valuable help in organisation and administration of the project and the preparation of the materials for publishing.

# **Cross Countries Study: State Enterprises Restructuring in Bulgaria, Romania and Albania**

## **1. Introduction**

In this part of the book we summarise the findings from a project about the restructuring of state enterprises in Albania, Bulgaria and Romania.

The main finding of our study is that the degree of restructuring in state owned firms in the three countries under consideration has been surprisingly modest. This is in sharp contrast to the significant pace of change noted in earlier by studies by, for example, Belka *et al* (1993) for Poland or Estrin *et al* (1995) for the Czech Republic, Hungary, Poland and Slovakia. It is also surprising given the length of time since the commencement of serious market oriented reforms. The study suggests that this is in large part because the economic environment in these three countries is much less clearly a market one than in the Vishegrad countries. The final section speculates on additional reasons, including the scale of the external shock in these countries and the less favourable preconditions to reform. Policy recommendations are deduced from the analysis.

In the following section, we discuss project methodology and findings, before considering macro-economic preconditions to reform and indicators of progress in reform.

The third section is addressed to the issue of restructuring, defining the tasks to be undertaken by firms in the shift from planned to market environment. This framework formed the basis for the common questionnaire applied in all the case studies. In the fourth section, we enquire why progress in restructuring in state owned firms, as indicated by the case studies, has been so much less than in the Vishegrad countries. We also speculate on the reasons for differences between the three countries, before drawing policy conclusions.

## **2. Methodology and Background**

### **2.1. Main objectives of study**

The study comprises a parallel analysis of state enterprises restructuring in Bulgaria, Romania and Albania on the basis of unified research methodology applied to each of the countries, identical range of problems and comparable samples of enterprises.



This has made possible not only the description of the processes of restructuring but also the comparison of their development in the three countries.

The main purposes of the project were to collect and analyse the information concerning the institutional frame of the restructuring in each country and the macroeconomic environment in which it is executed and on this base to analyse and measure the stage of restructuring in the firms. The study was carried out in two stages. The first stage analysed the macroeconomic and institutional framework of the process of enterprises restructuring of the base of a quantitative and qualitative analysis of statistical data, review and analysis of relevant literature and normative documents.

The second stage includes original studies of 5 to 7 enterprises in each country using the "case study" method. The questionnaire applied is identical for all countries, and the sample of enterprises is formed according to preliminary determined unified criteria.

## **2.2. Method of Studying Enterprises**

The use of case study method imposes by several reasons. First, there is not enough and reliable data about the condition of the enterprises. The available statistical data is not enough and in some cases needs specifying. Second, may be more important reason, is that this method of study gives the opportunity for a detailed analysis of the qualitative characteristics of the proceeding in the enterprises processes and of the factors which determine them. The interview ranges the system cardinal questions of the reform at micro-level of the economy. The results show links and dependencies which in another way could not be examined.

The use of case study approach is not without problems. The studies require high costs. It needs too much time for their preparation and realisation. The interviews and especially the reports cannot be done by interviewers without the necessary qualification. And not at the last place, the access to the enterprises gets more and more difficult on considerations of – firm secret".

Mainly because of these difficulties the research team made totally 19 case studies 7 in Bulgaria, 7 in Romania and 5 in Albania. On these circumstances inevitably rises the question about the representativeness of the sample – to what extent the studied enterprises reveal maximally the existing problems and to what extent their reactions can be considered as typical for the relevant country. In order to satisfy the requirements for maximum possible representativeness the research team was guided by determined criteria and expertise so that it can determine the enterprises which will be included in the sample.

First, the range of the research was limited. The attention was focused only upon the state enterprises in the industry. The private firms were not studied because of their still small sizes and not big percentage in this branch. The enterprises from the military industry and the infrastructure were not included in the study because of the specific character of their restructuring and adjustment as well as the system control practised upon them by the administration.

Second, a group of 10-12 indicators was determined so that the choice of the conditional group of enterprises can be made on the base of their varied combination. In order to eliminate the identity of the enterprises, at least half of the number of the indicators should not be repeated in any two enterprises in the sample. The following indicators were used – branch, produced products, technological character, size, region, juridical form, attitude to privatisation, production share, market share, main markets of realisation.

In order to get comparison between the studied enterprises by countries the condition was accepted three enterprises to be from the branches of light industry, one from chemistry and three from machine-building, which approximately corresponds to the weight of these branches in the economy. As in Albania it was difficult to be found machinebuilding enterprises which can correspond to the chosen in Bulgaria and Romania, the total number of the studied enterprises was decreased from three to one and the possibility it to be from extractive branches was permitted.

### **2.3. Preconditions to Reform**

The three countries of our study belong to the second tier of reforming economies, clearly starting from a lower initial level of development than for example the Czech Republic or Slovenia. As can be seen in Table 1, which brings together numerous indicators pre-reform, income per capita was low in Albania and in Romania and medium in Bulgaria using purchasing power parity measures for 1990. These levels of development are reflected in other social indicators such as infant mortality rates and school enrolment ratios, notably for Albania. It is also reflected in the agriculture share, which is relatively high in all three countries, but notably Albania where it was 40% in 1990. Of the countries, Bulgaria is most developed while by a considerable margin Albania faces the greatest development challenge.

Evidence for the severe excess development of industry typical of communist regimes can be seen in the extraordinary industrial shares in Bulgaria and Romania, reaching more than 50% of GDP in Bulgaria and only just below in Romania. Ironically, Albania may have some slight advantage in restructuring from being less developed, because so much of industrialisation in the other countries was misdirected according to market criteria. These levels of industrialisation are high, even by the standards of transitional economics: – the share in Hungary in 1990 for example was only 29%. The over industrialisation was associated with total integration into the CMEA, for Bulgaria at least. The figures are lower for Romania and especially for Albania, which had followed more autarchic path. Taken together, these facts left Bulgaria particularly exposed to the trade shocks associated with the disintegration of CMEA and the Soviet Union. None of the countries had any great trade links to the West, and these have had to be built post-reform.

The countries also differed considerably in macro-economic balance pre-reform. Bulgaria already had accumulated considerable foreign debt and had a large monetary overhang associated with a considerable budget deficit. Albania and Romania for quite

different reasons had followed more controlled and autarchic policies, leaving them with better macro-economic balance and much less international debt. Bulgaria decided in the early years of reform to default on much of its foreign debt, at considerable cost in terms of credibility on world capital markets.

## **2.4. Progress in Reform**

Economic analysis of transitional economies (see eg. Fischer and Gelb (1991), Portes (1993), Estrin (1994)) argue that there are four distinct but inter-related elements to a transition process, namely:

- ✓ macro-economic stabilisation
- ✓ price liberalisation, including trade liberalisation
- ✓ institution building, including capital markets
- ✓ privatisation.

Albania, Bulgaria and Romania were all placed by the World Bank Development Report 1996, into the second group of reforming economies in terms of the extent of liberalisation. The first group, including Poland, Slovenia, Hungary and the Czech Republic, had average "scores" on liberalisation 1989-95, of around 0.65 on a scale from zero to unity. This compared with a value of around 0.5 in Bulgaria and 0.45 in Albania and Romania. The EBRD Transition Report, also contains progress indicators in its Table 2.1, which confirm these economies comparable and middle ranking position in the transition process.

The attainment of macro-economic stabilisation following the traumas associated with price liberalisation in situations of severe macro-economic imbalance has led to large declines in output across the region. The situation in our three countries is summarised in Table 2. Interestingly, the output drop was largest in Albania, but there has since been three years of steady growth restoring somewhat the initial position. The output drop has also been partially recovered by recent growth in Romania, which is beginning to creep towards 1989 output levels. However it continues in Bulgaria, whose position is now slightly worse than that of Albania, both relative to 1989. Albania is also performing well on the inflation front, with initially high levels being brought under control and 1995 projections being close to OECD standards. Inflation has been much higher in Bulgaria and Romania, but there is some evidence that control is being reasserted at least in Romania. In summary, the macroeconomic situation is at best moderate in all three countries, but perhaps surprisingly is clearly best in Albania in terms of both growth and inflation, and worst in Bulgaria.

Progress in the process of privatisation in the three countries is summarised in Table 3. Progress has been modest in all countries, though arguably more advanced in Romania in terms of formal procedures, especially for small firms and in Albania in terms of GDP shares (probably because of the emergence of private agriculture).

Turning finally to institution building, the World Bank Development Report produces indicators across three variables – laws and legal institutions; the banking sector and the role and management of government. These are reproduced for the three countries in

Table 4, with the variables moving on a scale from 1-4. In these deeper areas of reform, the more developed economies of Bulgaria and Romania have established a lead over Albania, especially with respect to the banking and financial sector.

In summary, Albania was a significantly less developed economy pre-reform than the other two, was also less integrated within the CMEA system and less industrialised. Bulgaria was most developed, particularly integrated into the Soviet bloc and highly over-industrialised while Romania had pursued an expensive policy of debt repayment. Given these preconditions, reform has arguably been most rapid in Albania, especially on the macro-economic side. However the low level of development has meant that Albania has made less progress in deeper reforms related to, for example the legal system and the capital market. We will see below that progress also appears less in restructuring, based on the findings from our cases.

### **3. Enterprise Restructuring in Transition**

This project has focused towards measuring the extent of restructuring of state owned firms in Albania, Bulgaria and Romania, using the case study approach. In developing a common analytical framework, the key issue is therefore to define restructuring in the transition context, and to find indicators of progress. The obvious starting point is an understanding of the socialist enterprise in the planned economy, in contrast to capitalist firms operating in a competitive environment. We can then categorise the changes that must take place in the firm in a number of ways. In what follows, we employ the following categories:

- ✓ enterprise objectives and constraints
- ✓ organisational restructuring
- ✓ "unbundling"
- ✓ product market restructuring
- ✓ input restructuring, notably of capital, labour and energy.

The most important point to stress is that restructuring in a transitional context is a multi faceted phenomenon. Firms have to restructure their products, production methods, quality control, stock systems, and accounting systems, not to mention their organisational structures and the balance between the "make or buy" decision. Firms can be making progress in some dimensions but not in others. An obvious reason might be differences in the costs of restructuring. Changes in energy use, production layouts, or quality of supplies purchased (made available by liberalisation of foreign trade) might be virtually costless or even cost saving while the purchase of new equipment or information technology might entail capital expenditures which firms would not be in a position to finance. But restructuring may also depend on governance mechanisms. Firms effectively controlled by their labour force or by local government authorities might be much less willing to reduce employment or to cut back on social assets than managerially controlled firms with docile labour forces. Thus restructuring cannot be regarded in a unidimensional way, and progress in a particular direction need not necessarily be associated with progress in other areas.

### **3.1. The Socialist Firm**

As is well known in the literature on central planning (see eg. Gregory and Stuart (1989), Ellman (1989)), the socialist enterprise could be viewed effectively as merely a production unit. The central planning apparatus operative in most communist countries (Yugoslavia, Hungary and in the 1980s Poland were exceptions) arranged for the bulk of material inputs to be delivered, and for the disposal of most production, whether as inputs to further down the value chain, to domestic consumers or for export. Money was passive and while formal accounts were kept, positive or negative financial balances had little decision-making role in a system controlled by quantitative allocation of inputs and outputs. Investments were largely decided at the centre, and funded by direct grant.

Managers were put under considerable pressure to achieve quantitative output targets, upon which their considerable bonuses largely depended. At the same time, informational deficiencies in the planning system itself and the desire by the Centre to use pressure on managers to motivate plan fulfilment meant that the plans themselves were often infeasible and typically very hard to achieve. This gave every incentive for managers to cut corners in the attainment of current production goals; quality, planning, husbandry of capital and human capital, careful input management, energy and resources control were all sacrificed in the search for higher output.

Managers understood that the profitability of production was at best a secondary issue for planners. Indeed, if the "value" of planned output at centrally determined prices exceeded the "value" of inputs, also at centrally deterred prices, this was of no little or no consequence. Budget constraints on firms were therefore soft.

Even in decentralised economies such as Hungary, where output and supply planning had been abolished, managers could rely on subsidy virtually without limit to finance production. Managers also quickly learnt that it was often easier to achieve plan targets by getting their targets softened, or by getting special favours or grants from the Centre in supply allocation, than by improving technical efficiency or company performance. The motivation structure favoured systematic rent seeking amongst managers.

The mentioned general features of the socialist firm were shown in the specific institutional environment of the different countries. Its knowing could help in some cases for the better understanding of the changes in the state enterprises attendant the reform. In the end of 80s in Bulgaria a rejection from the strict centralism in the management of the economy was declared. The Planning Committee and the branch ministries were removed.

The centralism in the economy was made through so called state orders which embrace different part of the capacity of the enterprises. The management of the enterprises for a short period of time went through the experiment to be introduced from above the "self-management" including the choice of directors from the staff. After frustrating this experiment the decision was searched in so called firm organisation of the economy with forced role of the signed from above director of the enterprise. The mentioned specific moments could be connected with the shown later disinterestedness of the government to the state enterprises as well as with their forced decapitalisation.

Specific for Romania is the combination of hyper centralised planning, strong budget

dependence and interference of the party apparatus with quasi autonomy, manifesting in own fund of the enterprises (5% of the profit) and turning the workers to "share holders". As we will see the reform period is characterised with comparatively strong centralisation and creation of funds for private ownership which own 30% of the ownership of each enterprise.

The specific model of Albania is characterised with hyper centralisation and command management with strict hierarchy structure including state planning commission, branch ministries and municipalities. In the end of the period the directors had limited rights combined with decreasing of the subsidies, i.e. as a view of the incapability of the government to subsidise the losing enterprises and not so much as of a desire to give autonomy of the enterprises. The efforts for a change of the centralised model of management the economy were weakest shown in Albania in comparison with the other countries. That is why it was easier to eliminate it totally and to the least extent to influence to the reform model. Nevertheless the west specific role of the municipalities as a hierarchy link for management and after 1990 shows a certain continuity.

### **3.2. Reform and the Firm**

The reform led not only to a change in the macroeconomic conditions for functioning of the firms but also to a change of the firm organisation and the firm structures. In all transition economies, including Bulgaria, Romania and Albania, can be seen evidences for executed decentralisation, change of the juridical status of the firms and diversifying of the size structure of the enterprises.

In Bulgaria the decentralisation of the state enterprises and the changes in their juridical status were executed considerably early – in the first half of 1991. The newly accepted Trade Law has the aim to equalise the main economic legislation with this of the developed western countries and the special Law for Creation of Trade Companies put the base for the corporatisation of the state enterprises. The main part of these enterprises were restructured the very same year in joint-stock companies and limited liability companies.

By this time was made decentralisation and demonopolisation of the big state unions with the exception of the firms from seven branches – electronics, telecommunications, energy industry, metallurgy, military industry, etc., for which the plan was the decentralisation to be made with a special decision of the government.

The mentioned measures led not only to diversifying of the organisational forms of the state enterprises but also to a sharp increase of their number. The total number of the municipal and the state enterprises including de novo increased more than 22 times for the period of four years and the most rapid this process was in 1991. In the industry the increase of the state enterprises is more than 7 times.

The increased number of the independent enterprises in the economy as a whole and in their branches helps for the elimination of the monopoly. In many of the branches the maximum possible decentralisation as a base for demonopolisation of the economy is achieved. Monopoly position in the production still have small number of enterprises

which are the only producers of the product in the country or unions (complexes) of enterprises which have been specialised in the frames of AMEA (for instance Balkankar, Bulgartabak, etc.). But even these complexes differs very much from their condition before 1989 because of the executed partly decentralisation in them. In the last years the competition by import had a strong influence for the damaging or eliminating of the monopoly at the domestic market for the enterprises from both mentioned groups.

One of the most important fields of influence of the reform is the change in the control and the management of the state enterprises. In this connection in 1991 an essential step in the determination of the property rights was made and the existing till then unclear combination between workers self-management, technocratism and government interference was eliminated. The Council of Ministers was chosen as the body which responds for the functioning of the state ownership. The main rules for holding of the managers contests for management of the enterprises were also established. Unfortunately these contests were hold very quickly and quite formally and did not lead to the expected results.

As a whole we can say that in Bulgaria to a great extent was executed the decentralisation and were created considerably diversified modern forms of organisation of the enterprises. The existing legislation has not been an obstacle for their perfection in the next years. In spite of these positive changes we still cannot say that the state enterprises function as normal institutions of the market economy. The development of this process depends on the development of the other institutions of the market economy, on the privatisation of the main part of these enterprises, on the establishment of the normal market environment in which they function.

In the first few years of the reform in Romania were accepted over 20 laws which established in general the legislation framework of the transition to the market economy. One of the purposes is the state sector to become in public by giving operative independence to the enterprises and implementing their policy at market principle.

An opportunity for diversifying of the forms of the state enterprises is created. By name new forms are close to those existing in the country before the war but by character as it can be seen in the other transition economies they have the marks of the previous state enterprises.

Autonomous companies are the strategic enterprises in the Romanian economy which are state ownership and will not be privatised in the next few years. The law suggests only the possibility the management of these enterprises to be given to private subjects by leasing or management contract. This could be made by public auction and in condition that the government will receive annual sum not less than the average profit of the enterprise in the last five years.

Another basic form of enterprises are trade companies which have the biggest share in the economy. A part of them are predominantly or totally private. But most of them have mixed capital – state and private.

The state ownership embraces 70% of the current assets while 30% are distributed by ownership certificates through the adults in the country. The share of the state is managed by State Ownership Fund and the share of the people – by private Ownership Fund. In practice by the first one the state has decisive influence both in determining the managers

teams and their behaviour.

The decentralisation of the state enterprises in the industry in Romania is realised with much less intensity than in the other countries from Central and Eastern Europe. The increase of the total number of the enterprises as a result of the decentralisation is less than twice. Later the government estimates that at many places necessary and important technological link have been broken and realises the opposite process of merging of some state enterprises.

The legislation framework of the restructuring in Albania start to establish in 1992. In July the same year State Enterprises Law was accepted by which the management and the financial autonomy is given to the enterprises the basic questions concerning their activity in the market condition were cleared. Trade Associations Law deals with the questions about the types of associations, their status, their financial interrelations, their management and juridical responsibility including the problems with the failure. Later is accepted a separate Enterprises Failure Law which deals with the questions about the time, the conditions and the procedure of the failure.

It is notable that the diversification of the organisational forms of the state enterprises in Albania is not so big as in the other East European countries. That is probably because of the lack of tradition and the considerably small sizes of the country. A general law which deals with the status of all forms of enterprises, with state, private or mixed ownership, is lacking. The decision of the problems of the 30 biggest enterprises is searched by the creation of Enterprise Restructuring Agency, it is accepted that because of their small number it is possible this institution to find and apply a concrete decision to every separate case.

As one of the forms of decentralisation of the economy the enterprises in Albania were separated in two groups – subordinated to the branch ministries and to the municipalities. In the condition of undeveloped market, unclear status and lack of managerial traditions, many contradictions between the second group of enterprises and the municipal bodies arise, when the last have interfered directly in their production and financial activity.

### **3.3. Main Areas of Restructuring**

As we noted above, a full transition reform programme would involve macro-economic stabilisation; price and trade liberalisation; the formation of market based institutions and laws; and privatisation. The three countries in our study have made moderate progress in all of these areas, though notably less has been achieved than in the Visegrad countries, for example. If we presumed that a total transition reform programme had been introduced, one can categorise the resulting "restructuring" at the enterprise level in the five areas noted above.

#### **3.3.1. Enterprise Objectives and Constraints**

The collapse of the planning system will deprive the socialist managers of the traditional incentives to maximise production to the detriment of costs and quality control. However, it is unclear what incentives it will put their place. This depends upon two



factors. The first is the governance system which emerges with the decentralisation of decision-making authority to the firm consequential upon the formation of markets. For example the state as owner could create a governance system to reward managers for progress in attaining profit maximisation, and to penalise alternative objectives such as employment maintenance. Another possibility is that the collapse of the communist party at the time of reform so weakens the apparatus of the state that governance is effectively non-existent, and state owned firms are controlled by their employees – either managers, workers or both together. The objective of the firm would in this situation depend on the balance of power between groups within the enterprise itself, and on the objectives of the constituent groups. It seems likely that managerial control would emerge, but managerial objectives are not simple in the transition context. One possibility might be a strong concern for employment and local social issues; another could be a gradual looting of state assets into "private hands", with massive growth in the unofficial economy.

The second important factor in the objectives of the organisation post-reform is the softness of budget constraints. Whatever the governance mechanism, there will be little incentive for managers and workers to undertake complex and potentially painful restructuring in situations where the status quo is effectively underwritten by the state. Earle and Estrin (1995) have argued that there will be clear interactions between these two factors; the impact of manager versus employee ownership on restructuring for example will depend on whether budget constraints on the firm are hard.

The authorities may manage to reduce government subsidy, thereby introducing some crack into the walls of government regulations and bureaucracy surrounding enterprise decisions in which case competitive pressures can be brought to bear. Then enterprises will be forced to take account to some account of their market situation, regardless of the governance and motivation structure. In the limit, if the firm is subject to full competitive market pressures, rents will have been eradicated so even if insiders do control decision-making, they will have to respond to market pressures.

This implies that, even in state owned firms which are not yet being privatised, the governance system will be very important. Moreover, the process of "depoliticisation" – breaking the links between the enterprise and the state – will be crucial. There are a large number of indicators of this relationship, from the scale of direct subsidy or sales through the state to the extent of special licenses, regulations or quotes for inputs, outputs or other aspects of the production process. The extent of depoliticisation therefore represents a crucial dimension of enterprise restructuring in transition.

### **3.3.2 Organisational Restructuring**

The remaining elements of restructuring are perhaps more straightforward and conventional. At its simplest level, the socialist firm will have to create new divisions to take on new functions previously undertaken centrally. These will almost certainly include finance, marketing and human resource management. In some organisations, they might also include R&D. The Board structure will have to be changed and new personnel

recruited to fill these crucial new slots. At a deeper level, multiproduct firms may seek to change organisational structure in favour of profit centres, divisions and subsidiaries. The potential role of joint ventures and strategic alliances fits here also. Many of these changes can be measured directly in terms of organisational and employment changes.

### **3.3.3. „Unbundling,,**

Because of the pressures and uncertainties of planning, combined with the great rewards to plan fulfilment, incentives were skewed in favour of vertical integration, particularly in the manufacture of material inputs. Large socialist firms therefore often maintained their own foundries, machine shops, generators and repair units. Moreover, the enterprise also undertook important social welfare functions, notably in the areas of housing, child care and health, but to some extent also as a retail outlet. These social assets often absorbed a significant proportion of enterprise turnover.

The emergence of a market system also seems likely to lead to a completely different balance on the "make or buy" spectrum for most firms. Clearly scale economies and experience benefits were being lost by firms supplying their own inputs separately, and once the market has eradicated shortages and queuing, there is little logic in disproportionate reliance on internal supply. Similarly, in a market economy the role of the state – both central and local – vis a vis enterprises will shift, and the firm will need to divest many of its social assets, perhaps to local government.

The process of unbundling will not necessarily all be one way however. Socialist enterprises previously had little concern with supply quality or delivery standards. These might become major elements of competitive advantage in a reformed market system, and lead firms to develop or acquire new capacity up or down stream to their production process.

In summary therefore, restructuring should include divestment of non-core activities, both productive and social, as well perhaps as some acquisition in new areas. Divestment may also have financial benefits for enterprises undertaking restructuring in other areas.

### **3.3.4. Product Market Restructuring**

Reforms should lead to major changes in what firms produce, how they produce it and to whom the output is sold. Restructuring might include a shift to the production of consumer goods, to an increase in production differentiation, and to major improvements in quality control and standards of production. The key factors will be for firms to begin to understand their markets, and to shift supply so as to satisfy demand. In terms of supply channels, firms should begin to develop new distribution mechanisms to replace centralised purchase, and to focus more on delivery standards and pricing. There should also be a major reorientation of customer base, from the state and other central buyers in CMEA to consumers and other firms domestically and internationally, especially in the West. Once again, it is straight forward to find indicators of progress in these areas.

### **3.3.5. Input Restructuring**

One can here separate out five main areas for restructuring activity, in capital, labour, material inputs and energy. In all, the key element will be efforts to minimise costs, and to maximise profits.

On the capital side, firms in the region – especially those outside the priority defence and space sectors – often possess antiquated equipment. Restructuring in products and quality may well require major investments in new equipment, both fixed assets and information technology. Such changes have major financial implications because socialist firms typically had little or no financial assets (or what they had was eradicated by inflation) and the banking systems in these countries remain severely important. Investment will therefore have to be financed largely from own resources in the short run, and this requires either current profitability or asset sales. Financial restructuring is therefore a key element in enterprise turn around, and will depend crucially on improved accountancy standards.

Overmanning was typical in socialist economies, partly as slack to ensure that output plans could be attained in huge production bursts at the end of each plan period, and partly as a full employment policy subsidised by soft budget constrained. This problem has been exacerbated in socialist countries by the large output drop associated with reform. A key indicator of restructuring is therefore performance with respect to labour productivity, and in the reduction of the labour force. However, while gross employment will typically have to fall, the other aspects of restructuring noted above may also imply significant labour recruitment mainly of white collar staff in finance and marketing. These will be in contrast to the sharp declines in blue collar employment. Training will also be important, for example in changing employee attitude towards absenteeism or quality control.

On the material input side, reform offers enterprises opportunities to change their suppliers, and perhaps to buy higher quality inputs from abroad. Information technology will also be important in stock control.

Finally, socialist firms were traditionally highly wasteful of energy, which was traditionally provided very cheaply within CMEA. The cost implications are now serious, not only at the enterprise level but for the balance of payment in countries where energy resources need to be imported. This is a major and fairly easy area for market restructuring, though investment will typically be required for fundamental shifts in energy usage. The serious environmental problems caused by poor standards and emission controls are also typical of socialist enterprises, and are an area in which restructuring yields social but not necessarily private benefit.

The questionnaires employed in our cases attempted to quantify or qualify developments in all these areas of restructuring. They also attempted to capture the impact of changing macro-economic conditions, notably the decline in demand, the shifting terms of trade, the increase in certain costs, notably capital and energy and the developing nature of the relationship between the state and state owned enterprises.

## **4. Assessing the Findings**

### **4.1. Short Characteristics of the Studied Enterprises**

After the mentioned above procedure and limits for the choice were followed, a list of enterprises with conditional characteristics for each country was prepared. After that the national teams made their efforts to study the real enterprises which should have close characteristics to the mentioned in the list. The combination of the indicators in each of the enterprises in each country is shown in Table NoNo 5, 6 and 7.

The Bulgarian enterprises are from 7 main branches of industry – electronics, machine-building, electrical, chemistry, textile, sewing and food industry. Three of the enterprises are big (2000 – 4000 employees), three are middle-sized and one is small (120 employees). All enterprises are state but two of them have privatisation projects and there is an application for partly restitution for one. Five of the enterprises are jointstock companies with 100% state ownership and only two are limited liability companies with 100% state ownership. For the first time this indicator shows crossing of the structure of the studied enterprises with the structure of all enterprises in the Bulgarian industry in which the number of state enterprises having status of limited liability companies dominates. The sample shows enterprises producing final products (3 of them) as well as producing intermediate products (2 of them). Two of the enterprises produce both final and intermediate products. Three of the enterprises are the only or main producer of this product and the rest are one of the many national producers in its sphere. Three of the enterprises produce mainly for the domestic market, another three produce for both the domestic and foreign markets and in one of the cases the production is mainly for export. Only one enterprise has monopoly positions on the domestic market and the other enterprises function in the conditions of competition with both national production and import. Thus the given picture of the studied enterprises is too close to this of the whole economy which is an additional reason for the representativeness of the sample of the studied enterprises.

The studied enterprises from Romania also present the main branches of its industry – machine building (mining and oil equipment, busses, trolleys and special cars), electrical industry, chemistry (pharmaceutics), textile, shoes, porcelain. All enterprises, with one exception, are big which is not surprising as the decentralisation of the state enterprises in Romania was not made so strictly as for instance in Bulgaria, Hungary and Czech Republic. After the decentralisation the number of the state enterprises in these countries increased 7-8 times and in Romania twice. Also connected with this is the fact that almost all enterprises are either main producer or one of the few big producers of this kind of production. Only in two branches (shoes, porcelain) the studied enterprises are ones of the many producers of this kind of production. The monopoly at the market is less seen because of the influence of the import and three of the studied enterprises keep monopoly or oligopoly positions not only in production but also in sells at the domestic market.

The studied enterprises have the same structure of ownership – 70% belong to the State Ownership Funds (SOF) and 30% – to Private Ownership Funds (POF). According

to their juridical status all the seven enterprises are commercial companies which is the most popular form of organisation in Romanian industry.

The studied enterprises in Albania are from the branches of light industry (textile, clothes, food), chemistry (pharmaceutics) and energy industry. All enterprises are state, one of them is at double submission – to the municipality and to the ministry of agriculture, one – to the State Agency of Restructuring and one is part of so called corporations. One of the enterprises is partly privatised and another has prepared privatisation project. All enterprises are middle-sized with the exception of one big enterprise which consists 10 branches. Two of the enterprises are the only producers of this kind of production and the monopoly of one of these two is undermined by the import of the production. The rest of the enterprises are ones of the many producers and sellers of the products they produce.

The characterisation of the studied enterprises shows that it is closer to this of the whole combination of enterprises in the relevant country, this is one more reason for representativeness of the studied enterprises. Concerning the comparison of the sample by countries, the results show that three enterprises from each country are from the branches of light industry and one from chemistry (pharmaceutics). Machine-building is presented only in samples in Bulgaria and Romania with two enterprises while the relevant Albanian enterprise is from energy industry. The reasons for the last difference were discussed in the previous part. As a whole we can say that in the existing differences in the industrial structure and in the extent of development of the different branches these are optimal structures which both show the specifics of the industrial enterprises in each country and give opportunity for comparisons between them.

## **4.2. Assessing the Findings**

A careful reading of the cases reveals that the pace of restructuring in all the dimensions under consideration has been very modest. In this section, we seek to explain why this might be the case, and to deduce policy conclusions.

We can summarise the findings across the cases in the five main areas of restructuring according to a scale from 1 (minimal restructuring) to 5 (maximal restructuring) for each of the cases. This is attempted using our own judgement in Table 8. It can be seen that in general the pace of restructuring has been very modest. In terms of country, Bulgaria appears to have made the most progress, and Albania the least. For all the countries the progress has been greatest in depoliticisation on average, and least in Albania. There appear to be limited sectoral differences in the pattern of restructuring. Only in the sphere of organisational restructuring we can see priority of the enterprises from machine-building branches above those from the light industry which is valid for the three countries. In Bulgaria the enterprises from light industry have priority above the other in the product restructuring and in Romania those from machine-building have priority in unbundling above the other.

Our study does not show direct link between the extent of restructuring and the size of the enterprises, their monopoly position in the production or the market and the share of the export in their sells.

### **4.3. Explaining the Findings**

The first major issue concerns why restructuring in state owned firms in Albania, Bulgaria and Romania appears to be so much less than has been found in previous studies for the Visegrad countries. The reasons are probably largely to be found in Tables 1 to 4 above. First, the preconditions to reform in these three countries was significantly worse than in the Visegrad countries; the level of development was lower, the degree of integration into CMEA for Bulgaria at least was higher, the extent of overindustrialisation was greater; the involvement in Western trade was less. There had been almost no decentralisation of the planning system especially in Romania and Albania, in sharp contrast to Poland or Hungary. Moreover unlike the Czech Republic the low level of international debt in Albania and Romania had been bought at the price of autarchy and improvement. Reform therefore involved a much greater institutional shock than in most of the Visegrad countries, in economic conditions which were inherently poorer. It is sometimes argued that the degree of responsiveness of an economic system is positively related to the scale of the shock that it faces. Arguments of this sort underlie the case for "big bang" as against gradualist reform packages. However, once one begins to look in detail at the macro-economic level, it becomes clear that very large exogenous shocks – the loss of markets, the collapse of supply systems; the inability to secure inputs or to pay for labour and energy – effectively paralyse enterprises which become unable to make even modest changes. This is partly an incentive problem -the situation appears irretrievable which mitigates against undertaking minor restructuring – and partly a matter of soft budget constraints. The authorities in such a situation are aware that they cannot let all firms go under, and hence permit continued subsidy, which itself demotivates restructuring.

The three countries in our study, as noted earlier, have made significantly less progress in the introduction of a market economy than the Visegrad countries. Though the extent of reform is considerable given the initial statutory conditions, the degree of price and trade liberalisation remains modest, leaving considerable scope for bureaucratic intervention, rent seeking and the insulation of firms from market forces. The pace of development of the private sector, both *de novo* and through privatisation, also leaves much to be desired, and this affects detrimentally the competitive pressures under which the firm operates. Capital market development has been particularly weak – and in the context of a recession which has severely strained enterprise resources, funds are simply not available for the more costly aspects of restructuring. Perhaps most significantly, the patchy evolution of the state apparatus has left governance of state owned firms largely under the control of managers, and to a lesser extent workers. Managers have had only limited incentives to undertake profit-maximising restructuring because the personal benefits to them will be modest, the effort considerable and the process will be unsettling and perhaps painful. Moreover, in none of these countries has a management market been established, in which managerial performance in state owned firms can be viewed as a signal of likely performance post-privatisation, thus giving managers incentives to restructure in order to enhance their own marketability.

The erratic and sometimes half-hearted approach to reform taken in these countries is also a reflection of political realities. In all three, communist or post-communist parties play an important political role, and either share in power or retain a significant prospect of returning to power. This is in part because income levels are low, distributional inequities are great and the threat of high unemployment is considerable. All of these act to slow reform. They also discourage foreign direct investment, which has been very low in all three countries. It is arguable that foreign direct investment can play a particularly important role in the transition process by unleashing competition based on quality, brand and price on hitherto closed markets, as well as by disseminating improved know-how, labour practices, training and production methods through the economy.

When one looks at differences in terms of progress in restructuring between countries, it seems likely that these can be best explained by preconditions rather than current progress in reforms. We saw earlier that it is arguable, especially on the macro-economic front, that Albania leads the way in this group, with Bulgaria lagging. From our cases, the order seems to be reversed at the enterprise level; progress in restructuring in our Bulgarian sample is somewhat more advanced and more broad ranging than in Albania with Romania in the middle. These differences probably derive from initial levels of development; despite the worse macro-economic performance, underlying human capital and other long run supply characteristics are probably superior in Bulgarian leading to greater responsiveness. The gap between macro and micro-economic performance should warn against excessive reliance on the former as an indicator of progress.

#### **4.4. Policy Conclusions**

We have argued that to some extent the relatively less satisfactory restructuring performance in Albania, Bulgaria and Romania compared to the Visegrad countries is inevitable, deriving from worse preconditions, less progress in reform for real political and institutional reasons, and lower levels of development. But some of the wounds are also self inflicted, and these can be addressed by policy measures. The key problem is that in all these countries, the governance of state owned firms is inadequate; the extent of "depoliticisation" is insufficient and the development of competitive market forces is at best partial. Concerning governance, the state must either exert greater authority over firms to ensure profit maximisation, or must dramatically accelerate privatisation. The latter policy would provide clear managerial incentives to restructure while firms were still in state hands, as well as through the changes in ownership and control. The state also clearly has much work to do in all three countries in eradicating subsidy and other government controls, and in withdrawing the state as an economic actor. Finally, faster progress towards liberalisation, freezing prices, opening trade and building market institutions including a capital framework and a capitalist legal system are clearly crucial elements in ensuring more rapid restructuring.

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World Bank Development Report, 1996



**Table 1.**

*Preconditions to Reform, 1990*

	Albania	Bulgaria	Romania
Population	3.3	8.7	23.2
Development levela	Low	Medium	Low
External debt (\$b)	0.09	9.9	0.6
Share of industry/GDP	37	51	48.2
Share of agriculture/GDP	40	18	18
Natural Resources	Medium	Low	High
Government deficit (%GDP)	-3.7	-12.9	1.2
Primary School enrolment rate	85	97.1	99.4
Infant mortality rate (<5 years)	44.1	20.9	30.3

Sources: EBRD Transition Report, 1995.

**Table 2.**

*Output and Inflation*

		Albania	Bulgaria	Romania
Real GDP in 1995 as % 1989		75	75	81
(%) Output drop 1989-93		63	83	73
Inflation (CPI) (%)	91	104	339	223
	92	237	79	199
	93	31	64	296
	94	16	122	62
	96*	5	50	30

Source: World Bank Development Report, 1996.

**Table 3.**

*Progress in Privatisation*

	Albania	Bulgaria	Romania
% Employment in privatesector,1994	n.a.	34.7	51.4
Private sectors share in GDP, 1995	60	45	40
Progress indicators			
- large firms*	2	1/2	2
- small firms*	2 '	1/2	2/3

Sources: EBRD Transition Report, 1995., World Bank Development Report, 1996.

**Table 4.**

<i>Institutional Reform</i>			
	Albania	Bulgaria	Romania
Laws	2	3	3
Banking sector	1	3	3
Role and management of government	4	2	2

Source: World Bank Development Report, 1996

**Table 5**

<i>Bulgarian Enterprises</i>	
Sector, product, group	Enterprise characteristics
1. Electronics components consumer goods	state, joint-stock company, plan for privatisation, large – 4000, main producer, export, competitive market
2. Machine-building food machines	state, joint-stock company, plan for privatisation, large – 3800, final products, main producer, domestic/export, monopoly/competitive market
3. Electrical industry illuminants	state, limited liability company, no plan for privatisation, middle-sized – 400, final products, only producer, domestic, competitive market from import
4. Chemistry pharmaceuticals, cosmetics	state, joint-stock company, no plan for privatisation middle-sized – 4-500, final/intermediate products, a few producers, domestic/export, competitive market
5. Textilecloths, yarns	state, joint-stock company, no plan for privatisation, large – 2000, intermediate products, many producers, domestic/export, competitive market
6. Sewing industry knitwear, store clothes	state, joint-stock company, application for partly restitution, middle-sized – 800, final products, many producers, domestic, competitive market
7. Food industry flours	state, limited liability company, no plan for privatisation, middle-sized – 120, intermediate products, many producers, domestic, competitive market

**Table 6.**

*Romanian Enterprises*

Sector, product, group	Enterprise characteristics
1. Manufacturingmining and oil equipment, reducers	SOF/POF 70-30%, trading company, large – 2600, final products, main producer, export/domestic
2. Machine-buildingbuses, trolleys, special vehicles	SOF/POF 70-30%, trading company, large – 4200, final products, main producer, domestic, monopolist
3. Electrical industry lamps, glass, semiproducts for lamps	SOF/POF 70-30%, trading company, preparation for privatisation, large, final/intermediate products, one of the three producers of lamps, 5050% export/domestic, the only supplier
4. Chemistry (pharmaceutics) drugs, medicaments	SOF/POF 70-30%, trading company, preparation for privatisation, large, final/intermediate products, 50% main producer, domestic/export (10% of the production), main supplier
5. Textilewool tissues	SOF/POF 70-30%, trading company, preparation for privatisation, large, intermediate products, one of the five producers, domestic/export 55-45%, many suppliers
6. Light industry leather, shoes	SOF/POF, trading company, large – 9000, final products and semiproducts, many producers, domestic/export (10% of the production), many suppliers
7. Light industry porcelain	SOF/POF 70-30%, trading company, preparation for privatisation, final products, many producers, domestic/export 2:1, many suppliers

**Table 7.**

***Albanian Enterprises***

<b>Sector, product, group</b>	<b>Enterprise characteristics</b>
1. Electric industryelectric energy	state, electro-energetic corporation, no plan for privatisation, middle-sized, final products, one of many, domestic, natural monopoly
2. Chemistry (pharmaceutics)	state, no plan for privatisation, middle-sized – 200300 medicaments final/intermediate products, the only in Albania, domestic, competitive from import
3. Textile cloths	state, Enterprise Restructuring Agency, plan for privatisation (close and sell), middle-sized – 200-300 now 40, intermediate products, many producers, domestic (army), competitive from import
4. Textileclothes, shoes, tents	state, no plan for privatisation, large – 10 branches (factories), final products, the only military enterprise, domestic, monopoly for the army
5. Food industrybread	state, depends on municipality and ministry of agriculture, partly privatisation, middle-sized – 100400, final products, 18% of the bread production in Albania, domestic (regional), 20% from Tirana, competitive from new private firms

**Table 8.**

<b>Cases</b>	<b>"depoliticisation"</b>	<b>Organisational restructuring</b>	<b>Unbundling restructuring</b>	<b>Product restructuring</b>	<b>Input restructuring</b>
Bulgaria					
Electronics	4	4	2	3	3
Machine building	4	4	3	3	3
Electrical	4	2	2	2	2
Pharmaceutics	4	2	2	2	2
Textile	4	3	2	4	3
Tailoring	4	3	2	3	2
Foods	4	3	2	4	3
Romania					
Manufacturing (equipment)	3	3	2	3	2
Manufacturing (busses, trolleys)	3	3	3	2	3
Electrical	3	2	1	2	3
Pharmaceutics	3	2	1	1	3
Textile	3	2	1	3	2
Shoes industry	2	2	1	3	3
Porcelain	3	2	1	2	2
Albania					
Electric Co.	2	2	1	1	1
Profarma(drugs)	2	2	1	2	3
Woollen Textile	2	1	1	1	2
MCPE (clothes, shoes)	2	2	1	1	2
Bread Factory	2	1	1	1	1

**Part I**

**Restructuring  
State Enterprises  
in Bulgaria**

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# **Restructuring State Enterprises in Bulgaria**

## **1. Specifics of Economic Structure at The End of The 1980s.**

The knowledge about the characteristics of the economic system at the start of the reform period is of considerable significance for understanding its behaviour in the new conditions and forecasting its further changes. This applies especially to those of its elements which reflect the nascent market relations and/or the structure of the economic system. In order to characterise the economic structure of a country, one should consider the ownership structure, the organisation-and-management structure, the patterns of enterprises and the organisation and nature of their relations.

### **1.1. Ownership Structure**

Bulgaria was among the countries with the highest share of state ownership. A further argument to this conclusion is the fact that cooperative ownership has been turned into a variety of state ownership and the two of them covered 99,9% of the national economy in the 1970s.

A steady policy of restriction and liquidation of private ownership and merger of cooperative and state ownership has been pursued even till mid-70s when a compulsory purchasing of the last private units in craft industry and trade took place. The creation of agro-industrial complexes made cooperative ownership in agriculture de jure equal to state ownership.

In the next years, shifts in the ownership pattern were observed in two directions mainly. First, ways had been searched for the autonomizing of state owned enterprises. There was a very brave attempt witnessed in 1987, when by a declaration of the Parliament state ownership was committed to workers' collective to manage it. To this end, contracts should have been concluded sharing the ownership rights between the state and the workers' collective, and the General Meeting of Workers was to become the chief body of enterprises management. Given the preserved centralised character of economy and minimal opportunity of self-initiative, however, the greater part of workers collective (especially in enterprises with worse than average conditions) did not sign the contracts and the experiment proved to be a failure. Since the beginning of 1989, the rights of the General Meeting of Workers were restricted as 50% plus one of the Governance Board members were nominated by the state.

The second direction of shifts in the ownership structure was related to the admittance of some new specific patterns of private ownership. The first of them were the so-called individual farms. Within a very short time, they accounted for about 30 to 50% of the production of certain agricultural goods, mainly in cattle-breeding and vegetablegrowing. Another pattern of private ownership was for the first time since decades recognised equal in rights to the others, and citizens were allowed establishment of individual, collective and partnership firms. In 1989 the number of registered firms was 9583, of them 7875 individual, 1592 collective and 116 partnerships, in other words, 82% of firms have one employee, i.e. the owner. Actually, their number was much greater – more than 45 000 according to some estimations, it should be taken in mind, however, that 90% of them were private taxi-cabs.

Most of the established farms and firms are small-sized, individual or family businesses which are dependent and subordinate in behaviour. Actually, private activity is rather an additional source of incomes than a factor influencing the changes in ownership structure and contributing to the creation of conditions favourable to market relations development.

## **1.2. Organisational Structure and Subordination of Enterprises**

The organisation-and- management structure of the Bulgarian economy in 1989, as described by Decree 56, was radically different from that in previous periods and rather close to the structure of market economies. There were no branch ministries and a Planning Committee, enterprises were the main entities and they could unite in groups, associations or other organisations to fulfil part of their functions, their relations were regulated on a contract basis.

In order to have a more precise and comprehensive understanding of the real state and character of economic organisation, one should consider the management-organisational structure of Bulgarian economy in the previous years as many of its characteristics were still existent in 1989.

The Bulgarian version of a reform of centrally managed economy is characterised by the presence of intermediate management bodies between the ministry and the enterprise. They vary considerably in range and names. The economic groups proved to be the most stable and long-standing organisation form; usually, they integrated the enterprises in a certain subindustry. In case the number of enterprises exceeded 30 or 40, then the economic group was created on a lower level. In the period from 1976 to 1978 the so-called committees were formed in machine-building; due to the great number of integrated enterprises (from 26 to 67), however, they were soon transformed into smaller groups.

Another form of enterprise integration was the Economic Combine. It was built up on a lower level and had a narrower scope. Economic combines existed either independently or as parts of the economic groups. During the period 1981-1986 they were considered the main economic units.

Changes were also taking place in the scope and name of higher management bodies and organisations. For the longer part of the period considered, branch ministries were



the intermediaries between the economic center and enterprises (economic groups). Though short-lived, the so-called National Economic Complexes integrated enterprises in several close or mutually dependent branches came into being as well. In 1976-1978 they were even considered the main units in the national economy. The formation of industry-based Associations began since 1986. The total of 12 associations were created and the branch ministries were integrated in the Ministry of Economy and Industry.

It is pretty obvious that the Bulgarian economy has been experiencing a non-stop reorganisation and quite dynamic changes all the time. As a rule, changes in the structure or status of economic bodies and organisations had been initiated each five years, in line with the successive Congress of the ruling Communist Party or even between whiles. Changes were of rather ostensible character and did not reflect a real strive towards creation of market relations. Actually, the main concept of the nature of socialist economy and its mode of management remained unaltered.

The proclaimed goal of economic reforms undertaken in the mid-60s was the substitution of economic for administrative way of management of main entities. In practice, this concept affected economic organisation in the following ways:

First, decrease in the number of managed units through creation of groups of enterprises. This ambition was so strong that it resulted in the following paradox: after 1986 when enterprise was declared the basic economic unit in industry not a single independent enterprise actually existed, unlike in previous years when the largest plants were directly subordinate to the branch ministries.

Second, decentralisation of part of the functions on management, coordination and distribution.

Third, estimation of the activity of enterprises groups in terms of not only administrative but some economic indicators as well. The viewpoint was essentially prevailing that production and economic processes in the public economy were related similarly to those in a factory and the problem was to merely determine the optimum scope of its subsystems and the centralism-decentralism ratio.

The changes in the beginning of 1989 were the most radical ever made; anyway, they were to a high extent affected by the former state of economic organisation. Firm organisation was declared the basis of economic activity but the greater part of groups were preserved and just formally re-named into firms. The Planning Committee was no longer existing but state plans, state orders covering up to two-third of firm capacity remained. In its prevailing part, economic activity was regulated by firm rules and normative acts. Although declared one of the bases of economic activity, along with planning and regulation functions of the state, market faced enormous difficulties in the process of its emergence and functioning. In fact, the adoption of Decree 56 in 1989 was only a simulation of market institutions and not a creation of real market relations.

### **1.3. Pattern and Size of Enterprises**

Enterprises are the most stable pattern of economic activity and therefore their variety in size, i.e. small, middle and large scale (multiplant enterprises), is one of the

most significant features of industrial structure.

Industrialisation in Bulgaria was carried out in the 1950s and the 1960s on the basis of technics and technology typical of that time and characteristic of the second stage of development of machine production and its inherent enterprise pattern, the one-plant enterprise.

In the 1970s the necessity emerged of both horizontal and vertical integration of one-plant enterprises with view to creating conditions for their transformation into multiplant enterprises. The Economic Groups established, however, were only horizontal and included automatically all enterprises in a subindustry, while the specialised units dealt with non-production activities mostly.

The situation changed after 1976 when the setting-up of Economic Combines started and especially after 1981 when they were wide-spread in the economy. Combines were considered a pattern of organisation of itself which created possibilities for changes in the primary production unit, they comprised a small number of enterprises, 3 to 6 in average, and integrated both horizontal and vertically, i.e. there were grounds for their transformation into a united production and economic entity.

As was mentioned above, Economic Combines were intermediary management and coordination organisations. This dual nature resulted in a number of combines greater than that of emerging multiplant enterprises. Notwithstanding, the latter exist and this circumstance should be paid due attention in the processes of decentralisation, demonopolisation and privatisation of Bulgarian economy.

In some subindustries (heavy machine-building, for example) multiplant enterprises were created through new construction. One should, however, take into consideration the difficulties faced by centrally planned economies in accomplishing the changes in enterprise pattern through mergers, concentration and specialisation, based on enterprises' initiative.

Another specific feature of socialist economy was the neglecting of small enterprises. They were long treated as a foreign substance or a means for solving social problems, e.g. employment in small cities. Unlike some other socialist countries, in Bulgaria this concept was to a great extent overcome and the implementation of a Programme for building small and medium-sized enterprises was initiated in the beginning of 1981. Enterprises set up under this Programme were characterised by modern equipment, high productivity and efficiency and high quality of produce. Given this, the Programme was extended in 1984 and more than 2000 small enterprises were envisaged to be established till 1990.

After 1986 the accomplishment of the Programme went on a very slow pace and in 1990 it was actually abandoned. There were several reasons for that. First, Bulgaria was experiencing a rising deficiency of convertible currency and the greater part of small enterprises equipment had been imported from the developed capitalist countries. Second, contradictions had emerged between the high-profit small enterprises and the economic organisations they were subordinate to, connected with redistribution of profit. The arguments were that the large enterprise had participated in the design and construction of the small one. A problem like that could have been easily settled in the presence of

corporate ownership and not in the conditions of public ownership, anyway.

The number of modern small enterprises established in Bulgaria in 1981-1988 totalled to about 200-250. They still are among the most attractive subjects of privatisation, including for foreign investors. Moreover, the experience accumulated in creating conditions by the state for the development of small enterprises could be very useful in the period of restructuring of Bulgarian economy.

#### **1.4. Principles of Management**

The model of state enterprises management in the conditions of centralised economy (as was the Bulgarian case, too) was characterised by: fixed plan indicators and results reporting before the higher authorities; centralisation of enterprise profit in the budget and its top-to-bottom redistribution; regulated use of profit residual in enterprises; centralised appointment of directors, etc. Management was executed by two parallel structures, i.e. a purely production and a socio-political structure, represented by the local units of the Communist Party, the Comsomol and the trade unions.

The main shortcoming of this model was the absence of interest and initiative on the part of workers and managers in rising the efficiency of production organisation and management.

The first attempts to change the principles of management of economy dated back to the mid-60s. They were directed at increasing the economic independence of enterprises, i.e. reduction of the number of centrally fixed plan indicators and implementation of some market economy instruments (profit, in particular) for promotion of management efficiency.

These changes were accompanied by enlargement of production structures and introduction of new management units. By the end of the 60s enterprises were integrated in state economic groups. In its relationships with the latter, the Center applied some elements of the new mechanism, but the structure and mechanisms of enterprises remained unchanged.

At the same time, the multi-tier system of management made for the stronger bureaucratisation of the latter and further alienated producers from the final results of their work. Economic groups were therefore rejected and enterprises regained their role of basic economic units. The low rates of growth at the end of the 1970s pressed the state to re-estimate the management approaches.

The concept was then born about the 'new type of brigade' as a basic economic unit which had been allowed building-up of independent accounting and labour remuneration system within the enterprise. The system of so-called counterplanning was implemented aiming at the complete mobilisation and use of enterprise's resources.

Radical changes in the principles of economic management took place in the early 1980s and especially after the adoption of the new Labour Code. Compared to those in the previous years, they were characterised by: first, inclusion of all levels and structures of management in the enterprise; second, a new conceptual basis of the worker-enterprise relationship, on the one hand, and enterprise relationship on the one hand and enterprise-state relationship on the other. This concept found expression in the formula

'The state is the owner, the workers' collective is the stopanin'.<sup>1</sup>

It was for the first in the socialist economy practice when the workers' collective had been assigned management functions. The procedures were also worked out of transferring the property of the state to be managed by the workers' collective. The new model of management envisaged also a change in the source of external pressure over enterprises, i.e. from central plan to market. The market and the workers' collective had to determine the dynamics and structure of production.

The concept about the workers' collective as a stopanin of state property introduced thorough changes in the internal structure of management as well. The General Meeting of Workers turned into the main management body which was responsible for the choice and appointment of the enterprise director. From its very beginning this practice proved to generate complete elimination of the social-and-political structures of enterprises which seriously endangered the political role of the Communist Party in the management of economy. The adopted in January 1989 Decree 56 on the Economic Activity actually stopped the democratisation of management relations and introduced the principle of firm management of economy. Some of its articles contradicted the Labour Code and were gradually abolished.

## **2. Macroeconomic Changes and Creation of Market Environment for the Functioning of Enterprises after 1990**

Bulgaria started economic reforms under rather unfavourable conditions. It was most closely related and respectively dependent on the former CMEA and Soviet Union markets. The moratorium on foreign debt servicing of March 1990 resulted in the country's isolation from the international financial markets. The national economy still suffers the consequences of the moratorium although an agreement was made with the London Club banks providing for reduction and rescheduling of the debt. Despite the serious problems with the agreed debt serving this is perhaps the best achievement for the five years of the reform.

The Persian Gulf crisis and the Yugo-embargo contribute additionally for the collapse of the Bulgarian economy. The internal situation is far from less disturbing. From its past, Bulgaria inherited considerable imbalances, i.e. excess of solvent demand over supply, high capital and energy intensity of the industrial production, etc. The relative political stability was marked by the slow-pace solution of the avalanche-growing problems implying urgent and unpopular measures. These are partly the reasons which caused the implementation of economic reforms under the conditions of an unprecedented economic slump ever seen throughout the contemporary Bulgarian history.

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<sup>1</sup> The term "stopanin" in its economic, social and political sense has not a direct equivalent in English. The nearest are "manager", "supervisor", "administrator"; but the term was used at the same time in political discourses.

## 2.1. Dynamics of Gross Domestic Product

It is since recently that the National Statistical Institute of Bulgaria (NSI) has been calculating the Gross Domestic Product (GDP) of the country. Formerly, data was published only on National Income and Social Product as according to the method of Material Product (Material Balances). The calculation of GDP is done on the basis of correlating the two accounting systems, i.e. of Material Product and of National Accounting.<sup>2</sup> As foreign and Bulgarian experts point out, this methodology has partly caused the significant discrepancy in different estimation of GDP.<sup>3</sup> Besides, this is the reason for the differing forecasts of GDP dynamics. The question here normally arises about the horizon of business revival in Bulgaria. The Bulgarian economy is obviously very close to the "bottom". The expected stabilisation on a rather low level can hardly provide grounds for forecasting a relatively stable growth in the near future. The greatest decline in GDP was recorded in 1991. According to different estimations, in comparison to the previous year the reduction varied between 16.7 percent<sup>4</sup> and 11.7 percent.<sup>5</sup> The decline gradually calmed down in the next years. Yet, the figures for 1994 – 1995 are not very optimistic.<sup>6</sup> The growth from these two years has compromised in (Table 1).

**Table 2.1.**

*Bulgaria: Selected Macroeconomic Indicators*

	1990	1991	1992	1993	1994	1995 Est	1996 proj.
Gross Domestic Product (%)	-9,1	-11,7	-7,3	-2,4	1,8	2,6	-4,0
Industrial Output (%)	-16,0	-27,8	-15,0	-11,8	7,8	8,6	-
Inflation, CPI, annual average (%)	26,3	333,5	82,0	73,0	96,3	62	-
Unemployment rate (as % of labour force, end-year)	1,5	11,5	15,6	16,4	12,8	10,5	-
General government balance (cash balance) in % of GDP	-	-	-13,0	-10,9	-5,8	-5,7	-5
Trade Balance (mln USD)	-	-	-212,4	-885,4	-16,8	431,8	-
Gross external debt (billion USD, end-year)	-	-	12,6	12,9	10,8	10,4	-

Source: Economic Transition in eastern Europe and the former Soviet Union, Transition report, 1996; NSI.

<sup>2</sup> National accounts for Bulgaria, sources, methods and estimations, OCDE and NSI, Sofia, 1996; Statistical Bureau of UNO, document F-20.

<sup>3</sup> See La Bulgarie – Evaluation de la situation économique. OCDE, 1992.

<sup>4</sup> The economy of Bulgaria till 1996. Sofia, 1993, pp. 29-39, 114-115.

<sup>5</sup> PlanEcon Rewiev and Outlook for Eastern Europe, December, 1993, p. 62.

<sup>6</sup> Economic Transition in Eastern Europe and former Soviet Union, EBRD, Transition Report, October, 1994; Transition report 1996, Infrastructure and savings, EBRD, 1996.

The GDP changed considerably in structure. The sharp shrinkage in industry, construction and agriculture resulted in a decrease of their relative share at the expense of services which are continuously expanding. Regarding services, one should bear in mind that their growth is also due to the higher prices in this sector. (Table 2)

**Table 2.2.**

*Structure of GDP*

	Mln. Leva, current prices				
	1992	1993	1994	1995	1996
Agriculture and Forestry	23329	29694	60184	111041	
%	11,6	9,9	10,9	12,7	
Industry	78417	97708	180790	272699	
%	39,0	32,7	31,7	31,3	
Services	92005	151735	268668	401262	
%	45,8	50,7	45,9	46	
GDP	200832	298934	548015	871396	
%	100	100	100	100	

Source: Statistical Reference Book, NSI, 1996, 188-189.

In 1993 – 1995, positive growth rates were recorded in some industries including metallurgy, chemistry, and printing and publishing industry, the latter being in a good condition from the very start of reforms. A nucleus of big state enterprises is developing which successfully adapt to the shocks of transition. The prevailing part of enterprises, however, are in a heavy financial condition. The lack of adequate bankruptcy regulation and delay of settlement of state enterprises "bad debts" accumulated after 1990 is making for the continuing allocation of national savings with inefficient activities. The first signs of revival in industry have been neutralised by the negative results in agriculture.

The unprecedented slump in the Bulgarian economy has been caused by factors which are still working.

They can be classified into two main groups, namely: first, factors related to reduction in demand, and, second, factors related to problems of supply.

**The first group** of factors include the sharp decline of Bulgarian exports to the CMEA area, the deterioration of Bulgarian terms of trade amounting to nearly USD 600-800 million, the reduction and subsequent actual disappearing of investment demand, the formation of undesired production stock etc.

**The second group** of factors stem from relative prices modification in favour of the first-echelon industries; this might result in the disappearance of branches of high relative value added share. This modification is seriously restraining the possibilities for

economic restructuring. The difficulties in financing Bulgarian imports, which result from foreign debt problems, are acting in the same direction.

The crisis in 1996 showed that in result of not executing of the inevitable structural reforms the unfavourable action of these factors increases.

## **2.2. Inflation and Antiinflationary Policy**

Following vain discussions on the issue of what to start reforms with, i.e. demonopolisation and privatisation or liberalisation of prices, Dimitar Popov's coalition government made what seemed to be the only possible step – liberalisation of all prices – with the exception of- but those of 14 commodity groups.

Parallel measures were undertaken for partial compensation of incomes. Besides, there were attempts to demonopolise the economy through the opening up of the existing units (and respectively the change of their governments).

Subsequently, the commodity groups under control were further reduced by seven. Under control remained the prices of fuel, energy, and some services as transport, communications etc. Except for the activities of the State Price Inspectorate, which has very limited functions, government intervention in price formation is practically non-existent. For a full liberalisation of the prices was spoken up after the crisis 1996 in the eve of the introduction of the Monetary board.

The combination of price liberalisation and foreign-trade regime liberalisation, on the one hand, and the enacting of domestic convertibility of the BG Lev, on the other, made the Bulgarian economy suffer serious price shocks. According to data of European Bank for Reconstruction and Development, the consumer price index in 1991 was 339 percent, in 1992 – 79 percent, and in 1993 – 64 percent etc. Unfortunately the pessimistic expectations of the bank for 1996 were increased twice. In the end of 1996 and the beginning of 1997 Bulgaria faces hyperinflation process.<sup>7</sup> (Table 1)

Following price liberalisation, the scissors opened between consumer and producer's prices. The latter are considerably lagging behind consumer prices. In the period 1991-1992, the low prices maintained by regional purchase organizations (monopsony) had a certain restraining effect on inflation. This situation began changing in 1993, although the relative prices in agriculture still make for the rather heavy situation in the sector. The average monthly inflation rate in 1993 was 0.7 points lower than in 1992. The dynamics of consumer price index in 1993 was due mainly to the quick rise in the prices of some services resulting from the growth the controlled prices of energy, fuel, transport and communications.

The 1994 increased inflation rate is due to both the enforcement of the Value Added Tax Act which was not relevant to the local environment, and the currency market crisis which caused considerable depreciation of the Bulgarian Lev.

The avoidance of inflationary spiral remained a priority of economic reforms. In spite of this after the relatively stable 1995 Bulgaria appeared in dramatic economic

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<sup>7</sup> Transition report 1996, EBRD, p. 113; National Institute of Statistics.

situation and is facing the "loop" of hyperinflation.

Due to all that the antiinflationary policy is based on reduction and restructuring of budget expenditures. Price liberalisation brought forth removal of subsidies. The important problem here is the high level of budget deficit and its financing mechanism in the conditions of monetary restriction. (Table 3; Table 4) Given the almost vital delay in structural reforms, further hardening of budget restrictions makes financial discipline even worse. The inflation-generating interfirm indebtedness is increasing as well.

**Table 2.3.**

*General Government Operations: Revenues, Expenditures, and Fiscal Balances (In percent of GDP)*

	1988	1989	1990	1991	1992	1993
Revenues	57,5	58,0	53,3	42,3	37,0	30,6
Expenditures	58,4	61,4	64,3	50,7	43,9	41,7
Fiscal Balances	-0,9	-1,4	-12,7	-15,1	-14,0	-13,5

Sources. NSI, FMI staff estimates.

**Table 2.4.**

*General Government Operations at 30 of November (mln. leva)*

	1994	1995	1996 '
Revenues	118834,0	176536,7	278570,6
Expenditures	150926,8	232205,5	432727,8
Fiscal Balances	-32092,8	-55668,8	-155857,3

Sources: Information bulletin, BNB, 1994-1996.



**Table 2.5.**

*Money Supply, Bulgarian National Bank Exchange Rate  
and Interest Rate (Mln Levs)*

	1992	1993	1994	1995	1996
Broad money	158567	234072	418009	583663	-
Money (M1)	37833	48303	75131	107886	-
Quasi -money	117149	181619	333978	463419	-
Exchange Rate – Levs/USD (end of the period)	24,429	32,711	66,015	70,704	-
Interest Rates (end of the period)	41,0	52,0	72,0	34,0	

Sources: Statistical Reference Books, NSI, 1994-1996, Sofia.

The Bulgarian National Bank succeeded in maintaining a relatively stable rate of BG Lev till the autumn of 1993 (the absence of stabilisation fund, however, hampered its use as an anchor of economic stabilisation). After that and especially since the March, 1994 the currency rate became an important pro-inflation factor. (Table 5). In 1996 the Bulgarian lev depreciated over 4 times to the USD. The economy could not stand long postponed structural reforms and the serving of the foreign debt.

Monetary and incomes policy have been and still are the main components of antiinflationary policy.

Monetary policy relies on administrative and "quasi-market" instruments, i.e. high interest rate, credit ceilings, and some forms of trading idle credit funds; determined by the Bulgarian National Bank. Restrictive monetary policy limited the growth of money stock below the inflation rate. This was particularly noticed in 1993.<sup>8</sup> (Table 5)

The continuing restriction has its negative effects, too, as credit flows increasingly gravitate to "bad" loans. This is inevitable in the absence of a strict bankruptcy regulations and state strategy of large enterprises restructuring.<sup>9</sup>

It is a common opinion that the incomes policy in Bulgaria has not been restrictive to the full. That's why stabilisation in Bulgaria is considered rather of mixed than orthodox character. Perhaps, it was exactly the situation in the first years of system changes when the principle of collective bargaining was accepted.

<sup>8</sup> Analytical Review of the Bulgarian Economy in 1993. Agency for Economic Forecasts and Development, Sofia, 1994.

<sup>9</sup> Externely interesting study of the monetary polisy in the transition economies is made by N. Nenovski in his dissertation: "Money Market in the Transforming Economies (theoretical analysis and econometric studies of the example of Bulgaria)", Sofia, 1996.

Subsequently, given the sharp reduction of possibilities for budget manoeuvres (especially after the expected introduction of Monetary board), the hardening of budget restrictions on non-financial public sector and wage freeze seemed inevitable.

### **2.3. Unemployment**

The successful course of economic restructuring depends on the level of unemployment. It is well-known that when unemployment exceeds a certain level society gradually loses patience. In Bulgaria, like in Poland and Romania, unemployment is very close, if not above the socially admissible limit. Unemployment in Bulgaria is accompanied by worsening of the demographic situation. Population growth rates have been negative since years, down to -2.9 per thousand in 1993 and to -5,0 per thousand in 1995. The average age increased from 37.5 years in 1991 to 38.7 years in 1995. By the end of 1995, the working age population numbered 4,745,423. From them to the end of 1995 employed are 3310,9 million persons. (Including 1902,3 million employed on labour agreement in the public sector).<sup>10</sup>

**Table 2.6.**

*Unemployed Persons Registered at the Employment Offices, 1990-1995*

Year	January	June	December
1990	—	—	65079
1991	74134	233724	419123
1992	426017	475822	576893
1993	578788	586538	626141
1994	631987	508638	488442
1995	499176	408453	423773
1996	-	-	-

Source: Main Macro Economic Indicators 1991-1995, NSI, Sofia, p. 105.

According to data of NSI, by the end of 1995 the rate of unemployment was 11,1 percent. The number of registered unemployed increased from 65 thousand in 1990 to 423773 thousand in 1995. The situation was extremely hard in 1991 when unemployment manifested a sudden rise from 65 thousand to more than 400 thousand. (Table 1, Table 6) The average monthly rate of unemployment decreased from 1.48 percent in 1992 to 0.86 percent in 1993.

There is a certain "normalising" of the unemployment structure by qualification. It is highest with low-qualified people and lowest with specialists. What is disturbing, however, is that about half of the unemployed are below 30 years old. The greatest decline in employment has been registered in industry and agriculture. Services mark a relatively stable level of employment, and the only increase has been observed in the financial sphere.<sup>11</sup>

<sup>10</sup> General macroeconomic indicators 1991 -1995, NSI, Sofia, 1996; Statistical Reference Book, 1996.

<sup>11</sup> See, J. Christoskov, *Mam tendencies in employment and unemployment in Bukgaria*. Ikonomicheska Missal, 1993, № 11.

Presumably, the acceptance and enacting of the Fourth chapter of Trade Law determining the failures will bring about the closing of enterprises of 300 thousand employees. In the announced for liquidation from the Videnov cabinet about 60 enterprises are employed over 60 thousands people; and the enterprises from the so-called "isolation" scheme – more than 200 thousands. These lists are abolished by the official Sofianski cabinet but the extremely serious and painful problem with the closing of the losing enterprises remains. In the middle run, the number of unemployed in Bulgaria is expected to "stabilise" at about 450-500 thousand. According to the official 1995 data a lower number of the registered unemployed individuals is reported. (Apparently, this is due to the increased number of the non-registered unemployed individuals which is normal under high unemployment rate.) In the same time the series of laws providing the legal framework of economic reforms and state enterprises restructuring is not finished by those closely related to business and production. Laws on social issues are also institutions of free market economy and bear direct relevance to securing the economic reforms. The lacking balance and complementarity between strictly economic and social laws, and the underestimation of the latter (in Bulgaria, in particular, it found expression in the continuous neglecting of the Labour Code and in the absence of Law on Employment), bring about social tension and discredit on the reform.

## **2. 4. Opening of Economy**

Macroeconomic stabilisation was attended by the initial steps of opening of the Bulgarian economy. These included implementation of floating exchange rate<sup>12</sup> and removal of the allow-and-ban regime of foreign trade transactions and quantitative import restrictions. Subsequently, the latter was to a certain extent regulated by the imposed import taxes. Subsidies were also abolished on goods imported for production of export commodities. On 1 July 1992 Bulgaria introduced a new custom tariff. It is oriented to a rise of import duties. The average increase of duties amounted to 17.8 percent, including the formerly introduced import taxes. Experts, however, expect a lower real increase.<sup>13</sup> These measures, along with import quotas, additional duties, anti-dumping import regulation, etc. make for the conclusion that – at the first stages of the reform – the liberalisation of foreign trade in 1991 and the beginning of 1992 has been gradually yielding room to protectionism.<sup>14</sup> The policy from 1992 was continued in 1993, 1994 and 1995. Practically each government announces before the beginning of the calendar year a list of goods the trade with which (mostly their export) is determined in a specific way. During the year a different ad hoc modifications are made<sup>15</sup>.

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<sup>12</sup> BG Lev will be fixed to one or some west currencies (may be dollar/mark) with the introducing of Monetary board.

<sup>13</sup> See, T. Houbenova-Delisivkova, The association of Bulgaria to the European Community – possibilities and perspectives. *Ikonomicheska Missal*, 1993, № 1.

<sup>14</sup> Analytical Review of the Bilgarian Economy in 1993. Agency for Economic Forescast and Development, Sofia, pp 93

<sup>15</sup> R. Dobrinski, Current state and prospects of Bulgarian exports, Bucharest, may 1996, mimeo

One can hardly expect something quite different, having in mind the problems of import financing and the fact that Bulgarian export is dominated by resource intensive sectors. Nevertheless, a step-by-step decrease in duties is envisaged aiming at the formation of free-trade zone between the European Community and Bulgaria within the next ten years.

Three important circumstances determine the national frame of the foreign sector of Bulgaria after the disintegration of CMEA:

1) From 1 February 1995 Bulgaria is associated member of the European Unions. Foreseen is the creation of Zone for Free Trade between the European Unions and Bulgaria. The Bulgarian government ratified the three additional protocols to the European agreement concerning the trade with textile goods and clothes; temporary agreement on trade; the quantity limits upon the ferrometals and goods from them, coals, etc.

2) On 2 October in Geneva was signed the Protocol for association of the country to the Marrakesh agreement for creation of World Trade Organisation. With this act Bulgaria engaged with the packet of agreements concerning the rules and norms in applying its national trade policy for the movement of goods between the member countries; concerning the trade with services; as well as concerning the protection of the rights of the intellectual property.

3) The agreements for creation of zone for free trade between Bulgaria from one side and Czech Republic and Slovakia from the other dated from the beginning of 1996. These agreements lay on the institutional base of the association of the countries to the European Unions and of their membership in the World Trade Organisation and create perspectives for the association of Bulgaria in CEFTA.

There was a sharp reduction in the volume of foreign trade after the collapse of CMEA and the start of system changes. Besides, specific difficulties emerged related to its accounting. According to OECD experts, the Bulgarian statistics does not record about one-third of the foreign trade turnover of the country. Discrepancies also exist between the information provided by the National Statistical Institute on the basis of customs declarations, on the one hand, and that of the Bulgarian National Bank on the basis of settlements of commercial banks accounts, on the other. Another problem of similar nature is the accounting of trade in terms of US dollars.

At the first stage of the transition Bulgaria paid a lot the consequences of its considerable commitment to the former CMEA and the former Soviet Union. According to some estimations, the value of Bulgarian exports in current prices fell from USD 6.65 billion in 1989 to USD 3.40 billion in 1992; the value of imports respectively decreased from USD 7.33 billion to USD 3.36 billion. To make a comparison, during the same period the Hungarian exports grew from USD 9.67 billion to USD 10.68 billion, and its imports – from USD 8.86 billion to USD 11.12 billion. A sharp decline was recorded in Bulgaria's turnover with the East European Countries, i.e. from USD 7.51 billion in 1989 to USD 2.65 billion in 1992. The same situation was observed with regard to the OECD

countries from USD 4.01 billion to USD 3.0 billion. The decline was due to the sharp reduction in imports.<sup>16</sup>

The commodity structure (Harmonised system – HS) of Bulgarian foreign trade underwent considerable shifts. At present, fuel, minerals and metals are the most important items of exports. Next come foodstuffs and chemicals. In 1992, the export of investment goods was reduced down to 12 percent. The import is dominated by fuel, minerals and metals. Their relative share was 60 percent in 1991 and 40 percent in 1992. The import of investment goods was thus reduced to 10-15 percent.<sup>17</sup>

According to newer study of the Bulgarian trade with industrial goods with the countries from the European Union (...U-12) for the period 1990-1994 the Bulgarian export increased from 436 mln. USD to 1 211 mln. USD. The percentage of the goods from 06 and 08 (by SITC), where are respectively ferrous and non-ferrous metals and textile and swing industry is higher. At the same time the Bulgarian import of industrial goods (positions 05-08 – SITC) from the Union increased from 956 mln. USD to 1451 mln. USD. The goods from 07 (equipment and transport vehicles) are with the greatest percentage. The Bulgarian deficit from the trade with goods from 05 and 07 (SITC) does not compensate from the positive trade balance from 06 and 08.<sup>18</sup>

The potential of re-orienting the Bulgarian foreign trade could be assessed on the basis of comparing its regional structure to that in countries like Portugal and Spain before they joined the EC. According to J.J.Boillot, such a comparison points to a continuing overestimation of Bulgarian trade with the former CMEA-area, i.e. +13 points, and underestimation of trade with developed West European countries, -15 points, respectively. J.J. Boillot makes these estimations on the base of the use of traditional models. The tendencies of the Bulgarian specialisation can be shown using indicators of external trade specialisation such as – relative export and import structure of a specific kind of goods and for Bulgaria; position in the foreign markets (indicators Lafay); indicators intra-branche/intra-produit, etc. (Table 7)

The analysis of the relative structure of the Bulgarian export and import of industrial goods with the countries from the European Union show possible advantages in the trade with traditional industrial goods – metallurgy and textile; and significant advantages for the Union in the trade with equipment and transport vehicles. This is confirmed by the values of the indicators Lafay for the positions of the Bulgarian export and import on the international market. Concerning the indicators of B. Balassa – intra-branche/intra-produit – a specialisation for Bulgaria is seen in the trade with goods from 06,08 and mostly 07 (by SITC), on which position Bulgaria is almost the only importer.<sup>19</sup>

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<sup>16</sup> See J.J. Boillot. *La transition commerciale et la stabilisation a l'Est*. 1993, Paris.

<sup>17</sup> *The Economy of Bulgaria till 1996*, Sofia, 1993; V. Yotsov, *Bulgaria's foreign trade in transition*, *Ikonomicheska Missal*, 1993, № 9-10, pp 74-75; NSI, *Exports and Imports*, 1992.

<sup>18</sup> Look for details in Vesselin Mintchev, *Les échangés industriels entre la Bulgarie et l'Union Europeene*, *Enchevetrement industriel et gravitation commerciale*, PHARE-ACE P 95-2030-R, mimeo. The study is based on mirror statistics of OICR – 05-08 positions at SITC – to 3rd mark for the period 1990-1994.

<sup>19</sup> *Ibid.*, p. 13-16.

**Table 2.7.**

*Indicators for stabilisation of the Bulgarian trade with industrial goods with the countries from the European Union, 1994, %, (compared with the trade on the world markets)*

	Relative structure		Indicators Lafay	Indicators intrabranche intra-produit
	EU - 12		EU - 12	EU - 12
	export (t)	import (u)		
05	118,42	97,68	-0,01	91,79
06	167,20	111,22	0,03	78,53
07	33,24	97,32	-0,04	49,33
08	174,37	113,88	0,00	74,87

Source: Vesselin Mintchev, *Les echanges industriels entre la Bulgarie et l'Union Europeenne*, 1996, mimeo, p. 13-16.

Even after the reduction of the Bulgarian foreign debt to the London Club banks, the diminution of foreign indebtedness will be still possible only if nearly 10 percent of GDP is placed for debt servicing. Given the present crisis of transition, it would be more realistic to prevent a further debt increase, and thus expend smaller portion of GDP on its servicing. According to some experts, with 5 percent of GDP on servicing, the debt should not grow any more.<sup>20</sup>

In 1992, Bulgaria's net debt was calculated at USD 12.3 billion. (Table 1) The debt-GDP ratio increased from 0.42 in 1989 to 1.48 in 1991 and 1.39 in 1992.

Bulgaria succeeded in renewing its debt agreement with the Paris Club. Bulgaria signed the very important agreement with the London Club banks.<sup>21</sup>

The foreign debt service, despite its 40% reduction and the renewed access to the international financial markets, is still a serious barrier to the structural reform. The Debt Agreement covers the period up to 2003. The largest portion of payments should be made in 1995 – 1997 at a rate of 0,7 – 1,3 billion USD. In the period 1995 – 1997 the largest payments to the International Monetary Fund, World Bank and G-24 are to be provided; in the period 1998 – 2010 the payments to the Paris Club banks will mature, and in the later period (2002 – 2010) the London Club banks will require the due payments. Until the end of the century one fourth of the Bulgarian export and more than 10% of the budget expenses have to be "allocated" to serve the foreign debt. (Table 8)

<sup>20</sup> See, *Eurasia Outlook for Foreign Trade and Finance*. The WEF A Group, January 1994.

<sup>21</sup> "Pari" Newspaper, 6 May 1994.

**Table 2.8.**

*Foreign Debt Service (mln. USD)*

	1995	1996	1997	1998	1999	2000
Foreign Debt Service	741	910	1,313	662	774	862
- London Club	278	299	309	318	327	335
- Paris Club	36	36	36	92	165	181
- IMF, IBRD, G-24	339	336	522	168	195	225
- Miscellaneous	88	239	446	84	87	121
Foreign Debt Service/GDP – %	8,0	9,5	13,2	6,5	6,9	7,0
Debt Service Ratio %	17,4	20,4	27,6	13,0	14,1	14,4
Interest payments/ budget expenditure %	40,6	34,8	33,0	25,3	22,2	19,3
-External Debt %	12,8	13,6	14,3	9,3	9,2	9,3

Sources: Angelov, Ivan, Economic Outlook of Bulgaria, 1995-1997, S, 1994, p. 124-126.

Bulgaria could not manage with the challenge of the foreign debt in 1996. The end of 1996 is marked with the suggestions for introducing a monetary board. The currency reserves of BNB in the beginning of 1997 are 408 mln. USD. They are under the "sanitary control" according to which the reserve should be able to assure three-month import of the country. The availability of reserves with BNB and the respective possibilities of debt servicing result from the balances of the current account and capital account of the balance of payments. Bulgaria is with negative trade balance in the period 1992-1994. By preliminary data of NSI the deficit is overcome in 1995 (Table 9) Trade balance is likely to stabilise at an extremely low level, i.e. about 30-40 percent the foreign trade turnover in the period 1985-1989. This stabilisation does not generate a lasting growth and 1996-1997 will be the serial worse years for the Bulgarian transition. The balance of services is passive, too. It was for the first time in 1991, when Bulgaria recorded unfavourable balance in tourism. A turn for the better is expected to appear in 1994-1995. The problems in transportation balance are to a great extent due to the Yugo-embargo losses.

Foreign investors in Bulgaria can be classified as follows:<sup>22</sup>

- Transnational companies, aiming at developing, consolidating and preserving their position and advantages within the international oligopoly;
- Followers', aiming at improving their general condition, taking advantage of the specific potential of the Bulgarian market;

<sup>22</sup> See détails in L. Maroudas et Y. Rizopoulos, La Bulgarie dans les stratégies d'internationalisation des firmes occidentales, Revue d'études comparatives Est-Quest, 1995,1(mars),p. 125-129.

- Big groups or small and average enterprises that settled on the Bulgarian market before 1989, with steady position and contacts.

Typical of the first group are participation in privatisation – some of the first privatisation deals in Bulgaria are a result of the global strategy of transnational companies for coming into position on Eastern markets. Thus, the Belgium subsidiary *Amilum of Tate & Lyle* (the *Sara Lee* group) purchased Tzarevitchni Producti, Razgrad'. Following the same strategy, *Kraft Jacob Suchard* purchased 80% of *Republika*, Svoge, *Danone* purchased *Serdika*, Sofia, etc. It is no coincidence that *Shell* are among the first investors in the country.

**Table 2.9.**

*Balance of Payments of Bulgaria*

(*mln. USD*)

	1992	1993	1994*	1995*
Current account	-360,5	-1098,0	-24,8	293,3
Trade Balance**	-212,4	-885,4	-16,8	431,8
Export of goods, f.o.b.	3956,4	3726,5	3935,1	5110,3
Import of goods, f.o.b.	4168,8	4611,9	3951,9	4678,5
Services, net	-191,0	-249,5	-181,7	-270,4
Transport***	-2,5	-72,2	-89,9	-6,3
Tourism	-98,7	50,5	117,9	277,8
Interests****	-95,6	-192,3	-192,5	-454,8
Other •	5,8	-35,5	-17,2	-87,1
Private transfers, net	39,8	36,9	164,1	117,0
Official transfers	3,1	0,0	9,6	14,9
Capital account	785,6	791,2	31,9	-53,9•
Direct Investment, net	41,5	40,0	105,4	90,4
Direct investments abroad	-	-	-	8,0
Portfolio investments (net)	-	-	-9,8	-41,3
Middle-term and long-term credits received, net	129,9	-46,3	220,8	-93,9
Support of the payment balance	-	32,0	143,6	• 0,0
Loans extended, net	307,7	285,5	263,1	292,6
Short-term debt	-147,6	-0,1	17,0	-118,4
Other capital	454,1	480,1	7,8	-191,3
London – Club	-	-	-716,0	-
Errors and omissions	-29,2	17,3	79,7	172,1
OVERALL BALANCE	395,9	-289,5	86,8	411,5

Sources: Statistical Reference Book, NSI, 1996, Sofia, p.92

\* – Preliminary data

\*\* – Duty data

\*\*\* – Including passenger transport

\*\*\*\* – On the base of paid (reseived) interests



The “followers” are primarily Bulgaria's neighbouring countries, such as Greece. Comparatively non-competitive at European markets, they have comparatively big opportunities for expansion at the Bulgarian market.

In the third group of enterprises the *Dow Chemical* stands out, which have been working for years with many Bulgarian companies.

Foreign investments in Bulgaria are settled by the *Law on economic activities of foreign persons and protection of foreign investment* adopted in 1992. With its adoption the Law on foreign investment of 1991 was dismissed.

The law provides definition of the term 'foreign investment' (Art. 9 of the Law). No restrictions are provided concerning the amount of foreign share in newly established or existing companies (Art. 3).

The 'permission' regime is dismissed. There are exceptions for investments in certain sectors, as for example the defence industry (Art. 5). Investments in the banking sector are liable to registration by the Bulgarian National Bank (Art. 5). Under certain conditions, foreign companies are freed from taxes. Repatriations of gain, as well as of liquidation quotas are permitted.<sup>23</sup>

A decline in the inflow of direct foreign investment could be observed in 1995. (Table 10) Investors expect the preparation of the mass privatisation scheme, the specifying the shares offered for mass and cash privatisation, etc. The reported decrease is compensated for by increase in items 'indirect' and 'other' foreign investment, as well as by fulfilling engagements on privatisation deals for additional investments.

**Table 2.10.**

*Direct foreign investment, by years*

Year	Total number	Amount, in USD	Percentage of total amount
1991	33	14 128 702	2.66
1992	38	50 727 798	9.56
1993	606	130 357 825	24.58
1994	2279	234 003 217	44.12
1995	1850	101 153 553	19.07
Total	4806	530 371 096	100.00

Source: Agency for Economic Coordination and Development, Sofia

Branch structure of direct foreign investment remains unchanged. The level of investments is such that any more significant engagement could seriously change the situation. (Table 11) There are changes, however, in investment structure by countries. Almost 40% of investments are of Germany. Greek enterprises are growing more and more active, especially as regards to increasing the capitals of existing companies. (Table 12) About 90% of capital invested in the country is concentrated among 70 companies. (Table 13)

<sup>23</sup> See the Law on economic activities of persons and protection of foreign investments.

**Table 2.11.**

*Foreign direct investment, by branches (as of 1511211995)*

Branch	Relative share, in %
Industry	37.0
Transportation	21.0
Trade	19.5
Construction	5.5
Others	17.0
Total	100.0

Source: Agency for Foreign Investment, Sofia

The bulk of investments in Bulgaria are result of privatisation deals. About \$159 million were paid about them. To this value should be added also the contracted future investments amounting to \$ 189 million. Liabilities of privatised enterprises, amounting to \$17.2 million, and BGL 146.6 million are covered. (Table 14)

**Table 2.12.**

*Direct foreign investments by countries (as of 1511211995)*

Countries	Number	Amount, in USD	Percentage of total amount
Germany	221	204 282 571	38.52
Switzerland	77	41 645 923	7.85
Belgium	64	40 768 143	7.69
Greece	781	36 543 708	6.89
USA	147	32 327 398	6.10
The Netherlands	63	31 977 526	6.03
Austria	159	26 009 771.	4.90
Great Britain	97	23 224 400	4.38
Former USSR countries	317	13 484 078	2.54
France	67	11 665 257	2.20
Others	2814	69 442 321	12.90
Total	4806	530 371 096	100.00

Source: Agency for economic coordination and development, Sofia.

**Table 2.13.**

Direct foreign investment, by amount (as of 15/12/1995)

Amount, in USD	Number	Value, in USD	Percentage of total amount
1 000<	3543	1 588 186	0.30
1 000 – 10 000	742	2 056 591	0.39
10 000 – 100 000	331	11 688 665	2.20
100 000 – 1 000 000	120	38 818 346	7.32
> 1 000 000 000	70	476 219 307	89.79
	4806	530 371 096	100.00

*Source:* Agency for economic coordination and development, Sofia.

**Table 2.14.**

Transaction by the Privatisation Agency with participation of foreign investors (1993-1995)

Enterprise	Date	Sector	Sold shares%	Price (mln)	Future investment	Foreign investor
Tzarevitchni		Food				Amilum,
Producti	12.05.93	industry	81	USD 20	USD 20	Belgium
Republika	15.11.93	Food	80	USD 2	USD 10	Kraft General
Hidroprobivna	10.02.94	industry	97	USD 0,35	USD 0,35	Foods, Ltd
Technika	11.02.94	Machine	100		DM 5,6	Breakers A/S
Gazobeton	13.06.94	tools	70	USD 2,1	USD 7	Co., Denmark
Sh.Z I.-Solia	02.08.94	Construe	55	USD 55	USD 48	Ytong Ltd,
Somat	16.09.94	tion	80	DM 0,7	DM 4	Germany
Eskos Dograma	28.10.94	Food	80	USD 21,7	USD 41,4	Gibu Ltd, Italy
Zagorka	03.11.94	industry	80	DM 65	DM 31,87	Brewinvest
Separate unit	14.12.94	Trans	67	USD 5,02	USD 19,7	S.A., Greece
from VAMO-	25.01.95	port	80	USD 0,1	USD 6,5	Rover-
Varna	27.04.95	Wood	67	BGL 185	BGL 350	Bulgaria, Ltd
Vitosha Hotel	02.11.95	process	80			Ivan Zografski,
Kamenitza	03.15.95	brewery	70			Germany Interbrew,
Burgasko pivo						Belgium
Storko						Interbrew,
Trading Ltd						Belgium
Pirinska mura						Luxcraft
						Evrotech Ltd
						USA-Bulgaria

Source: V. Blagoev, Privatisation in Bulgaria, Bulgarian Privatisation Agency, 1996, mimeo

Difficulties originate from discrepancies between supply of enterprises, offered by privatisation programmes up to now, and investors' demand. No sooner than 1996 a decision was reached on the privatisation of 16 attractive infrastructure, chemical and mining industry enterprises.

**Table 2.15**

*Registered joint ventures in Bulgaria, by years*

Year	Number of joint ventures
Before 1991	17
1991	13
1992	20
1993	15
1994	16
1995	3
Total	84

Source: Agency for foreign investment, Sofia.

Bulgaria is losing its satisfactory start of making joint-ventures in the beginning of the 80s (Decree N 535 of 1980). During the period 1979-1988 among preferable forms of cooperation between the East and the West, along with joint production contracts, sub-execution and joint research, are also the establishment of joint ventures. There are about 20 ones in Bulgaria. Some of them, as BIMAC, are presently among the most successful foreign participation.

For the period 1990-1995 establishment of join ventures in the country is rather unsatisfactory. They are not among frequent forms of foreign investments. Most numerous are Bulgarian-Russian and Bulgarian -Greek joint ventures. As Table 16 indicates, most numerous are joint ventures within the system of the Ministry of Industry, where the foreign investor is generally of a majority participation.

Flimsy establishment of joint ventures can be attributed to the country's foreign trade orientation until 1989, as well as to procrastination of privatisation and structural reforms, of oppressive and continuous procedures, duty taxation on non-monetary payments (fées) of foreign partners.

According to the Bulgarian AECD investments in the banking and financial sectors are grouped into 11 banks and bank branches, and in several investment funds.

The bulk of the banking sector investments, 67.2%, were made in 1995. Among the most significant ones are: the Bulgarian-Russian Investment Bank, Raiffeisen Zentralbank, BNP – Dresdner Bank, Ionian Bank. The efforts of most foreign banks are to administer contacts between their foreign customers and local enterprises. (Table 17)

**Table 2.16.***Registered joint ventures, by branch ministries*

Institution	Number	Average amount of share the foreign investor, in %	Total amount of foreign share, in USD
Energy Committee	7	1.4	504 248
Posts and communications Committee	4	50.9	131 976
Travel Committee	14	62.2	1 334 233
Ministry of Transportation	17	76.5	24 996 016
Ministry of Industry	28	61.0	60 541 102
Ministry of Agriculture and Food Industry	14	49.4	5 802 697
Total	84	-	93 310 272

Source: Agency for foreign investment, Sofia.

**Table 2.17.***Foreign Investment in the banking sector by years, in %*

Year	Relative share, in %
1993	3.29
1994	29.68
1995	67.2

Source: Agency for Economic Coordination and Development, Sofia.

**2. 5. Development of the Private Sector**

In the transition from command-administrative economic system to market economy, the executive power should pay special attention to the recovery and development of private sector.

In June 1992, the Council of Ministers passed a Decree 107 on creating conditions for the development of small business. Under this Decree, "Small Enterprises" Fund was established with the former Ministry of Industry, Trade and Services, subsequently transformed into Ministry of Industry. The Fund is managed by a Management Board appointed by the Council of Ministers. The Fund's resources are supplied by the state budget, foreign financing, endowments, purpose contributions, etc. The Fund is crediting on easy terms the small and medium-sized business. Besides, a Small Business Act is to be entered in the Parliament in the near future.

The Bulgarian Chamber of Commerce and Industry (BCCI), the Bulgarian Economic Chamber (BEC), and the Union of Private Enterprising (UPE) are the institutions which

represent the private sector in the country. They have suggested the setting up of an Investment Bank of private entrepreneurship aid.

According to data of the National Institute of Statistics the total number of registered firms was 508 429 by December, 31 1995; of them 466 455 were of prevailing private ownership and 41984 – with predominantly state property. The greatest part of private firms operate in trade-sector – 285 543. There are 61 121 in industry, 40 441 firms in transport and communications, etc.<sup>24</sup>

At the first stage of the reforms out of the all registered private firms, 69 percent have present annual accounting reports in compliance with the requirements of the Accounting Law. Firms, which have not provided data are most probably non-operating. Of those, which produced information, 61.7 percent were profitable, 32 percent losers, and 6.3 percent break-even. Firms of annual revenue below 100 thousand BG Lev numbered 43,430, and those above 1 million BG Lev were 7,618. Of the latter, 886 reported a revenue above 10 million BG Levs.

The best financial condition was observed with firms in construction, finance and transport. Regarding employment, 91.3 percent of private firms have less than 5 employees, and only 0.3 percent – more than 50.<sup>25</sup>

The relative share of employment in the private sector in Bulgaria was 5.9 percent in 1990 and 40,7 percent in 1995.<sup>26</sup> The increase is due to the entrance of part of the employees fired from the state and cooperative sectors. The estimations of employment in the private sector at the first stages of the reform vary from 670 thousand (NSI) to 900 thousand (AEFD). Given the considerable difficulties in determining the framework of private sector, these estimations should be considered rather conditional and, probably, very exaggerated. By data from NSI in 1995 the employees in the private sector were 1348 910 people.

The share of private sector in the Gross Value Added increased from 9.1 percent in 1990 to 30,5% in 1994 and 49,6% in 1995. The greatest contribution to this growth came from services and agriculture. The private sector is dominant in agriculture<sup>27</sup>and trade, and comes up to 64 percent in construction.

### **3. National Policy and Institutional Framework of State Enterprises Restructuring**

The transition to market economy in Bulgaria started in the conditions of full domination of state ownership in industry. At the end of 1989 the state sector covered more than 95% of fixed industrial assets, nearly 75% of industrial labour force and created about 84,1% of the National Income. In the state sector, subject to centralised planning was not only the prevailing part of production but also the establishment, expansion or closing (respectively reorganisation) of enterprises. Most of them were large

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<sup>24</sup> Statistical Reference Book, NSI, 1996, p. 202-203.

<sup>25</sup> Results of private firm activity in 1992, NSI, 1993.

<sup>26</sup> Statistical Reference Book, NSI, 1996, p. 62-63.

<sup>27</sup> Statistical Reference Book, NSI, 1995, p. 105. Statistical Reference Book, NSI, 1996, p 190-191.

units allocated mainly in machine-building, chemistry, metallurgy, electrotechnical industry and electronics, textile industry, etc.

The specific regime of their functioning and the lack of real competition, fixed prices (often set in compliance with national expenses) secured markets within the CMEA etc., in particular, concealed to a great extent the real efficiency of particular productions, allowed the artificial maintenance of activities, organisation structures and units and made for the emergence of imbalances throughout the economy.

State enterprises restructuring is one of the means for overcoming the imbalances and for the entire restructuring of economy. This process of changes simultaneously going in production and technology structure of industry and in the priorities of individual productions and sectors, on the one hand; on the other, these are changes in the organisation-and-economic conditions of functioning, in the organisational and legal status and in management and technique of decision-making.

**State enterprises restructuring in Central and Eastern Europe is connected first of all with the abolishing of the model of centralised state management of production and establishment of economically and financially independent entities.**

The following steps have been undertaken to carry out the process: **demonopolisation**-abolishing of giant economic structures dominated by giant enterprises and establishment of a greater number of independent economic agents; **corporatisation** -- changes in the organisational and legal status of enterprises and setting their relationships on business grounds; **privatisation**-transformation of state enterprises into private. Privatisation is considered the radical and obligatory way for economic restructuring. However, being a long process which cannot be implemented everywhere, it necessitated the search of alternative forms of restructuring, some of them representing intermediate steps to privatisation itself.

State enterprises restructuring implies coordinated national policy based, on the one hand, on clearly determined priorities of national economic development, and on the political consensus about the model, pace and stages of transition to market economy, on the other.

It is evident from practice that attaining such a coordination is one of the most difficult elements of economies in transition, highly polarised political space in Bulgaria hampered the development of a clear national strategy on the model of transition. The absence of parliamentary consensus on the priorities of laws indispensable for economic reforms made not only for the low synchronisation of the elements of reform but also for the critical lagging of legislative behind economic reform.

### **3.1. Legislative Framework of Restructuring**

The restructuring of the state enterprises in Bulgaria began in the conditions of a sharp deficit of legislative norms. The first juridical regulators of this process were:

- ✓ Commercial Law (State Gazette, 48, 18 June 1991);
- ✓ Decree 56 on Economic Activity (State Gazette, 4 January 1989);
- ✓ Law on Economic Activity of Foreign Persons and on the Protection of Foreign Investment (State Gazette, 8, 28 January 1992); it-evoked the former Law on

Foreign Investment (State Gazette, 47,14 June 1991);

- ✓ Law on Ownership (State Gazette, 92, 16 November 1951);
- ✓ Law on Transformation and Privatisation of State and Municipal Enterprises (State Gazette, 38, 8 May 1992);
- ✓ Law on Restitution of Ownership on nationalised Real Estate (State Gazette, 15, February 1992);
- ✓ Law on Protection of Competition (State Gazette, 39, May 1991);
- ✓ Law on Establishment of Sole Merchant Companies with State Property (State Gazette, 55, July 1991).

At quite later stage were adopted laws regulating the creation of market infrastructure, tax procedure and also additions to the Trade Law which treats the insolvency of the traders and trade deals. Here we will give just some of them:

- ✓ Law on Goods Exchanges and Market-Places (State Gazette, 93,1996);
- ✓ Law on Securities and Stock Exchanges (State Gazette, 63,1996);
- ✓ Law on Privatisation Funds (State Gazette, 1,1996);
- ✓ Law for Changing and Adding of the Trade Law (Chapter 4, Insolvency of the Traders) (State Gazette, 63,1994);
- ✓ Law for Changing and Adding of the Trade Law (Article III, Trade Deals), (State Gazette, 62, 1995);
- ✓ Law on Protection at Unemployment and Encouraging of the Employment;
- ✓ Law on Financial Recovering of the State Enterprises (1996).

The contradictory political interests related to the changes in the model of ownership postponed for more than one year the passing of the main restructuring law, i.e. the Law on Privatisation.

The Bulgarian Socialist Party (former Communist Party) which gained the majority in the first democratically elected Parliament stood up for the idea of mass or so-called 'social' privatisation as the means for state enterprises restructuring. However, BSP did not venture to put up this idea into practice.

The Union of Democratic Forces, the second big political group, backed up the idea for market methods of privatisation, the latter being preceded by a process of general restitution. Later coming into power in November 1991 the UDF together with the Movement for Rights and Freedom (Party of Ethnic Turks) succeeded in promoting the idea. Other parties and their representatives took the legislative initiative too. As a result, a total of 8 draft laws on privatisation were submitted; however, none of them was put forward to plenary discussions. In this way, the restructuring of state enterprises in Bulgaria till mid-1991 was regulated by a socialist normative act, i.e. **Decree 56 on Economic Activity (January 1989)**. Partly, it was in operation until the end of 1996.

With regard to restructuring the significance of Decree 56 found expression in two main directions:

- first, it laid the beginning of spontaneous or so-called "hidden" privatisation and created conditions for initial accumulation of capital. By starting the organisational restructuring of state enterprises on a company basis, Decree 56, on the one hand, opened bigger opportunities and freedom of organisation of economic activity, including in the



field of contradiction, amalgamation, partnerships, etc.; on the other, it allowed the establishment of firms of individuals and public organisations, with certain limitation on the number of persons employed. Parallel firms of state firms' managers working as subcontractors of state-owned enterprises turned to be the first form of hidden privatisation of state-sector created income, this model is still existent.

Expansion of firm independence and in the field of foreign economic activities, in particular, including the possibility for setting up and participation in off-shore companies and other institutions without special permission of higher authorities (except for the cases envisaged by the Decree) gave impetus to another kind of "spontaneous privatisation", i.e. through privatising the business contacts of state-owned firms by their former manager.

- second, Decree 56 provided equal rights for economic activity of foreign persons and strengthened the interest in joint ventures with foreign capital participation. By the end of 1989 the joint ventures in Bulgaria numbered 51.

With a lot of amendments, Decree 56 is still regulating the activity of non-transformed state enterprises as well as the issues related to their liquidation.

The structural adjustment of economy during the first years of transition was characterised by measures for decentralisation of economy. These processes were regulated on governmental level mainly (Decree 54 of the Council of Ministers, 3 April 1991) and resulted in the development within a month of a number of programmes for decentralisation and demonopolisation of state economic groups, combines and enterprises. In legal terms, the processes of decentralisation and demonopolisation were regulated by the Law on Protection of Competition. The law gave a post-factum determination of the concept of "monopolistic position", abolished restrictions on competition and determined the cases of unfair competition.

The administrative nature of the process and the extremely short terms of implementing decentralisation measures resulted into a series of failure connected with broken technology chains, artificial indebtedness of enterprises, preservation of particular monopolies and the subsequent difficulties in their restructuring.

Very soon the Law showed its insufficiency. It does not guarantee distraction of the monopoly situation of the economic subjects in regional scale. Quite limited and insufficient turned to be the authorities of created by it organ – Commission for Protection of Competition in order to exercise effectively its control functions.

The adoption of the **Commercial Law (June 1991)** brought about a more adequate regulation of these processes, through revocation of the texts in Decree 56 treating the establishment of different types of firms and regulation of new procedures for their establishment.

In the first version the adopted in 1991 Trade Law remained incomplete. It did not regulate in particular the relationships between the different economic subjects or the procedures on closing of their activities in case of financial insolvency. Almost till the end of 1994 this whole was filled by the Decree 56.

With the Law for Changing and Adding of the Trade Law from August 1994 the insolvency of the traders was arranged. The law gives the conditions in which a solvency

procedure is opened, determines the subject insolvency as well as the sides which can want such procedure. It explains also the procedure of opening an insolvency procedure and the management of the insolvency.

Later, in April 1995, with a new Law for Changing and Adding of the Trade Law were determined the trade deals, the order and the conditions for their making, the types of trade securities, the different types of contracts, etc.

The **Law on Establishment of Sole Merchant Companies with State Property (July 1991)** provided the legal framework for the rights of the state as sole owner. Under this law, the establishment and transformation of state enterprises is done by an act of the Council of Ministers.

The concentration of this activity in the Council of Ministers made the restructuring procedure quite difficult and exerted unfavourable influence on the development of this process, since centralism contradicted sharply with the wide range and great variety of cases in practice. Only 460 industrial enterprises were transformed in the period from September 1991 to May 1992.

This made the lately adopted **Law on Privatisation** to cover also issues related to the transformation of state enterprises into commercial companies.

The **Law on Transformation and Privatisation of State Owned and Municipal Enterprises was passed with delay (April 1992)** and not without the IMF intervention. It was a framework character. From the initially envisaged 70 articles, only 34 were adopted. For this reason, the law comprises a lot of references to normative acts regulating main procedures related to privatisation. This made for the additional delay of its application.

Under the law, priority is given to market privatisation with regulation mainly of sales of stock and capital shares owned by the state in enterprises transformed into limited and stock companies; beside, the sale of whole non-transformed state enterprises or their units is regulated too. According to the clauses of the law, the state-owned shares in transformed enterprises can be sold in the open market, by public auctions, public tenders and after negotiations with potential buyers. Non-transformed enterprises or their parts are sold by public auctions or tenders.

Owners of real estate nationalised by laws, decrees or normative acts in the period from 1946 to 1962 which currently exist but are elements of the long-term assets of state enterprises, have the right to receive due shares in capital or stock of transformed into joint companies enterprises.

There are three groups of persons who are allowed to buy at a discount up to 20% of the state-owned shares in an enterprise undergoing privatisation, namely: current personnel with at least two years length of service pending the privatisation decision; persons whose labour contracts with the enterprise were cancelled five years ago; and persons who retired from the enterprise ten years ago.

The market approach to privatisation was not backed up with texts providing for the financial support of participation in the process, on the one hand, and limited the range of implementation techniques, on the other. This resulted in the highly narrowed circle of participants.

In June 1994 the **Amendments and Additions to the Law on Privatisation** were adopted with the aim to remove the above shortcomings. These were formulated as Chapter 8 (the last) of the Law under the name of „**Privatisation through Investment Bonds (Vouchers)**„, also known as mass privatisation.

According to these Amendments, every Bulgarian citizen aged 18 and living in the country is allowed receiving privatisation investment bonds of 25 thousand BG Levs, for 500 BG Levs administrative expenses. Vouchers can be inherited or transferred on a direct line of descent and they cannot serve as a credit collateral. They can be used only for buying stock or capital shares in enterprises announced for privatisation under this scheme.

The participation in privatisation through investment bonds can be either direct or by means of vouchers. Persons given preferences for participation in the privatisation process can use vouchers as additional preference.

Under the Amendments, certain preferences are given to persons connected with the economic activities of enterprises to be privatised. For enterprises with balance value up to 10 million BG Levs and businesses in trade and services up to 5 million BG Levs, preferences are given to their personnel, including leaseholders or renters. Moreover, they are offered easier terms of payment. For example, 90% of the value of enterprises in production and 70% of the value of businesses in trade is paid by instalments within five years. A further one-year grace period of the initial instalment is envisaged for production enterprises.

The attitude to the Amendments varies considerably in the range from expectations for fast privatisation of nearly one-third of state enterprises to statements qualifying them as a means for deriving political dividends.

The arguments of the critics go along the following lines:

- first, untimeliness of the scheme of mass privatisation. It is considered that the suitable time slipped by about four years ago when this scheme could play a prerequisite for speeding up market privatisation. The experience of the Czech Republic is being referred to;
- second, the Agency of Privatisation has expressed fears about the eventual locking effect of mass on market privatisation, resulting from recently strained relations between the Agency and the Council of Ministers in the course of developing the privatisation programme;
- third, in their turn trade unions criticise the Amendments because of: (a) the priority of mass privatisation and underestimating of other methods of participation of employees in enterprise privatisation; (b) the vague criteria of enterprise selection under this scheme and the resulting possibility for including a great number of losing enterprises in it; (c) the simultaneous inclusion of too many enterprises in a rather disputed scheme;
- fourth, the employers' organisations are also critical of the Amendments. They stand for higher priority of workers and managers participation in privatisation.

Apart from the general critical notes to the Amendments to the Law on Privatisation, the implementation procedures are also criticised. These refer to the lack of adequate

legal regulation of relationships connected with mass privatisation. A number of laws are still to be elaborated, namely: on investment funds, on protection of small investors, on securities and stock exchanges, etc. The possibility that most of these relations be regulated by normative acts will rather hamper than facilitate the process as the present contents of Chapter 8 and the Law as a whole incl. a great number of references to normative acts of the Council of Ministers.

The practice show that the truthfulness of the critics, connected only with the unpreparedness for quick start of mass privatisation. It took more than one year additional work on creation of the necessary normative and other conditions (including adopting Law on Privatisation Funds, Law on Securities and Stock Exchanges and a lot of sublegal normative acts) for applying the model of mass privatisation.

In the first wave of mass privatisation (1996) the participants were about 3 million people (over 50% of rightful claimant people) with 75,2 billions investment bonds.

In December 1995 the Law on Privatisation had some changes insuring preferences to workers-managers teams in acquiring shares and percentages of the enterprises. The changes envisaged possibility for prolonging the term of the extended payment to 10 years, possibility for using the investment bonds for acquiring shares at preferential conditions, etc. At the same time a limitation to the trade with shares acquired at preferential conditions.

The last changes in the **Law on Privatisation (August 1996)** concern mainly the management of this process. It is more centralised focusing in the Government and in particular in Ministry of Economic Development which part took the functions of controlling body over the Privatisation Agency.

Three laws on restitution in Bulgaria were adopted in 1991, one of them being of certain importance for state enterprises restructuring. This is the **Law on Restitution of Ownership on Nationalised Real Estate**. It repeals eight laws on nationalisation in the period from 1947 to 1952, including the Law on Nationalisation of Industrial and Private Mining Enterprises under which more than 4000 enterprises were nationalised in 1947.

Under the Law on Restitution, subject to restitution are units preserved in their real boundaries (except for those legally acquired by private persons which are hard to find in industry) and cooperatives.

Similar to the German privatisation legislation and unlike some Central European countries, non-residents of Bulgaria are also allowed restitution of their property rights within a fixed term. This concerns both physical persons and legal entities.

Foreign participation in state enterprises restructuring is regulated by the **Law on Economic Activity of Foreign Persons and on the Protection of Foreign Investment (January 1992)** which repeals the former Law on Foreign Investment (June 1991) as the latter contained bigger restrictions on foreign presence in Bulgarian economic life.

Under the Law equal rights are provided to both Bulgarian and foreign physical persons and legal entities. The cases requiring special permission are specified by the Law. The size of foreign participation in newly established or already existing companies is unlimited.

Joint ventures enjoy a series of tax concessions, including a five-year profit tax exemption for companies with economic activities in the field of high-tech branches (determined by the Council of Ministers) and in agriculture and foodstuff industry.

Restrictions envisaged by the Law concern mainly the right of foreign citizens to buy land, and for joint ventures with more than 50% foreign capital – the purchase of arable land. Foreign investments in specific geographic areas determined by law and in specific activities (production and trade in arms and ammunitions, extraction of natural resources from the territorial sea-waters, etc.) require special license from the Council of Ministers. A license from the Bulgarian National Bank is required for carrying out banking and insurance activity and for participation in banks and insurance companies. Neither the Law on Foreign Investments, nor the Law on Privatisation contain any restrictions on the participation of foreign persons in state enterprises privatisation.

The changes in the **Law on Foreign Investments (1996)** specified the form of external investments as well as their minimal amount (\$50 000) to be registered as such. The new texts in the law foresee non-monetary payments (in the form of machines, equipment, technologies, licences and industrial models on the amount over \$100 000) to be freed from duties and taxes. Unchanged remains the prohibition for foreign persons to own agrarian land.

The successful restructuring of state enterprises depends to a great extent on laws providing the building up of market economy infrastructure. The lack of law on stock exchange and on trade in securities creates the possibility of arbitrary acts and uncontrolled entries in the market, moreover, it facilitates hidden privatisation.

In 1995 was adopted a **Law on Goods Exchanges and Market Places**. It determines the order and conditions for creation, structure and activity of goods exchanges and market places. The law enacts the creation of a state body (state commission) to regulate and control the establishment and the activity of goods exchanges and market places.

Till the end of 1995 in Bulgaria in chaos, on purely market principle appeared more than 20 stock exchanges and stock departments to the stock exchanges. The Bulgarian National Bank introduced a regime of licensing of the securities traders but nevertheless the capital market, as far as it existed, was characterised by absolute absence of public information for the deals and the financial condition of the issuers. The adopted in 1995 Law on Securities and Stock Exchanges legally regulates the capital market, defines the securities, determines the functions and conditions for work of the stock exchanges, of the investment moderators and investment companies. The law enacted the creation of a state body (Commission for Securities and Stock Exchanges) with extremely wide authorities on regulation and control over the activity of the issuers, investment mediators and investment companies.

In addition to the regulative norms of the development of the capital market in Bulgaria was adopted a Law on Privatisation Funds, closely connected with the starting of the mass privatisation. Determined were the order and conditions for establishing and activity of the privatisation funds, their behaviour and functions at the capital market, their connection with the other participants in it. Specially treated is the question for the

state control upon them and the protection of the investors.

The bad financial condition of the firms and particular their great debts to the creditors, suppliers, budget, etc., was and continues to be one of the main obstacles in the restructuring. The repeated attempts for solving the problem with so-called "bad loans" did not give a special result. Together with the many partly measures in the end of 1993 was adopted a special Law on Arrangement of the Non-Served Credits, contracted till 31 December 1990. According to this law, by issuing of long-term state bonds in levas and foreign currency the state took part of these loans. Very soon the firms had new "bad loans".

The continuous absence of legal norms determining the insolvency of the firms (of the Law on Failures) helped this situation. The further increase of the debts of the firms applied the adoption in July 1996 of the Law on Financial Recovering. The law concerns a specific number of enterprises with biggest losses which continue to work at a specific regime under the control of the Ministry of Finances.

The law foresees simultaneously stopping of the payment of old debts and prohibition for having new credits. The law does not limit the rights of the creditors to gather their debts, including by requests for announcement of the firm-debtors in Failure. The law obligates the firm-debtors to work out recovering programmes on the quality and executing of which will depend their faith.

The process of state enterprises restructuring in Bulgaria is further constrained by the absence of laws regulating the stability of market environment. What matters in this case is a comprehensive legal framework of development of private business (there is not still a Law on Small and Medium Business), an adequate law on obligations and contracts, etc. In their absence, business environment is unstable and uncertain and therefore domestic and foreign investors are demotivated to develop economic activities in Bulgaria.

The series of laws providing the legal framework of economic reforms and state enterprises restructuring is not finished by those closely related to business and production. Laws on social issues are also institutions of free market economy and bear direct relevance to securing the economic reforms. The lacking balance and complementarity between strictly economic and social laws and the understanding of the latter (in Bulgaria, in particular, it found expression in the continuous neglecting of the Labour Code and in the absence of Law on Employment, Law on Social Insurance, Law on Social Assistance, etc.) bring about social tension and discredit on the reform.

### **3.2. State Industrial Policy and The Problem of Restructuring and Privatisation**

A wide-spread reaction against state intervention in the economy was observed in Western Europe and the United States in the 1980s. Most of the Western governments had adopted the principles of monetarism which implied strong restriction of the role of state policy, particularly on micro-level. The reaction against state intervention reflected the exhausted potential of macroeconomic regulation in the 1970s and the growing confidence in the efficiency of "market forces". In addition, there were the emerging

processes of rejection of total state control over economy in the former socialist countries. The conception was thus developed of state industrial policy being incompatible with market economy and therefore impeding the action of market forces.

The experience of Western economies points to their differing attitude towards industrial policy during different stages of their development as well as to the various sets of tools they have applied depending on the problems they have faced.

However, **the 1990s did not bring much room for policy choice in the former socialist economies.** Pressed by their domestic economic problems, the claims of foreign creditors and the activity of experts of international financial institutions, the former socialist countries took **the road towards market economy by substituting levers of monetarism for centralised regulation.**

As a result, the main efforts of the state were aimed at attaining macroeconomic stability, overcoming financial imbalance and restraining inflation. Next (in sequence, not as a simultaneous process) came the structural adjustment of economy. The stress was put on monetary policy as the main instrument of regulation of economic processes; state industrial policy was actually rejected. In the spirit of Friedrich von Hayek's philosophy, the state was expected to just "set the general rules", i.e. create market environment and conditions for competition.

There were several reasons behind this behaviour, namely:

1. The identification of state industrial policy with dirigisme and the inherited from socialism fears of new bureaucracy in economy.
2. The initially wide-spread naiveté and groundless optimism about the success of reforms based on the view-point that market economy and competition will automatically solve the problems of restructuring and economic efficiency.
3. The absence of strategy of economic development in transition and the domination of short-term goals like financial stabilisation, implying the use of tools of monetarism and underestimating, including time delay of structural reforms.
4. The prevailing monetarism views among politicians and executives (in the Government of UDF, in particular) which doubted the co-existence and compatibility of industrial policy and the transition to market economy.
5. The hostile attitude of experts of international financial institutions towards industrial policy which was treated as working rather against than pro market forces.<sup>28</sup>

**The denial of industrial policy as a specific aspect of governmental economic policy resulted in the sudden withdrawal of state from economy and liberalisation of domestic and external conditions of functioning of enterprises with no bearing on the structural accents of reforms.**

Budget dotations to enterprises were sharply reduced, regardless of financial state and reasons. Unsuitable forms of demonopolisation and the break of economic and technology relations made for the artificial increase of enterprises' debts; in addition, the rise of interest rate on credits reduced most of them to the verge of bankruptcy.

Foreign trade liberalisation prior to any more or less successful adjustment of

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<sup>28</sup> United Nations Economic Survey of Europe, p. 16, 1992-93.

Bulgarian enterprises to new conditions deprived domestic producers of any sort of protection. In addition, exchange rate liberalisation in the absence of customs policy aimed at promoting exports of particular commodity groups, on one hand, and imports of goods assisting technological development of production, on the other, resulted in the spontaneous formation of structures often contradicting with national interests.

The Government failed to suggest programmes of enterprise recovery. Measures on the redemption of "bad loans" accumulated till 1990, were late, inconsistent and halfway; beside, they concerned mainly the high-tech industries. It was only by the end of 1993 when a law was adopted giving a radical solution to the problem.

The sudden withdrawal of state from economy found expression in the lack of working procedures for efficient management of state enterprises. The rejection of managers selection through competition turned management assigning contracts into mere formality and determined the hierarchical subordination and total administrative dependence of managers on higher executive bodies. The absence of strict parameters of manager behaviour, fixed by contract, on one hand, and the impossible centralised state control over their activity, on the other, along with the non-existent market of manager services and institutions to provide objective estimations of managers activity, made the status of this group very uncertain and unstable. Manager teams were thus forced to direct their initiative towards short-term measures, most often connected with the survival of the firm. For the sake of stabilisation, the state did not provide protection and special measures to promote and improve the state of private sector – one of the potential factors of restructuring. Only few of the private firms could use credit facilitations; beside, risk investments were denied any support thus reducing to the minimum the opportunities of nascent small and middle-sized business to participate in the industrial and economic restructuring.

All this contributed to the **artificial prolongation of the stabilisation period**, also postponing the structural stage of reforms, **deepened economic hardships and created further problems for the process of restructuring**. Worsened economic state of enterprises reduced their attractiveness for potential buyers while the fast impoverishment of population due to production decline and price liberalisation restricted its capabilities to take part in privatisation.

The rejection of state industrial policy and the adoption of principles of monetarism resulted in the formulation of a **particular philosophy of restructuring and relevant approaches towards it**.

In the light of these principles, the restructuring of economy (industrial and market) was considered a natural result of the action of market forces and privatisation. By putting enterprises in market conditions, the problem of their selection (survival of viable and liquidation of the rest) had to be solved while the market behaviour of the new owner after privatisation had to determine the place of the unit in the branch and the economy as a whole. The efficiency of this selection was not considered from the viewpoint of national interests; similar attitude was demonstrated towards the role of privatisation in the economic policy of the state.



Practice in East European countries and Bulgaria, in particular, suggested that the creation of market environment and market mechanisms is far from quick and easy process as anticipated. According to estimations of Western experts, it will take from 20 to 30 years.<sup>29</sup> In the course of its emerging, the market system is imperfect. The basic institutions and mechanisms of market influence on enterprises behaviour are still non-existent. The parameters of economic environment are unstable, quickly changing and frequently unclear to economic agents. Along with deepening economic difficulties of enterprises, all this created **pressure for „rehabilitation„ of state intervention** in economy on the part of both companies and foreign observers and politicians. "In the conditions of CEE, states R. Portes, we cannot trust the market to select and eliminate negative value-added activities and to develop those that do have long-run prospects"<sup>30</sup>. For this reason his advice is that "the authorities should immediately take steps to reverse the state desertion (underlined by the author) that has left state-owned enterprises floundering ... improve corporate governance insofar as is possible without privatisation and rehabilitate industrial policy"<sup>31</sup>. The unfavourable effects of state withdrawal from economy in transition are gradually realised as well. 'The danger of resorting to the old central planning mistakes obviously always exist but it cannot justify avoiding the issue of how best to intervene in the transition. In the absence of this realisation there will be intervention in practice but in ways that are not clearly stated and involving costs that may violate the macroeconomic budget constraints without awareness of its scope and implications".<sup>32</sup> The restored interest in industrial policy in the transition to market economy is partly due to the revision of its role in the practice of Western economies. However, this is to a greater extent a reflection of the necessity that transition economy governments actually take part in a series of activities related to the management of economy, such as: decentralisation and demonopolisation, transformation of enterprises into different kinds of companies, centrally organised privatisation, etc.

The Government of Hungary was the first (January 1993) to manifest changes in its attitude towards industrial policy. It adopted a moderate industrial policy providing support for the creation of market-oriented microenvironment, incentives to innovations and elaboration of government programmes for technology development, modernisation of infrastructure, promotion of main market services like marketing, finance, etc.<sup>33</sup>

In April 1993, **Bulgarian Government (led by Professor Ljuben Berov) also declared its interest in industrial policy** by stating its intentions to stress on the structural part of reforms, parallel with measures on stabilisation. At the end of 1993, the clearout conclusion was made of the **necessity in policy based on reasonable balance of stabilisation and structural measures**. The financial stabilisation and restructuring

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<sup>29</sup> Landesmann, "Industrial Policy and the Transition in East-Central Europe", Discussion Papers on Economic Transition № 9204, Cambridge, Dept. of Applied Economics, 1993.

<sup>30</sup> R. Roberts, "Comment on the Contradiction of Eastern Europe's Economies' Introduction to the Conference", p 10

<sup>31</sup> Ibidem.

<sup>32</sup> M. Bruno, "Stabilisation and Reform in Eastern Europe: Preliminary Evaluation", p 32

<sup>33</sup> A. Tork, "Hungarian Industry and the Economic Transition", Institute of Industrial Economics, Budapest, mimeo, 1993

of certain economic activities had to be supported by moderate state budget subsidies. Structural reforms were determined as the basis of governmental policy. Its main aspects were announced as follows:

- speeding up of privatisation;
- imposing measures for losses reduction and financial discipline of enterprises;
- implementing corporate management of state owned enterprises.

The experience for working out of national strategy for restructuring and financial recovering of the state enterprises was the first visible attempt for constructing of the elements of the industrial policy. The enterprises were divided into four groups according to their financial condition, market strategy and opportunities for adjustment to the new conditions. Specific were the following groups:

- first, enterprises to be restructured by the new owners after privatisation, due to considerable financial resources needed;
- second, enterprises in which reduction of expenses and strict discipline should be applied as elements of their restructuring plan, including an explicit proposal for privatisation;
- third, enterprises and/or their parts to be liquidated, because of the lack of market prospects for covering their losses; and
- fourth, a limited number of enterprises to be restructured without direct binding to privatisation plans, as these can neither be privatised nor liquidated due to clearcut unfavourable social or economic consequences.

Compared to former views on restructuring, two new aspects are worth mentioning. The first is related to liquidation as an operational means for enterprises restructuring; the second concerns the officially stated possibility of restructuring beyond privatisation schemes.

**Financial recovery** of enterprises turned into indispensable element of the policy of restructuring. The first steps in this direction were connected with the issue of "bad loans" and the normative regulation of their redemption. By Decree 45 of 9 March 1994 the Council of Ministers adopted Ordinance on the criteria for working out programmes for financial recovery and restructuring of state enterprises, firms and commercial companies. The Ordinance was supplementary to the set of normative acts regulating the "bad loans-into-government debt" swap (for credit negotiated till 31 December 1990) against long-term government bonds. State enterprises with bad loan swaps effected under the Law on bad Loan Settlement (State Gazette, 110, 1993) make a contract with the Ministry of Finance or other authorised body, stipulating the term and conditions of redemption of swapped loans. This was done on the basis of programmes for financial recovery and restructuring developed by enterprises which included analysis of current state, strategy for future development and anticipated financial results. The estimation of these programmes showed that a great part of the companies in the main economic sectors are insufficient in revenues to maintain normally their economic activity, i.e. to meet expenses on raw material, wages, depreciation charges, credit repayment and social insurance contributions.

This made liquidation turn into an explicit element of restructuring policy. Prior to the adoption of the Law on Bankruptcy, the Ministry of Industry worked out an Ordinance and relevant rules and procedures for closing enterprises by liquidation. It concerns units which cannot organise their production activity independently and have no market prospects and possibilities for production and technological restructuring in the near future. Based on the analysis of operation of 1420 state firms in 1992 and 1993, a list was prepared of the first 34 enterprises (mainly in machine-building, light and foodstuffs industry) subject to liquidation. Liquidation procedures have been opened for 10 firms. The financial state of enterprises was estimated in terms of several indicators, namely: liquidity coefficient, fixed assets and stock turnover, profitability of sales and debt capital, interest payment on credits, total indebtedness.

State firms in heavy financial condition were classified in three groups, with respectively stages of liquidation:

This government could not realise the positive thought of its policy mainly due to two reasons: first, it did not come out of the frames of the traditional state administrative policy with its inherent vices: bureaucracy, clumsiness, inaction, etc., second, the role of the mechanisms and institutions of the market environment was underestimated as a factor, forming the behaviour of the firms (including their financial discipline). By the same reasons the attempt for stimulating the internal restructuring by changes in the cooperative management turned to be unsuccessful.

The first declarations of the next (1995) government (of the socialists) provoke new expectations for development and application of the conception for the industrial policy. It declared as a main priority the structural reform and the use of regulative-market approach in its executing and the management of the economy.

Declared was the intention for speeding the privatisation, for continuing the line of financial recovering of the enterprises, as well as of liquidation of enviable and non-perspective firms. For the first time was clearly determined the strategy of the state participation in the privatisation. Determined were the enterprises forbidden for privatisation without the explicit allowance of the state as well as those in which the state keeps the decisive share.

On the background of the overcome shocks of the reform (decreasing of the markets, of subsidies and competition from outside) extremely actual sounded the intention for active industrial policy connected with the looking for new sources of investments.

The expectations were strengthened on the result of the great public confidence in the government (at its coming to govern at the beginning of 1995) and of the absolute majority of the governing party in the Parliament which created the unique for the last 7 years chance to be worked out and adopted by the Parliament agreed national strategy for the restructuring and the future development of the economy in transition.

These expectations did not realise for some reasons:

First, the conception for the industrial policy in practice identified with the state regulation of the economy turned to be wrong. The mechanism of its working out was reduced to the expert foreseeing of the main macroeconomic indicators and structural ratios in middle-term perspective. There was lack of clear looming of the national priorities and the corresponding strategies at product, technologic, resource, market,

organisational, etc. restructuring. The public dialogue and empathy of the industrial elite and the syndicates for the working out of the national strategies was not searched. In the same way were worked out the branch and other programmes (as far as there were such) by the different ministries.

They remained at the level of "intentions" of the governments of the ministries: not connected between each other, uncoordinated and non-supporting. The approach to the conception for industrial policy determined the character of the used means for its realisation: centralised management of the processes of the privatisation and restructuring including the administration of the liquidation, centralising the management of the firms by artificially created (without the necessary conditions for this) holdings and consortiums, expanding of the controlled prices including the use of the state offers as an instrument for administrative influence upon the prices, etc.

Second, the role of the market environment and market institutions for the restructuring of the economy is underestimated. The practice of the first years of transition shows that the market instruments do not solve effectively the structural problems. But having clearly formulated aims and national priorities and programmes, they can play significant role for the speeding the structural changes. From the experience of the developed industrial countries is known that the small and medium business (the general institution of the market economy) at determined conditions can be a significant factor for the product and technologic restructuring of the big (including the state) firm.

The lack of the consistent, supporting this sector state policy (including the lack of law on small and medium business in spite of the existence of some projects for such) makes impossible the use of this reserve for speeding of the structural changes. On the contrary, the anaemic and unprotected small business turns into an additional load for the state enterprises increasing the pressure for the employment places and threat in them. Almost unused are the reserve of the capital and labour market for speeding of the restructuring of the economy.

On purely administrative reasons the use of the market of the managerial services as a source of effects in the field of interfirm restructuring is hold. The adherence to the state institutions for regulating generated the idea for administrative creation of the semi-market forms for investment crediting (Fund "Industry", "Development") and prevents the appearance and the use as a source of investments of the different private institutional investors (social, assuring, pension and other funds).

Third, the strong interference of the state in the management of the economic life in the country was surprisingly combined with sincerely liberal attitude to the international economic relations and encouraging of the competition from outside. The fear from national economic protection and the lack of protection measures for the domestic producers did not increase their competitiveness but surely cooperates for the destruction of the traditional productions and change for the worse of the structural relations in the economy. The same is for the underestimation of the export oriented productions and the lack of incentives for the expand of the export.

The unsuccessful till now restructuring and the deep financial crisis in which fell the country applies radical change in the policy and the ways of carrying out of the structural changes. They will be carried out in the conditions of total lack of financial instruments

according to the aims of the financial stabilisation of the country. This means total reconsidering of the idea for industrial policy and the possible ways for its carrying out.

### **3.3. State institutions of Restructuring**

The success of reforms depends on the role and efficiency of institutions influencing the course of state enterprises restructuring.

Underdevelopment of market environment and market institutions in the transition to market economy made for the increased importance of state institutions and their functions in the process of management, organisation and control of economic restructuring. Public institutions are responsible for the development of adequate legislative framework for restructuring and privatisation of state enterprises and for the creation of the institutional infrastructure of market economy which is of great importance for state sector reorganisation.

The following state institutions share the responsibility for state enterprises restructuring in Bulgaria:

- ✓ the Council of Ministers;
- ✓ Branch Ministries (and the Ministry of Industry in particular);
- ✓ Agency of Privatisation;
- ✓ Center of Mass Privatisation;
- ✓ State Fund for Reconstruction and Development.

**The Council of Ministers** is responsible for and controls the whole activity on economic restructuring. Its functions are related to:

- ✓ development of a global strategy of the contents and directions of economic restructuring in compliance with the national goals, real possibilities and experience of other Central and East European countries;
- ✓ elaboration and pursuit of economic policy in support of the restructuring strategy chosen;
- ✓ coordinating and control over the activity of other state institutions effecting restructuring.

The peculiarities of the political situation in Bulgaria (the late Government is missing actual parliamentary support and pre-term elections are therefore expected) are impeding the Government from efficiently fulfilling its functions. Only some of the elements of the restructuring strategy are existing. The coordinating of activities of state institutions is imperfect and low-efficient.

One of the reasons for that is the absence of strict and clear regulation of institutions' relationships and especially between the Agency of Privatisation and the rest of them. According to the Law on Privatisation, the Agency has been established as an independent unit to organise, control and carry out the privatisation process (Article 10.1.). However, it is actually dependent on the Ministries, for unlike the Agency, they exercise the ownership rights of the state in the subordinate enterprises and therefore have great administrative and economic power over them.

On the other hand, the efficient restructuring of enterprises is impossible without the

coordinated actions of branch ministries and the Ministry of Finance. Beside, the structural reform will hardly progress if the Ministry of Trade fails to provide a selective and balanced protection of particular productions through export-and-import regime, customs duty, etc. The uncoordinated actions of these institutions result in their low efficiency.

**The Agency of Privatisation** is a body of the Council of Ministers with the main task to organise and control the process of transformation and privatisation of enterprises.

The first Agency of Privatisation was set-up on the basis of Decree 16 of the Council of Ministers before the adoption of the Law on Privatisation. It had rather limited functions, mainly in the field of studying the experience of other countries and preparing drafts of relevant documents.

In August 1992 the former Agency was closed down in compliance with the already adopted Law on Privatisation and the new Agency of Privatisation was established with the technical and financial assistance of "Treuhand Osteuropa Beratungsgesellschaft".

The Agency has two Departments, namely: "Programmes and Methods of Privatisation" and "Organisation of Privatisation". The Agency has a network of regional offices acting in parallel with municipal authorities. It is run by an Executive Director while the controlling functions are exercised by eleven-member Supervisory Council, in which the Government and the Parliament have respective quotas.

The activities of the Agency of Privatisation include:

- ✓ elaboration of annual privatisation programmes;
- ✓ methodological direction and preparation of privatisation procedures;
- ✓ negotiations with potential buyers and execution of that part of transactions which is within its capacity.

The first privatisation programme was adopted in fall 1992. It envisaged the opening by end-1992 of privatisation procedures for 92 enterprises with total assets value of about 2359 billion BG Levs; two of them were to be privatised by the Agency, 32 by the Ministry of Transport, 15 by the Ministry of Industry, etc. At the end of the year, the 1993 privatisation programme was adopted. The new programme comprised a further 292 enterprises; later their number was increased to 318. In the two programmes, priority was given to enterprises in industry, agriculture and tourism. Market privatisation was the prevailing method.

The next years did not exceed the rates of privatisation. There is lack of deals for big enterprises. From the realised in 1995 309 deals – 205 are for specific parts, 100 – for small and medium enterprises and only 4 are sold big enterprises. From the realised from the beginning till the middle of 1996 total 2069 deals only 7% are the deals for whole enterprises. The predominant technique of privatisation (60%) are negotiations with potential buyers, at 35% of the deals are used public auctions and 15% of the sells are executed by a contest. In the end of 1996 almost 1/2 of the privatised objects are owned by the personnel of the enterprises. Till now as a whole are privatised only 4,2% of the assets of the state enterprises. More 12% are proposed for mass privatisation from which at its first auction are sold 40%.

By Decree 44 of the Council of Ministers of March 1994, a **Privatisation Revolving Fund** was set up with the Agency of Privatisation. Its main purpose is to provide funds to Bulgarian participants in privatisation. The Fund is run by a Governing Board, in which the Council of Ministers, Ministry of Finance, Bulgarian National Bank, Agency of Privatisation and Ministry of Industry are represented by one member each, plus two free experts. The members of the Governing Board are appointed by the Council of Ministers.

The Fund provides financial support to Bulgarian citizens to take part in privatisation by means of:

- ✓ extension of soft credits;
- ✓ application of by-instalment payment scheme covering up to 70% of the selling price of privatisation object.

The resources of the Fund are supplied by international organisations.

**The Branch Ministries** have the following functions in the field of restructuring:

- ✓ transformation and privatisation of enterprises with long-term assets up to 70 million BG Levs;
- ✓ selection and presentation to the Agency of privatisation of enterprises with higher value of assets;
- ✓ management of state participation in economy;
- ✓ closing down through liquidation of enterprises incapable to operate as independent entities.
- ✓ Given these functions, most of them have set up specialised departments responsible of restructuring. For example, in the Ministry of Industry these are the following:
- ✓ "Restructuring of State Industrial Ownership", including a specialised section "Liquidation";
- ✓ "Structural Policy and State Industry Management".

The Ministry of Trade is considered the most successful in the field, it has opened nearly 180 procedures which implies a start of denationalisation of almost 50% of the enterprises in the sector. Fifty privatisation transactions have been concluded amounting to 356 million BG Levs.

Due to many reasons, including the financial debts of the industrial firms, the privatisation in the industry is considerably slower. Only in 270 of total 1200 firms the capital is privatised over 50%. In 35 firms is introduced a regime of financial recovering and 34 firms are in the process of liquidation. About 100 other enterprises are expected also to be liquidated. In compliance with the additions to the Law on Privatisation, a new body was established with the Council of Ministers, i.e. the **Center of Mass Privatisation**. It is responsible for the organisation and supervision of privatisation through investment bonds. The Center is governed by an Executive Director appointed by the Council of Ministers.

For mass privatisation were prepared 968 enterprises with total capital over 200 milliards leva. The first auction (end of 1997) of the mass privatisation resulted in denationalisation of over 50% in 330 enterprises, 200 of which in industry.

**The State Fund for Reconstruction and Development** is a supradepartmental

body promoting economic restructuring through both financing of profitable projects in the private sector and temporary extension of renewal and investment credits to state firms and commercial companies.

State institutions have the difficult task to promote **also the building up of the institutional framework of market economy**, the underdevelopment of which is considerably delaying the state sector restructuring.

The first step made in this direction was the reorganisation of the financial sphere. The functions of the central and the commercial banks were full-delimited. A process of bank consolidation was initiated aiming at banks recovery. Still unaccomplished, it hampers bank privatisation. Notwithstanding the radical changes in the terms of functioning of commercial banks, their public status influences their behaviour as credit institutions and therefore reduces the effect of the economic policy of the state.

The lagging of the bank system behind the changes in economy and the delay in bank privatisation, in particular, has resulted in the low level of development of other institutions of the financial system. The number of hitherto organised stock exchanges is 16 with quoted stock of not more than 10 to 15 companies. The creation of a normally functioning money market to secure strong competition among participants is going very slowly as well.

Difficulties in institutional reforms are to a high extent common event for all Central and East European countries. They stem from the necessity in simultaneous reorganisation of economy and creation of relevant market institutions. The effect of reforms depends also on the synchronised building up and functioning of institutions, time is therefore additionally pressing state institutions. According to J. M. Buchanan, time "is the scarcest resource in the transition to market economy"<sup>34</sup>. This imposes the necessity of transformation and use of some former institutions (the State Savings Bank, labour offices, etc.), restoration of previously established institutions (credit and mortgage banks, etc.) and widening the functions of the newly established ones.

### **3.4. Other Institutions**

Pluralism in policy and economy established after 1989 created conditions for some non-governmental institutions to practically influence the course of reforms and economic restructuring. These with the greatest influence are the following:

- ✓ trade unions;
- ✓ employers' organisations;
- ✓ financial groups of big private capital.

**Trade unions.** They are represented by two most powerful trade unions, namely: the Confederation of Independent Trade Unions in Bulgaria (CITUB) and the Confederation of Labour "Podkrepa".

CITUB emerged in February 1990 as a successor of the former trade unions and made a successful transformation into a politically independent organisation. It numbers

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<sup>34</sup> J. M Buchanan, "What Should Economist Do?". Indianapolis, Liberty Press, p. 67, 1979



about 500 thousand members united in 70 federations and more than 30 regional structures.

CL "Podkrepa" was established before November 1989 as an underground organisation. At present, it has about 50 thousand members organised in 22 federations and 12 regional structures.

Trade unions exert impact on state enterprises restructuring on mostly national and branch level. The means they mainly use are the following:

- ✓ participation in the tripartite social partnership and attainment of mutually acceptable agreements with Government and employers on the issues of economic and structural policies with regard to employees; interests;
- ✓ strike remonstrance.

Workers are the party hit hard by restructuring in the course of reforms in both their incomes and job security. For this reason trade unions insist that restructuring is economically grounded and accompanied by programmes of alternative employment.

The coordination of interests of state powers, capital and labour in solving the problems of economic reforms opens wider possibilities for the Government to pursue its policy and guarantees social peace for its implementation. Trade unions have signed hitherto four national-level agreements with the government and the employers.

**The first national agreement (March 1990)** couldn't effect much the reforms but put the beginning of social dialogue. A tripartite body (National Committee on Coordinating of Interests – NCCI) was set up for discussions and search of a mutually beneficial solutions of the problems of economic reforms and their reflection on production and the social sphere.

In August 1990, **another national agreement** was signed concerning the acute problems stemming from the deepening economic crisis, i.e. the sudden and speculative rise in prices, the slump in production, etc. Eight working groups were created with the NCCI, including on privatisation and state firm management.

Immediately after the coalition government of Dimitar Popov came into office, it started negotiations with the trade unions and the employers which resulted in the **national agreement on preserving the social peace (January 1991)**. The Agreement included provisions on the rise of interest rate, gradual liberalisation of prices, changes in labour and social legislation, etc. The Agreement gained the support of the International Monetary Fund.

The **national agreement (June 1991) on further development of economic reforms and social peace preservation** had the greatest importance for economic restructuring. It included a coordinated programme for the continuation of the reform, i.e. stabilisation measures, restructuring and privatisation steps. Special attention was paid to the problems in uranium and ore mining and their future development.

The system of national tripartite partnership underwent considerable changes after 1992. Instead on national level, agreements are signed in specific spheres, e.g. coal mining industry, transport, etc. These changes stem from the unstable political environment and the absence of clear-cut parliamentary support to the Government of professor Berov.

There were three rather indicative cases after 1989 in which the institutional instruments (negotiations and tension control) failed to solve the conflicts, later resulting in national strike actions, namely:

- ✓ in the fall of 1990 – against the inertness of the Government of Audrey Lukanov; these caused its downfall;
- ✓ in the fall of 1992 – against the openly neoliberal stand to reforms and trade unions and the delay of structural reforms of the Government of Phillip Dimitrov. From January to June 1992 more than 40 branch-level strikes were organised. The major centers of tension were the military-industrial complex, coal mining industry, machine-building, chemical industry, etc.
- ✓ in April-May 1994 – against financial instability and further deepening of the economic crisis, including the uncoordinated policy of professor Berov's Government in the field of restructuring.

**Employers' Organisations.** They are represented by:

- ✓ Bulgarian Chamber of Commerce and Industry. It was created nearly a century ago; currently it numbers 7 thousand members (employers) from 10 industries in the state and private sectors organised in 212 territorial structures, its main functions are related to assistance, promotion and protection of interests of employers and development of their cooperation and association.
- ✓ Bulgarian Industrial Association, it was created in 1990 as a successor of the former Industrial Association (1984). It has 2 thousand member-enterprises from 37 branches, its functions include promotion of technical development, market policy formation, management, assistance in the process of association of its members, joint ventures, foreign trade activities, attraction of foreign capital, implementation of modern forms of organisation and management.
- ✓ Union of Private Enterprising (UPE). It is the first organisation of private entrepreneurs in Bulgaria. The Union was established in December 1989. At present, it numbers 503 members united in 40 regional and branch structures, the Union determines itself as a free voluntary non-profit organisation aiming at the promotion of business initiatives of citizens, creation of fair trade relations and abolishing of monopoly.

The functions of considered organisations give them wide opportunities to participate in the process of economic restructuring. They are however quite passive with regard to restructuring. Their attitude is due to: first, the rather limited powers of state employers in the field of economic reforms and restructuring. Power is considered in the hands of branch ministries; second, the fact that private employers represent small and middle-sized capital which is lacking the potential to intervene in restructuring processes; third, the existence of competition among employers' organisations which disunited their efforts.

**Financial Groups of Big private capital.** These financial groups take part in economic restructuring chiefly through the financial institutions. The main part of their capital is concentrated in banking and insurance activities, finance management and foreign trade. For the time being, only one of them (Multigroup) has really joined the

privatisation process; its subsidiaries has bought a sugar processing plant, a hotel, oil stations, etc. investment in new productions is still inconsiderable in size. A process of intensive concentration of the private capital, mainly in the form of holding groups, can be seen. 18 groups are already formed. Some of them are with especially big size and include more than 50 firms in the country and abroad, have foreign companies, etc. An attempt for coordination of the activity of the big financial groups was the creation in the end of 1993 of the Confederation of Bulgarian Industrials, known as "G-13". The internal contradictions of G-13 prevent it from participation in privatisation with a common strategy and lately it was destroyed.

Financial groups outside "G-13" also hesitate to announced their participation in privatisation. Most attractive to big private capital prove to be financial and forex transactions, trade in securities, foreign trade, tourism and foodstuffs industry. This was confirmed also by the analysis of subject of activity of investment companies. In the end of 1994 it was only 4 out of 12 registered investment stock companies which have mentioned participation in privatisation as one of their activities. Most of them deal in export and import, financial and forex transactions, trade in securities. One of them has declared interest in infrastructure projects.

The starting of the mass privatisation and the expected revival of the trade with securities on the stock exchanges stimulates the activity of the financial groups.

## **4. Structural Changes in The System of State Enterprises**

### **4.1. Ownership and Organisational Structures**

Changes in the ownership structure are among the most important characteristics of the transition to market economy and the conditions in which enterprises operate. In order to study this problem, however, it is not sufficient to just analyse the ratio of stateowned and private enterprises. It should be known whether private enterprises are privatised former state ones or *de novo* established, whether state enterprises are transformed into entities of new legal status, or not. It is therefore necessary to examine not only the changes in ownership structure and its present condition, but also the distribution of enterprises by their legal status.

#### a) Forms of economic entities in Bulgaria

The legal status of economic agents in Bulgaria is regulated by the Law on Commerce<sup>35</sup> which was adopted in June 1991 and which was aiming to harmonise the Bulgarian legislation with that of developed market economies. It was difficult to obtain a complete identity, since the historical and cultural specifics of different West European countries had resulted also in the forms of their economic activity. The goal, therefore, was an approximation rather in the essence and not in the terms, so that the Bulgarian system was made consistent with the western one.

Pursuant to the provisions of the Law on Commerce, a merchant is the common

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<sup>35</sup> Law on Commerce, State Gazette, 48/18.06.1991.

denotation for any physical or legal person engaged in business activity (purchasing and sale of merchandise, production, services, financial transactions, etc.) in Bulgaria. A merchant can be a commercial company, a cooperative or a person who has established an enterprise requiring that its activity be conducted as a commercial business. A "merchant" therefore is the most general concept on which the Law on Commerce is based.

The private merchant is the first form of economic activity envisaged by the Law which refers to any physical person who is registered at the court and who bears full liability for his obligations. The association of two or more physical or legal persons for the purpose of performing business activities is denoted as a commercial company. A commercial company shall be any of the following: an unlimited partnership, a limited partnership, a private limited company, a public limited company, and a public limited partnership. An unlimited partnership is a company incorporated by two or more persons engaged in business activity (commercial transactions) who bear joint and unlimited liability.

In the case when one or more of the partners bear joint and unlimited liability while the liability of the remaining members is limited to the extent of their pledged contribution, the commercial company is called a limited partnership. The management and representation of the company is executed by the unlimited liable partners.

A private limited company (Ltd.) is formed by one or more persons who are held liable to the extent of their contribution to the company's capital. The managing bodies of the company include the general meeting of the partners and the managing director. Should the company have more than 50 employees, they shall be represented at the general meeting with the right to a deliberative vote only.

A public limited company (Pic.) is a company which has its capital divided into shares and which is liable to its creditors to the extent of its assets. The managing bodies of Pic. include a general meeting of the members and a board of directors (onetier system) or a supervisory board and a management board (two-tier system). The members of the board of directors, respectively of the management board, represent the company jointly, except when provided otherwise by its articles of association. The difference comes from the fact that in a two-tier system the members of the management board are appointed by the supervisory board and not directly by the shareholders.

A public limited partnership is similar to the limited partnership except for that aspect that the limited liable partners are issued shares in return for their capital. The company is promoted and managed by the general partners who have a voting right in the general meeting and constitute the board of directors. Apart from these main forms of merchants, the Law on Commerce provides also for the existence of their alliances, or commercial groups, such as consortiums and holdings. The consortium is a contract-based group of merchants, while the holding is a public limited company established for the purpose of management, without engaging in any production or commercial activity of its own.

The Law on Commerce contains also provisions for the legal forms of state-owned and municipal enterprises, the main of them including the single-person limited company and the single-person public limited company. The formation of other commercial

companies or associations thereof is further allowed. It is also provided that, by virtue of a law, state-owned enterprises can be founded which are not commercial companies. The incorporation and transformation of state-owned enterprises in commercial companies is regulated by a special law, while the municipal companies are subject to a resolution by the municipal council.

b) Enterprises restructuring in terms of ownership and legal status

The most considerable changes in the industrial organisation of the Bulgarian economy are related to its organisation structure. These were accomplished in two main directions, namely: changes in the organisation forms of state-owned enterprises and a sharp increase in the number and forms of commercial companies owned by other economic agents, legal and physical persons mostly.

The provisions of the Law on Commerce had quite an advanced character, especially in the part on public limited companies, since they regulated economic relations which at that time were either completely non-existing or quite underdeveloped.

The Law on Commerce settled the problem about the consistency of formerly registered firms and the requirements of the new legislation. Firms registered pursuant to Decree No. 56 were re-registered with the following amendments:

- a one-man firm shall be considered as a private merchant;
- a collective or associated firm shall be considered as a partnership;
- a limited liability firm shall be considered as a limited liability company;
- a joint-stock firm shall be considered as a joint-stock company;
- an unlimited-liability firm which has not issued shares shall be considered as a limited partnership, while that which has issued shares – as a public limited partnership.

The above-mentioned regulations indicate that the transformation of the existing private firms (so-called citizens' firms) into commercial companies was a nearly automatic operation. The main problem pertained to the re-registration and changes in the legal status of state-owned enterprises.

Based on the provisions of the Law on Commerce, the Law on Establishment of Commercial Companies<sup>36</sup> was passed in July 1991, by which the transformation of state-owned firms into single-person commercial companies had started. State jointstock firms were registered as public limited companies, while the remaining state firms were registered as limited liability companies. In addition, a number of new joint-stock companies and limited liability companies were created as a result of the process of decentralisation.

The changes in the firm organisation of state-owned enterprises are presented in Table 1. Re-registrations pursuant to the Law on Commerce proved to be difficult to accomplish within short terms, hence the appearance in the statistical data on enterprise forms of both commercial companies and firms registered under Decree No. 56.

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<sup>36</sup> 36 Law on Establishment of Single-Person Commercial Companies with State Property, State Gazette, 55/12.07.1991.

**Table 1.***Registered Enterprises By Ownership and Legal Status*

Ownership, Legal Status	1993	1994	1995
A. Private Ownership			
1. Private Merchant	273194	341818	383382
2. Unlimited Partnership	36728	36769	34439
3. Private Limited Company	11867	20005	28655
4. Joint-Stock Company	941	1391	1983
B. Public Ownership			
I. Transformed Enterprises (Law on Commerce)			
5. Single-Person Limited Company	7711	12025	17021
6. Single-Person Joint-Stock Company	392	508	574
II. Non-transformed Enterprises (Decree 56)			
7. State Firm	1458	1097	776
8. Municipal Firm	1515	1036	459
9. Firm of Public Organisation	1558	778	554
C. Joint Ownership			
10. Unlimited Partnership	414	418	344
11. Private Limited Company	1189	1182	2416
12. Joint-Venture (Decree 56)	597	878	402
D. Other			
13. Subsidiary	1926	2115	2291

Source: Author's computations based on data from Statistical Reference Book, NSI, Sofia, 1996.

It should be taken into consideration, however, that data presented in Table 1 refer to the registered enterprises. Similar to other East European countries, the registration procedure in Bulgaria is lacking preciseness regarding the exclusion of non-operating enterprises from the list. According to expert estimations, functioning enterprises account for about 50-60% of the total number of registered. On the other hand, data are not included in the table about the number of operating cooperatives, agricultural farms and firms, and other entities of municipal or state significance which are registered pursuant to other laws and not to the Law on Commerce. Totally, they account for less than 10% of the number of registered entities.

The major factor contributing to the development of the private sector in Bulgaria is the creation of new private enterprises. The share of privatised state-owned enterprises is insignificant. Privatisation has made a little progress and up to now it has been applied mainly to small and medium-sized enterprises.

This conclusion is further confirmed by data in Table 3 which show that only 1558 enterprises have been privatised for the whole period (1992-95), the major part of them municipal property or single parts of enterprises. Substantial progress in privatisation is expected in the next year connected with the finalisation of a number of large-scale deals

as well as the completion of the first stage of mass privatisation. About 1,000 enterprises are to be privatised – entirely, or parts of them – through vouchers.

**Table 2.**

*Enterprises Approved for Privatisation and Privatised Enterprises by legal forms and type of ownership*

Legal forms and type of enterprises	Approved (nr.)	Privatised (nr.)
Total-	3607	1558
commercial companies	844	128
- non-transformed enterprises, autonomous parts	2763	1430
State ownership	1293	295
- commercial companies	791	108
- non-transformed enterprises, autonomous parts	448	187
Municipal ownership	2368	1263
- commercial companies	53	20
- non-transformed enterprises, autonomous parts	2315	1243

Source: Author's computations based on data from Statistical Reference Book, NSI, Sofia, 1996.

The main changes in state-owned enterprises are related to their transformation (incorporating). In general, this process has taken place mainly in the first year following the adoption of the Law (1991-92) and has developed at a considerably lower pace in the next years. After 1993, non-transformed state-owned and municipal firms decreased twice in number. This was due to two main reasons: first, the continuing process of transformation, and, second, the privatisation of non-transformed state-owned enterprises. Comparing the figures in Table 3 on the number of approved for privatisation non-transformed enterprises and the number of the remaining non-transformed public enterprises (Table 1), it can be concluded about a prevailing policy towards privatisation without a preliminary transformation of enterprises.

The increased number of independent enterprises in the economy as a whole and in sectors and subsectors is a solid ground for abolishing of monopoly. The maximum possible level of decentralisation has been achieved thus providing the prerequisites for economic demonopolisation in most of the sectors. Some one-plant enterprises have preserved their monopoly positions due to their role of sole producers of particular goods; the same applies to some enterprise complexes in sectors and productions in which Bulgaria has formerly specialised within the CMEA area (for example, Balkancar, Bulgartabak, etc.). Yet, even those complexes don't integrate all enterprises in the subindustry as it used to be before. For example, in lifting and transport machine-building

the production of elevating gears and equipment (cranes, lifts, electric hoists, store equipment) is allocated in independent plants. The same applies to some primary productions as electromotors, diesel engines, etc. As a result, except for "Balkancar" a further 31 independent joint-stock companies, limited -liability companies and firms have emerged in the subindustry of lifting and transport machine-building.

As is well-known, antimonopoly policy can be pursued by either domestic or competition from abroad. The impact of foreign producers is of considerable importance to large economic organisations in Bulgaria. The case of "Balkancar" is indicative of the fact that such kind of groups face extremely sharp competition not only at foreign markets but also at home because of the increasing supply of cigarettes from America, West Europe and Greece. State enterprises decentralisation is the main factor predetermining the creation of conditions for demonopolisation of economy. Although much more in number, private firms and other institutional owners exert a far smaller influence on the creation of competitive environment. This is due to both their small size and their just symbolic presence in many of the industrial sectors and especially in large-scale heavy industry. State enterprises decentralisation is the main but yet one of the steps towards establishing of really demonopolised and market competition sensitive enterprises. The latter should be further privatised (or the greater part of them, at least) and the very market environment should be created for their functioning.

The variety of organisation patterns in Bulgaria could be given a similar estimation. More and more firms and groups of different kind are continuously coming into being under the regulations of the Law on Commerce (for example, commercial groups like consortiums, holding companies, etc.). This is not enough, however, to state that organisation patterns of enterprises are created as institutions of normally functioning market economy. Their real creation and full-value existence needs time first; and second, this process is closely related and dependent on the development of other market economy institutions.

Changes in enterprise management and control are of the most important elements of the process of enterprise change. Depending on the different organisation patterns of enterprises, two aspects should be mentioned: first, building up of entrepreneurs capable to promote development and execute management and control in small and medium enterprises; second, creation of corporate management in joint-stock companies. The problem is complicated by the need in changes in two parallel directions, i.e. in the emerging private businesses and in the transforming state enterprises. Problems in the second direction are more complicated and hard to solve due to emerging non-economic contradictions and the necessity of bringing the requirements for efficient changes in compliance with avoiding the crash of the state sector since the latter is still the basis of economy.

Management and control of enterprises are closely connected and dependent on the clear-cut determination of property rights. In this respect, an important change was made in 1991 by abolishing the rather confused combination of workers' self-management, technocracy and state intervention. The Council of Ministers was assigned the responsibility for the functioning of state property and in August 1991 an Ordinance on the management of single-person commercial companies with state participation was



adopted. The basic rules of manager competition were developed aimed at changing the system of managers' appointment from based on political to one stressing the professional qualities of applicants.

Another important act regulating the activity of state enterprises was adopted in early June 1992. The Council of Ministers passed a Decree under which the Ministers of Industry, Trade and Transport were assigned the transformation of firms registered pursuant to Decree 56 into single-person commercial companies with state property, in this way, the final step was made towards equalising the status of state enterprises in correspondence with the provisions of the Law on Commerce. Under above mentioned Ordinance (1991) manager competitions were carried out by branch committees appointed by the Government. Moreover, direct state participation in management and control was also secured by the inclusion of government officials in the collective governance of enterprises.

The criteria of estimating the merits of applicants incl. not only their personal and professional qualities but also evaluation of the proposals they have presented on improving the functioning of enterprises, analysis of current state and programme for future development. Manager competitions failed to meet their goals in full. The greater part of former managers were dismissed but in many cases the newly nominated were not the proper ones in terms of competence and professional experience. This was partly due to the short terms of organising the competitions and the strong pressure exerted by influential and very active trade unions. The actions of the latter resulted in very difficult to settle contradictions between the Ministry of Industry and trade unions themselves. For particular cases, a compromise was reached by transforming limited-liability companies into joint-stock companies, so that representatives of both parties could enter the collective management bodies.

The competition results were unsatisfactory with regard to the second goal, i.e. approval of programmes for improvement of enterprise functioning. Given the applicant hadn't a preliminary prepared programme, it was simply impossible to cover in such a short time the enormous work on analysis of current state, estimation of possibilities, strategy choice and most adequate means for its implementation. Besides, a general branch committee is hardly expected to give a most precise estimation of specific production suggestions and programmes. Third, the general economic environment does not provide executives with much freedom for real manager behaviour. The general conclusion can be made, therefore, that changes in the ownership structure of Bulgarian economy are still at their initial stage. Most probably, the creation of modern forms of economic organisation will be completed in the next year. Certain problems can emerge in the functioning of enterprises, stemming from insufficient changes in ownership patterns. The large share of state ownership is sure to have a negative effect on the control exercised by proprietors on managers as well as on enterprises performance.

#### **4.2. Enterprise Size Structure**

In the conditions of transition, fast changes have started in the size structure of enterprises in the Bulgarian economy. These changes are accomplished in the following main directions: first, an increase in the total number of enterprises, both in the economy

as a whole and by branches.; second, an extremely fast growth in the number of small enterprises, which is the main generator of the changes in the former size structure.

The aim of studying these changes is to determine their intensity and to answer the question of whether and to what extent has the size structure of Bulgarian economy got closer to that in the developed market economies.

a) decentralisation and increase of the number of enterprises In April 1991, the Council of Ministers adopted a Decree providing for the accomplishment in very short terms of the decentralisation and demonopolisation of large state-owned associations and combines. The firms in seven branches, including electronics, telecommunications, energy, metallurgy, machine-building, chemical and cereal-processing industry, had to be restructured following a profound expertise according to a list of indicators suggested by the Minister of Industry and approved by the Council of Ministers.

Apart from associations, another group of state-owned and municipal firms with more than one enterprise had to be decentralised as well, which at that time hadn't the status of independent legal entities.

In its general part, this program was accomplished within several months, the greater part of associations decentralised in July 1991 by a series of decisions of the Minister of Industry and Trade.

Data point to the emerging variety in the organisation forms of state-owned enterprises as well as to the extremely sharp growth in their number resulting from decentralisation. For a 5-year period, this number has increased by more than 26 times, the fastest pace being in 1991.

The increase in the number of non-private enterprises (state-owned, municipal, cooperative, etc.) is observed in the total economy and by sectors (See, Table 1).

**Table 1.**

*Distribution of State-Owned and Other Non-Private Enterprises by Sectors*

	1989	1990	1991	1993	1994	1995
Total	1534	3491	30660	38779	42401	41984
Industry	563	823	3508	3971	4048	3798
Construction	305	409	1154	1313	1284	1106
Agriculture	259	1245	2537	4499	5570	5367
Transport	89	120	506	651	644	594
Trade	141	430	2449	3386	3511	3422
Science	81	198	534	833	793	643
Education	4	9	8459	9110	9067	8902
Culture and Art	8	12	5005	5158	5059	5043
Health, Tourism	12	34	3278	4024	4202	4210
Finance, Insurance	2	5	63	792	882	938
Other	-	2	2089	5042	7341	7961

Source: National Statistical Institute

Regardless of inevitable differences, the number of entities has increased by several times in each of the sectors. A particularly high growth is observed in trade, education, culture, tourism and finances. This is due to comparatively better opportunities for the creation of small enterprises in these fields, the higher profitability and certain preferences provided by Law.

Recent data, however, point to a stagnation and even a decreasing number of nonprivate enterprises. This indicates for an exhaustion of the capacities for existing enterprises decentralisation or for the creation of new enterprises in non-utilised production and service niches.

The highest growth rates are demonstrated by new-established private enterprises, i.e. from 24537 by end-1990 to 466445 by end-1995, of them more than 60000 operating in industry. Estimating the significance of private enterprises, it should be taken into consideration that by expert appraisals about 40-50% of them are not functioning, while more than 90% employ less than 5 persons. Therefore, admitting the high 'birth' rates of this sector, one should at the same time account for their weakness and quite probable high rate of 'mortality' unless incentives and preferences are adopted to support the small business.

b) changes in the size structure of Bulgarian economy

The decentralisation of state-owned enterprises and the fast growth of the private sector have made for the substantial changes in the size structure of Bulgarian economy.

**Table 2.**

*Enterprises by Size Groups in the Bulgarian Economy (1995)*

Sectors, Ownership	Total number	Micro, %	Small %				Medium %		Large %
			2-10	11-20	21-50	51-100	101-300	301-500	
Economy	77518	75.2	6.9	7.5	4.7	3.8	0.8	1.1	
- private	60074	92.2	4.9	2.7	0.9	0.4	0.05	0.06	
- state -owned	17444	19.6	14.9	23.9	17.7	15.9	3.4	4.6	
Industry	14863	70.6	6.7	6.6	5.4	6.6	1.7	2.4	
- private	11967	86.3	6.7	4.2	1.7	0.9	0.1	0.1	
- state- owned	2896	6.0	6.8	16.7	20.6	30.1	8.0	11.8	

Source: Author's computations based on data of NSI.

In Table 2, data are presented only for state-owned and private enterprises employing more than one person. The smallest size group, i.e. 1 or 0 employees, is excluded although it covers about one-half of the total number of enterprises in the developed countries and more than three-fourth of enterprises in Bulgaria. On the other hand, the greater part of non-functioning and unstable enterprises come from this size group.

In 1995, the size structure of enterprises in the Bulgarian economy approached the levels in the developed economies (See, Table 3). The share of micro and small enterprises in Bulgaria is still lower, while that of medium and large enterprises is exceeding the levels in the developed countries. Anyway, these differences are not so substantial given the initial structure in 1989. It is obvious from the figures in Table 2, that even after a multifold increase of the number of small state-owned enterprises, their structure differs a lot from the usual structures in market economies. The share of different size groups cannot present the whole picture of the on-going processes of adjustment of the size structure of a transition economy. An additional indicator could be the number of enterprises in a particular size group per 10,000 inhabitants (See, Table 4). The comparison of data points out that the total number of enterprises in Bulgaria is by 1.5-3.5 times smaller than that in the developed countries. The same ratio is valid with regard to micro and small size groups. Considering the upper subgroup of small enterprises (50-99) and the group of large enterprises (500+), the number of enterprises in Bulgaria is coinciding with the average levels in developed countries, while the middle size group outnumbers the corresponding figures by 1.5-2 times.

**Table 3.**

*Enterprises by Size Groups in the Developed Market Economies*

Countries, Enterprises	Total number	Micro, % 1-9	Small, %			Medium, % 100-499	Large, % 500+
			10-19	20-49	50-99		
EU	6744024	84.7	8.2	4.6	1.3	1.0	0.2
USA	5044808	77.1	11.2	9.3	5.2	1.7	0.7
Canada	822494	91.8			1.7	1.1	0.2
Japan	1706926	70.4	14.1	9.6	3.2	2.7	
Australia	360900	80.0	11.0	5.8	1.7	1.6	

Note: EU, USA, Canada, Australia – 1990; Japan – 1991.

Source: Enterprises in Europe. Third Report, Vol. I, Eurostat, p. 28

**Table 4.**

*Enterprises by Size Groups per 10,000 inhabitants*

Countries, Enterprises	Total number	Micro, % 1-9	Small, %			Medium, % 100-499	Large, % 500+
			10-19	20-49	50-99		
EU, 1990	2060	1744	169	95	27	21	4
USA, 1990	2019	1556	226	189	161	34	14
Canada, 1990	3092				53	34	6
Japan, 1991	1377	970	194	132	44	37	
Australia, 1990	2111	1687	232	122	36	34	
Bulgaria, 1995	923	695	64	69	43	42	10
- private	715	654	33	19	6	3	0.4
- state-owned	208	41	31	50	37	39	9.6

Comparing the figures, the following directions of changes in the size structure of Bulgarian economy can be expected: first, an increase in the total number of enterprises; second, an expansion of small size groups (1-49). The preconditions for such developments are available, since the total number of enterprises, incl. the zero-group, is equal or larger than that in the developed countries. It is normal to expect transformations and resulting expansions of the upper size groups.

Changes in the size structure of transition economies through an increase in the total number and the number of micro and small enterprises create better conditions for the development of market relations. As a next stage, a development of the relationships between small and large enterprises can be expected which will result in the formation of the 'dual' size structure of the economy.

### **4.3. Financial Restructuring**

In the transition period to market economy the necessity is still preserved of intensive relations between the state and the firms. Under the conditions of quasi-market environment and absent market institutions, the state has to fulfil functions similar to that of the market in normal market economies, such as obeying financial discipline, financial restructuring or liquidation of enterprises, etc. In Bulgaria, the main problems in this sphere are connected with subsidies and budget dotations, liquidation and financial restructuring of enterprises.

#### a) production subsidies and budget dotations

Direct budget financing of enterprises amounted to 12.5 bin. BGL in 1994 and 12.6 bin. in 1995. In terms of constant prices, this is a reduction of about 30-40% in both the relative share of subsidies and dotations in the total operational income of enterprises and in their absolute value. As seen from Table 1, as a relative share in operational incomes, this decrease is bigger in dotations (about 2 times) than in subsidies (25%), which is a positive tendency.

The major part of production subsidies (96%) is directed to two sectors, industry and transport. In terms of relative share, however, they are higher (4 times) than the average for the economy only in transport, almost equal to the average in industry, and lower than the average in all other branches.

The main part of dotations in 1994 (53%) was directed to industry. This share demonstrated a considerable decrease in 1995, down to 21%, yet remained above the average for the economy. The highest share of dotations went to construction, while the greatest increase in 1995 was observed in trade, the three sectors thus receiving about 80% of total volume of dotations.

Production subsidies and dotations are quite unevenly distributed between the subsectors of industry (See, Table 2). Nearly a three-quarter of subsidies is directed to coal mining and production of electricity. The same branches have also the highest level of subsidies per unit of operational income – 2-3 times in electricity and more than 20 times in coal mining. The rest of industrial branches are either close to the average for the economy (for example, non-ferrous metals) or considerably lower.

**Table 1.**

*Production Subsidies and Budget Dotations by Sectors and Years (in bin BGL and current year prices)*

Sector	Year	Operational Income	Production Subsidies	Budget Dotations
Total,	1994	714.9	9.9	2.6
incl.	1995	1029.3	10.7	1.9
Industry	1994	462.0	6,5	1.4
	1994	694.8	6.4	0.4
Construction	1994	28.8	0.1	0.3
	1995	39.4	0.1	0.5
Transport	1994	66.8	3.1	0.1
	1995	86.2	4.0	0.2
Communicat.	1994	14.0	0.02	0.3
	1995	19.3	0.04	0.3
Trade	1994	127.9	0.07	0.1
	1995	164.8	0.4	0.6
Other	1994	4.0	0.025	0.009
	1995	4.8	0.016	0.021

Source: Author's computations based on data of NSI, Financial Condition of Enterprises '95.

**Table 2.**

*Production Subsidies and Budget Dotations in Industry (in mln. BGL in current year prices)*

Sector	Year	Operational Income	Production Subsidies	Budget Dotations
Industry,	1994	462036.4	6464.1	1419.2
incl.	1995	894786.8	6382.0	378.7
Electricity and	1994	38099.2	1856.6	860.5
Steam Production	1995	59987.5	1425.0	4.9
Coal Mining	1994	11591.8	2919.0	-
	1995	15699.3	3943.1	-
Non-ferrous Metallurgy	1994	27782.8	545.2	397.2
	1995	43545.2	480.9	263.0
Chemical and Oil	1994	114866.3	7.1	2.4
Industry	1995	183309.2	6.5	2.6
Machine-Building	1994	41164.9	27.0	5.2
	1995	59630.5	20.2	10.6
Textile	1994	19281.8	0.2	0.9
	1995	27207.9	0.2	1.3
Sewing Industry	1994	5938.4	2.4	2.0
	1995	8249.0	8.8	8.9
Foodstuffs	1994	84605.8	334.2	82.6
	1995	118959.8	93.4	22.8

Source: Author's computations on data from NSI, Financial Condition of Enterprises '95.

In their main part (88%), 1994 dotations were directed to production of electricity and non-ferrous metallurgy. Actually, non-ferrous metallurgy was the only branch dotated in 1995. There was a drastic decrease in dotations for electricity, while their level in the other branches was insignificant.

Studying data in Table 2, it can be concluded that the main reason for direct financing of enterprises by the budget is the maintenance of lower prices of energy carriers.

#### b) Financial restructuring and liquidation of enterprises

The delay of structural reforms in Bulgaria has brought about a series of problems, incl. bad financial results in a great number of enterprises. In April 1996, the Government advanced a program for restructuring, consisting of two main parts – liquidation, and financial restructuring of loss-making state-owned enterprises.

The program of financial restructuring includes a list of 36 industrial enterprises: 15 in machine-building, 5 in electrotechnical industry, 4 in chemistry and oilprocessing, 5 in textile, 3 in non-ferrous metallurgy, 2 in ferrous metallurgy, and 2 in glass industry.

The total debt of these enterprises amounts to 54.6 bin BGL, which is equal to their capital (54.5 bin. BGL), or their fixed tangible assets (59 bin. BGL). This is an indicator of a very high degree of decapitalisation of enterprises included in the Program, yet comparing the figures it should be kept into account that a revaluation of assets has not been made in Bulgaria since 1992, therefore the value (resp. price) of these enterprises should several times higher.

In terms of current financial results and indebtedness, enterprises can be classified into 4 main groups, namely: positive results and small debt, positive financial results and very big debt, current loss and small debt, and current loss combined with very high indebtedness. Obviously, enterprises suffer different problems and the solutions should be searched for each case in particular.

Enterprises are given three months to prepare individual plans for financial restructuring in a one-year term. Be they successful, enterprises will be allowed rescheduling, reduction or cancellation of old debts; in the opposite case, measures will be undertaken for their liquidation. Enterprises included in the financial restructuring program are under the governance and supervision of the Ministry of Finance.

Like in some other East European countries, the governments in Bulgaria have proved to be rather reluctant towards the liquidation of state-owned enterprises. The reason here is neither the absence of adequate legal basis, nor the non-existence of badperforming state-owned enterprises. Actually, there hasn't been adopted a particular law on bankruptcy, yet the Commercial Law (1991) includes a special chapter regulating this issue.

It was realised only in spring 1996 that any further delay in the solution of these problems would be crucial, and steps were undertaken in two directions: first, workingout a program for liquidation of a part of enterprises in extremely bad financial condition, and, second, creating the prerequisites for the normal functioning and application of already existing legislation regarding the liquidation of loss-making state enterprises.

The program for liquidation has been initiated by the World Bank and the International Monetary Fund and is accomplished with the financial and expert assistance of these institutions.

There are 64 state-owned companies included in the list for liquidation, of them 38 in industry. These companies account for 3% of the total number of employees, 7% of the fixed assets, and more than 30% of the losses in the sector. The total debt of enterprises in the list exceeds by 2.6 times their fixed capital and by 2 times their long-term tangible assets. The goal of the program, therefore, is to improve the general performance of the sector, with a minimum negative effect on the employed.

Liquidation procedures have been opened for 27 of enterprises, while the remaining 11 will be privatised. Privatisation deals have been already concluded for 8 of them, the rest are in process of negotiations with potential buyers.

As a result of the application of the provisions of the Commercial Law regulating the liquidation of companies, closing and liquidation procedures have been opened for another group of 44 loss-making enterprises. These are mainly small-sized enterprises with a total of 1070 employed.

## **5. Case Studies of Bulgaria**

### **5.1. Electronics — A Restructuring at the Price of Severe Reduction of Personnel**

#### **5.1.1. General State of the Sector**

In 1993, Bulgarian electrical engineering and electronics produced 5.9% of total industrial production and employed about 10% of total industrial work force. The sector has fallen in a deep crisis since the start of reforms in early 1990s. In volume terms, 1993 production was 61.6% down the level in 1990. The decline is due both to the collapse of former CMEA markets and the problems connected with finding new raw material suppliers. (In the expenditure structure of enterprises in electrical engineering and electronics in 1993, material expenses amounted to about 60% of total expenses.).

The last data available give information for the first three quarters of 1994, evidencing for a continuing decline of production. Compared to the same period in 1993, the decline equals to 12 percent. The average machine loading as of October 1st, 1994 was 52% (51% in 1993, respectively).

#### **5.1.2. Characteristics of P-01**

P-01 is a state-owned company specialized in the production of three main product groups: disks, technological equipment and consumer goods. Till now, information has not been collected on the structure of sales by product groups.

The state company consists of 26 enterprises, all of them located at the territory of the city where the company's head office is placed.



P-01 can be classified as a 'big company', as under the classification standards companies with 1000 and more employees belong to the group of big companies. The employed numbered 6966 as of 31 December 1990, 5088 and 4015 at the end of 1991 and 1992, respectively.

The volume of sales in 1990 is incomparable to those in the next two years as in 1990 P-01 was still a state-owned firm with subsidiaries located outside the city of the head office. The volume of sales was 430974 thous. Leva in 1991 and 663480 thous. Leva in 1992. There was a reduction in the physical volume of production in the studied period, and the growth of sales was due to the rise in prices and product restructuring.

P-01 was established as a state-owned company in 1968 by an act of the Council of Ministers. The company was under the supervision of the Ministry of Industry.

After the transformation on November 1st, 1991, P-01 became a single public limited company (PLC) with a hundred percent state share. The pattern of ownership has not been changed since then. Managers are not informed about whether and, if 'yes', how the company will be privatized.

### **5.1.3. Shocks of the reforms**

Since the start of reforms in early 1990s, the collapse of the CMEA market has been the major shock effecting the company. Till end-1989, P-01 had a narrow specialization and a guaranteed share in that market fixed by the intergovernmental agreements between the East European countries. The fulfillment of planned orders has been provided by priority state assistance in the field of investments, credits and raw material supplies. The collapse of the CMEA market, however, put an end to the priority place of P-01 in the Bulgarian economy. The chain reaction of shocks started with the breakdown of CMEA relationships, went through the loss of preferences provided to P-01 by the state, and finished in the lack of markets for its production.

At the first stage of reforms, the following changes effected the company most severely, namely:

1. The collapse of the CMEA.
2. The abolishment of state subsidies.
3. The changes in employment terms, i.e. wages and dismissals.

The last one resulted from the lack of outlets. In practice, this meant permanent problems with payroll payment and firing of nearly 40 % of the employed in the period 1990-1992.

According to the managers, changes in ownership rights (relaxed ministerial control, changes in ownership, higher autonomy or changes in the management) cannot be estimated as considerable shocks to the enterprise.

In the opinion of managers, the company has been facing one and the same problems at the start and during the last six months of the reforms.

The loss of markets is the major problem.

Other priority problems include the increased resource expenses and the higher labour expenses, in particular, the improvement of quality, and the lack of investments in new technologies.

The change of information systems, mainly in the field of marketing and accountancy is an important problem as well.

It should be mentioned that the enterprise doesn't suffer considerable problems connected with durable equipment and labour force employed, as these are of high level. Neither has a necessity arisen in changing the volume of store.

#### **5.1.4. Short-term responses of the enterprise**

##### **5.1.4.1. Changes in management**

The present organization structure is a public limited company with 26 subsidiaries. The managers may propose the organization and management scheme of the company.

P-04 has a one-tier management system as under the Commercial Law and is governed by a Board of Directors. The members of the Board were changed eight months ago by the Minister of Industry. According to the managers, it is the Minister who can explain in detail the reasons behind the new appointments.

The constitution of the Board of Directors follows a procedure based on an order of the Minister of Industry. The competencies of the Board are regulated by the Commercial Law.

P-01 has a two-division organization structure: the first division is connected with the production of disks and disk components, and the second one with electro-mechanical equipment, parts and servicing. The top managerial staff of the company includes the Executive Director and the directors of the two divisions. The company hasn't a director of finance, nor a director of marketing.

The Executive Director is an engineer graduated from a Bulgarian higher institute, and has an international experience. He was promoted by the internal company circles.

The Director of the first division is an engineer, graduated in Bulgaria, appointed after a promotion from inside.

The Director of the second division is an engineer by education, graduated abroad. He was appointed after a company promotion, too.

Recently, some changes have taken place in the managerial staff of P-01. These were connected with the new management structure and the emergence of additional posts, i.e. the directors of divisions were appointed deputies to the Executive Director.

The remuneration of the managerial staff hasn't undergone recent changes. Due to its hard financial condition, the company couldn't take much advantage of Decree 265 of the Council of Ministers of December 28, 1992. The salaries of managers are rather close to the average level in the company.

##### **5.1.4.2. Organisation and management structures**

The shock connected with the collapse of the CMEA market has set forth the necessity in developing products oriented at the Western market. At present, a restructuring of the company is going on with product restructuring of P-01 as a first priority. Each of the 26 divisions of the company has undertaken restructuring, too, aimed at developing sellable products.

Organization and technological restructuring are on-going, too, yet they are subordinate to product restructuring as far as it is the determinant, and not vice-versa.

Notwithstanding shocks and negative effects, the reforms from the early 1990s have presented some, though rather small, opportunities to the company's development. These are connected with access to new markets and greater independence in setting prices, changes in the product structure and in the markets. The access to new markets and the investment decisions, however, are still goals to achieve. The release of abundant work force is also a positive factor in the new environment, yet it is under the limiting pressure of trade-unions.

The company has not found new sources of financing and resource supply. Though in an active search for foreign investors, the latter are not considered an important factor of company's development in the near future.

### **5.1.4.3. Markets, sales, production**

The main responses of P-01 to above-mentioned problems relate to the following aspects of its activity:

1. Production: A reduction in the volume. Production will be further diversified and its quality will be gradually improved. Prices are compatible with world price levels. A process of product restructuring is going on in the 26 divisions of the company.
2. Finance: An increase of bank loans. Even payroll payments are covered by bank loans.
3. Utilization of production capacities: It is hard to determine the movement in labour expenses per unit of production because of the rise in wages connected with inflation rate and dismissals.  
A small part of the machinery is under rent. The management is in a process of negotiating the sale of part of the long-term assets of the company.
4. Suppliers: New suppliers have been found both at home and abroad. These should not be connected with the creation of whatsoever new companies or ventures.
5. Markets: There is a certain number of customers created but it is not sufficient. The company makes technological transfer of licenses and not patents.
6. Organization and management restructuring: It is a result of product restructuring. The company is not privatized and there aren't clearly stated privatization plans. An important response to mention are the intensified negotiations with foreign partners aiming the attraction of investments and establishment of joint ventures.

The information systems of the accountancy and marketing departments are in a process of restructuring as well.

The managers estimate these responses as parallel in time and mutually consistent. Some of them are already accomplished – the reduction of production and the rise of prices, for example.

Anyway, the main adjustment responses of the company are on-going, including negotiations with foreign investors, the search for outlets, diversification of production, selling of non-usable assets, improvement of information systems.

Managers find it hard and useless to rank the responses according to their importance. They estimate them as a complex of factors directed at achieving the company's competitiveness at the international markets.

The factors which hamper the adjustment of P-01 to new conditions are ranked according to their significance in the following order:

First, the deficit of financial resources.

Second, the barriers to capital restructuring.

Third, the intervention of trade-unions in labour-force restructuring (reduction).

In their efforts to solve the problems of adjustment, managers have always been looking for the cooperation of other economic agents. With regard to domestic sources, the following initiatives can be mentioned, namely:

1. Attraction of foreign investors by providing guarantees for know-how, repatriation of profits, tax facilitation, etc. To this end, P-01 has approached the government with a proposal for creating a free customs zone on the territory of the company and on the territory of the city later on, given its importance as both commercial and production center.

2. In the sphere of product restructuring. The company has submitted projects to the Ministry of Industry and Technologies in order to apply for financing by the "Restructuring Fund".

3. In the sphere of financing. P-01 has applied for bank credits with guarantees provided by the Ministry as the owner of the company.

There is also a search for foreign cooperation but the company lacks guarantees to offer to potential foreign investors even when turnover capital is concerned.

### **5.1.5. Long-term responses of the enterprise**

Since the start of reforms, survival has been the main goal of the company. The maintenance of the current situation is a priority goal for the next year.

Growth of production, restructuring and marketization are the goals set in the midterm three-year programme of the company.

According to managers, the goals and priorities of the company change in compliance with the general economic state of the country. In the period following the first shocks, the aim was a mere survival. At present, having undertaken a series of steps for financial stabilization, the company makes efforts to preserve some of its achievements. Growth in production and penetration into new markets is expected after intrafirm restructuring which is connected with the general governmental policy towards restructuring of the economy.

Till now, the company has never been close to bankruptcy.

At present, finding of new outlets, providing of resources and maintenance of employment constitute the main strategy of the company. Profit maximization is not a strategic goal for the time being.

The design of new products, increase of market share, attraction of foreign partners, and investments in new technologies are set as both short and long-term goals of the company. Profit maximization, however, will be a priority in three years at earliest.

### **5.1.5.1. Enterprise management. Changes in ownership**

The managers of the state-owned P-01 do not consider ownership rights an issue of prime importance. The changes in ownership rights since the start of reforms in early 1990s (relaxed ministerial control, changes in ownership, greater autonomy, changes in the management) have not had the effect of shocks to the enterprise. A certain unclarity of this problem is not a factor limiting the enterprise adjustment. Managers have no information on eventual changes in ownership in the near future.

The collapse of the CMEA market and the abolishment of subsidies are pointed out as the main shocks to P-01. The loss of market is the main problem, along with the deficit of financial resources necessary for capital restructuring. The responses of the enterprise include various economic actions, and not restructuring of ownership rights, i.e. privatization.

The current situation of P-01 points to some other conclusions as well.

The main economic agents of P-01 as a single PLC are the government, the Board of Directors and the managers. In the structure of ownership rights, the owner of assets, i.e. the government (governmental officials) takes the residual risk and relevant responsibility, while the operative management is carried out by the managers under the supervision of the Board of Directors.

The question is who takes the residual risk for P-01 after the collapse of CMEA markets and the abolishment of subsidies? All the negative consequences should bear the owner, i.e. the government. State officials, however, take the risk rather because of their position than of any adventure inclination. Besides, they often lack the necessary personal and professional qualities and usually transfer to the company the responsibilities connected with the search for new outlets and financial resources for capital restructuring. This is done by giving the company the so-called 'autonomy', i.e. a hypothetical freedom in determining products, markets and investments. The residual risk is thus transferred to the company, which is very inefficient because: first, the bearer of the risk remains non-personified, i.e. board of directors, managers or the whole personnel; second, the risk-bearing function is transferred without legal restructuring of ownership and hence the great insecurity of future development.

Having this in mind, the main shock for P-01 since the start of reforms seems to be rather the higher autonomy of the company (residual risk and management functions) than the collapse of East European market, as the company is not the owner of assets and is therefore not allowed selling its ownership rights.

What is the reason behind the different degrees of autonomy given to different companies? Generally, it is determined by the quite complicated relationships between state officials, on the one hand, and managers, staff and company, on the other. Sometimes, as is the case of P-01, managers and staff suffer unfair losses, in other, enterprises gain unfair advantages. All this results in inefficient distribution of resources and social tensions.

P-01 has been established as a single PLC under the will of the executive power and not the free initiative of independent economic agents. Therefore its existence must be

supported even at the price of high transaction costs, including information supply, conclusion of contracts, supervision of labour behaviour, etc. Due to these high expenses, the government fails to meet its responsibilities and hence behaves as an irrational owner.

With the given structure of ownership rights, managers pursue strategies directed at company survival, revival of production and gradual growth. The absence of radical rationalization of ownership rights, however, turns these strategies into mere intentions. In the case of P-01, privatization will solve the problems with markets and financing of capital restructuring. At the present stage, state officials prove to be the most irrationally behaving economic agents. The members of the Board of Directors share different risks to lose their jobs. Managers and staff appear to be most interested in the company's vitality. They are therefore expected to undertake an efficient privatization initiative and make proposals for a substantial change in the way the company's problems are solved.

### **5.1.5.2. Investments. Changes in the production structure.**

At present, the enterprise is in a search for foreign investors. The available facilities are rationally used, including by renting and selling parts of the assets. Product restructuring is a priority from the viewpoint of creating real markets for the company.

### **5.1.6. Estimation of adjustment measures and perspectives of the company**

P-01 is a big company and its main agency problems are related to the mediation between the single shareholder-the government and the managers of the company.

It is a theoretical assumption that as far as the owners bear the residual risks of company activity, they are interested in the efficient use of capital and to this end can find mechanisms to 'disciplinize' the eventual manager opportunism. In the mixed Western economies, such kind of mechanisms are for example the capital market, the manager labour market, the market for corporate control, the managerial ownership, the system of manager compensations, the establishment of a special institution called 'board of directors', etc.

Obviously, since the start of reforms P-01 has functioned in an environment lacking developed market institutions, hence their negligible effect on manager behaviour. The peculiarity of the case is that by transferring to the company the risks from the market collapse and paying no attention to its initiatives related to the customs free zone, financing from 'Restructuring' Fund and providing credit guarantees, the owner, i.e. the state officials, behave in a way rather contradictory to the main axiom of capital ownership, i.e. that of efficient capital management.

In this situation the nominal owner, in fact the government and the Ministry, acts very inefficiently. Instead of preventing a possibly irrational manager behaviour, it is the owner of P-01 that manifests opportunism towards capital management. Who should defend the interests of capital in the company? Are managers capable of doing it provided they are interested in preserving their jobs?

In the conditions of underdeveloped capital and manager markets, it is hard to expect

anybody else but the capital investor to defend the company interests. The 'autonomy' of P-01 is a rather unstable condition with negative effects to both the national wealth and social peace. There are two possible directions of behaviour out of this disequilibrium state, namely:

First, the government should undertake all the rights and responsibilities related to residual risks, restructure the capital and take measures for the financial recovery of the company (its further privatization is just another question).

Second, instead of present 'pseudo-autonomy', the government should transfer to the managers and staff not only the responsibilities but also the ownership rights on the company assets.

State officials seem to dislike both the alternatives as in the first case they have to spend a lot of efforts and funds, and in the second they will lose their power.

The hypothesis of real company autonomy can be realized by a bottom-to-top manager initiative for privatization under Art. 4 of the Law on restructuring and privatization of state-owned and municipal enterprises, which provides big shares in ownership to managers and staff along with considerable financial sources for capital restructuring. To be fulfilled, such a project needs the approval of the government and the provision of guarantees to potential foreign investors. In other words, state officials take the leading role again.

The Board of Directors is the institution to exercise the supervision on managers of P-01. Its members are often changed, however, which is yet another proof of the lack of clear-cut and efficient owner behaviour.

Managers are not aware of any privatization plans; actually, they follow a wait-and-see position on the most important issue related to the use of capital.

## **5.2. Machine-Building — Active Management Towards Restructuring**

### **5.2.1. General State of the Sector.**

During the last thirty years there was only one major producer of foodstuff machinery at the Bulgarian market. This was the enterprise under study, P-02, its main three product groups covering more than a half of the market in the country. The rest of the domestic demand in foodstuff machinery was covered by imports, mainly from Italy.

The monopolistic market structure was shattered with the start of reforms in the early 1990s. At present, the share of P-02 in the Bulgarian market is about 25 %. The remaining part of production of foodstuff machinery is covered by other Bulgarian producers, 25 %, and by foreign producers, 50 %. According to an expert assessment of the managers of P-02, the competitive producers number from 5 to 20.

The production of foodstuff machinery and technological equipment in 1992 was 74.2% the level in 1991, and 61.2% the level in 1990. This is in conformity with the general tendency of decline in machine-building and metal-working as a whole. The volume of production in 1993 was nearly 55% less as compared to that in 1990. In 1993,

the sector accounted for 9% of the total industrial production in Bulgaria (17.3% in 1990), and employed 21% of the total number of employees in industry.

Statistical data for the third quarter of 1994 point to a slight upswing in the sector, i.e. a growth of 1% in production (compared to the same period of 1993) and an increased use of capacities as of 1 October 1994 (53% against 50% in 1993). This positive trend applies to the enterprise under study as well.

### **5.2.2. Characteristics of P-02**

P-02 is a state-owned enterprise in the machine-building sector, specialized in foodstuff machinery. In 1994, it had the following production structure: bottling machinery (40% of sales), canning machinery (20% of sales), dairy machinery (20% of sales), and other machinery for processing of agricultural products (20% of sales).

P-02 was established by the state in 1968. It is under the supervision of the Ministry of Industry. In 1991 the enterprise was transformed into single public limited company (PLC) under the Commercial Law (Art. 62).

At present, the enterprise has ten plants. Of them, five are located in the region of Stara Zagora, one in Haskovo region, two in Kardjali region, and two in Turnovo region. The plants are located in five towns and in two administrative-and-territorial districts, these of Haskovo and Lovech.

For the years since its establishment and till the start of the economic reform in the early 1990s, P-02 has been a monopolist in the production of foodstuff machinery in Bulgaria. Its production was traded in the domestic market, in the CMEA membercountries and in the Third World developing countries from Asia and Africa.

P-02 can be determined as a large enterprise. The active roll numbered 5000 employees by end-1991, 4500 in 1992, and 3385 in 1993. Data for 1994 are incomparable due to the decreased number of plants included in the enterprise. (Till early 1994, P-02 had 12 plants; later, two of them were declared for liquidation, so the total present number is ten).

The volume of sales of P-02 was 233 mln Leva in 1991, 334 mln Leva in 1992, and 382 mln Leva in 1993. The production is oriented for the domestic market and for export.

The status of ownership has not been changed since the transformation of P-02 into a single PLC in 1991. The enterprise is on the initial list of enterprises for mass privatization planned by the Government.

### **5.2.3. Shocks caused by the economic reform**

Since the start of reforms in early 1990s, P-02 has experienced the impact of several main shock, as follows:

1. The collapse of the CMEA market.
2. High interest rates on credits.
3. Higher prices of resource input.
4. Changes in the exchange rate.

This is the way the managers of the enterprise rank the main shocks of the economic



reform. P-02 has large production potential, with long-term assets estimated at more than 1 billion Leva and production capacity to build whole plants for the processing of agricultural raw materials. Till the end of the 1980s, the foreign production orders of the enterprise were provided and secured by governmental agreements. The destabilization of markets in the former socialist countries in the early 1990s and the withdrawal of the state from the economic life made the enterprise face a sharp shortage of outlets for its large production potential. The high interest rates set by the Central Bank are the second shock for the enterprise connected with the long production cycle in machinebuilding and the slow turnover of capital. The higher prices of resource input influence the enterprise through the changes in the exchange rate towards devaluation of the Bulgarian Lev. The sharp devaluation of the Bulgarian currency in 1994 (almost 85% within half an year) entailed an artificial rise in prices of import resources. Although at first glance beneficial for P-02 as an exporter, the movements and sharp fluctuations of the exchange rate act in rather a destabilizing and generally negative way. For example, the artificially maintained "strong" Lev in the beginning of reforms resulted in a cheap export for the enterprise. Managers point to some other developments in the economic environment, too, which have influenced the enterprise, yet with a smaller effect. These include the competition from imports, the decline in domestic demand and the rise in energy prices. The enterprise is no longer a monopolist at the domestic market for the presence of competition (mainly Italian producers).

There are two groups of factors, one impeding and the other favouring the adjustment of P-02 to the new conditions. The first group of factors includes:

- ✓ a deficiency of funds and the subsequent strong dependence on banks;
- ✓ lack of investments in new technologies, higher expenses on resources and labour, with the equipment available;
- ✓ a small number of clients at the domestic market (state-owned canneries which are close to bankruptcy, and small private producers of foodstuffs).
- ✓ The second group of factors favouring the adjustment of the enterprise includes:
- ✓ the monopoly position of P-02 in the main product lines of foodstuff machinery in Bulgaria;
- ✓ the bigger independence in setting prices, in the range of products and markets used;
- ✓ the bigger independence in work force dismissal;
- ✓ the enterprise hadn't been subsidized in the 1980s so it has no problems in adapting to the new subsidy-free conditions.

Managers point out the access to foreign investors and the access to new technologies as favourable factors for the enterprise. On the other hand, opportunities are lacking with regard to the access to new markets and new resources.

## **5.2.4. Short-term responses of the enterprise**

### **5.2.4.1. Changes in the management**

After the transformation of the enterprise into a single PLC in 1991, the governing bodies of the enterprise include the Board of Directors, appointed according to the

Commercial Law by the Minister of Industry with a managerial contract, and the Executive Director, him(her)self appointed by the Board of Directors with a contract of agency.

At the start of reforms, under the strong influence of CL "Podkrepa", a new Board of Directors and a new Executive Director have been appointed to replace the former director who was member of the Communist Party. Recently, another change took place in the Board of Directors, enforced by a decree under which a person may occupy only one place in one board of directors. (The former practice permitted that a person may participate in two or even three different boards of directors in single PLCs). The top management of the enterprise hasn't been changed since the last change mentioned above. The Board of Directors has four members. Of them, one is the Executive Director, the other three are officials in the ministry.

The top managers of P-02 include the Executive Director and two deputies, the sales director and the director of plant operations. The top managers have the following main characteristics:

*Executive Director.* Engineer, specialty "Electronics". Appointed without a competition, a long-year service at the same enterprise.

*Sales Director.* Engineer, specialty "Electronics". Appointed without a competition, a long-year service at the enterprise.

*Director of plant operations'.* Engineer, specialty "Machine-building". Appointed without a competition, with service at the same enterprise.

The predominant part of the directors of plants in the P-02 system are engineers by education. Data collected point to the conclusion that the top managers in the enterprise are mainly engineers, with long-year service at the enterprise and insufficient international experience.

No considerable changes have taken place in the remuneration system of the enterprise. The wage of the executive director is connected by a coefficient to the average gross wage in the enterprise. The remuneration of the members of the Board of Directors are determined as a percentage to the average wage in the enterprise. There is a very low differentiation between the wages of managers and those of other personnel. The wage of the executive director is 3.5 times the average wage and those of the members of the Board of Directors – 1.5 times the average.

The low level of remuneration during the years of reforms resulted in the outflow of high-qualified personnel who finds better paid jobs outside P-02. The shortage is particularly acute in specialists in the R&D department (designers, technologists).

#### **5.2.4.2. Organization and management structures**

After the transformation of the enterprise into a single PLC, its plants have lost their legal independence, they don't submit independent balances and have no bank accounts of their own. As a result, the rights and responsibilities of the plants and their relationships are rather unclear.

In the opinion of some of the managers, the profitable plants subsidize the losing ones in the system of P-02, which is a factor non-incentive and inefficient for the

goodworking collectives. On the other hand, according to the executive director, the directors of plants are allowed to sign foreign-trade contracts but it is the management of P-02 who is responsible for their execution and not the plants.

Due to negative financial results in 1994, two plants of P-02 were declared for liquidation. For the time being, this is a kind of a stabilization for P-02 but just a shortterm response to the challenges of adjustment.

The coordination among the plants is executed by a specially formed body called "Board of Directors". It is in charge for the operative management of the enterprise. The directors of the plants and the executive director of the single PLC are members of this body.

A lot of efforts have been directed at improving the marketing activity. A network has been established of representative offices abroad. The marketing department makes specialized studies of the regions the enterprise is interested in.

### **5.2.4.3. Markets, sales, production**

Till the start of reforms in the beginning of 1990s, P-02 was a monopolist in the Bulgarian market and a major exporter in the markets of CMEA and the developing countries. The collapse of the CMEA-market and abolished system of central planning of resources called for the necessity of searching new consumers. The enterprise has partially succeeded in the solution of this difficult task by penetrating in some new markets as South Asia, Nigeria, Argentina. The management made a proposal for P-02 to participate by a certain quota in the intergovernmental agreements with Russia and China, but it was rejected by the Bulgarian government. New customers were created in the domestic market outside the circle of state canneries which suffer a very hard situation. These are mainly small private producers of foodstuffs.

Due to the sharp market destabilization, P-02 was forced to sharply curtail the production and use hardly 30 % of its production capacity. Another response was the drastic reduction in personnel (nearly 1600 people, or 32%, within three years). According to the managers, this resulted in reduced labour expenses per unit of production. A restructuring of production was undertaken in order to meet the specific demands of the domestic market. Small-capacity units were created for the processing of fruits and vegetables.

By rising the producer prices, the enterprise has attained a permanent growth in the volume of sale during the last years.

Another response of P-02 was the selling and leasing of machinery and equipment.

The enterprise has succeeded in finding new suppliers (mainly from abroad) and it is speeding up the negotiations with foreign partners (China, Orenburg, etc.) on the establishment of joint ventures.

P-02 is cutting down the volume of investments and this is one of the main factors hampering the improvement of the quality of production.

In short, the most important steps of the adjustment of P-02 to the reform as seen by the managers, include:

1/ a search for new markets after the collapse of the CMEA;

2/ cooperation with West-European firms producers of foodstuff machinery for the supply of parts and functional units;

3/ a restructuring from large into small production units (small bakeries, dairies, etc.);

4/ shrinkage of credits by demanding bigger advance payments (up to 50%) from the clients.

Since the start of reforms, the most important goal of the enterprise was two-fold: new outlets and survival.

### **5.2.5. Long-term responses of the enterprise**

The main long-term strategic goals of P-02 include the penetration into new markets, the development of new products (for example, machinery for the production of vegetable oil, sesame-paste, etc.), and the maintenance of employment.

For the time being, profit maximization is a missing item on the agenda, as it will make production rather expensive. The more preferable strategy includes low prices and low profitability (from 1% to 5%).

Finding foreign partners is also connected with attaining the long-term goals of the enterprise.

#### **5.2.5.1. Enterprise management. Changes in the pattern of ownership**

The managers of the enterprise plan to restructure it into a holding. The former plants will be transformed from units of the single PLC into joint-stock companies. The former management of the enterprise will be transformed into a mother-company.

A project has been developed, connecting the restructuring of P-02 with its privatization. According to it, the formation of a holding will be of benefit to the individual plants in the system of P-02 as it will accumulate funds and make plants independent of banks and bank credits. Besides, a holding is quite attractive from the viewpoint of taxation. Given the possibility that a holding may report smaller profits, or even losses, as a whole, the enterprises with bigger profits will pay smaller taxes. In short, the main purpose of the organizational restructuring of P-02 into a holding is the formation of a common fund of resources to be used for the financing of the individual plants. The holding once established, a state participation in the mother-company and the subsidiaries is envisaged in the project followed by their privatization mainly through manager buy-outs. The privatization process will be initiated by the plants' managers who will form manager teams and offer the following privatization scheme: 51% of assets to the manager team (this share including the privileged ESOP plans) and 49% to the state. With the privatization of all plants concluded, the holding will manage only the state share in the subsidiaries, i.e. the new joint stock companies.

P-02 is on the list of enterprises for mass privatization. The enterprise is subject of diverging interests and different privatization projects. Anyway, it is hard to answer the question of how the privatization scheme suggested by the managers will coincide with the model of mass privatization. At this stage, the response of the managers to eventually

mass privatization will be the attraction of employees to a mass participation in the process.

#### **5.2.5.2. Investments. Changes in the production structure**

The export of production is the main opportunity of P-02 to rise the volume of sales. This means an increase of investments in new technologies, yet it is the shortage of funds and the high interests on credits that are stopping the process of capital restructuring.

In the long term, the solution is seen in the creation of joint ventures and a holding structure to accumulate funds. At the start of reforms, the expectations have been directed mainly towards the attraction of foreign investors to participate in the privatization of the enterprise. According to the managers of P-02, however, the would-be foreign partners haven't offered projects of mutual interest. At present, real possibilities are seen in the attraction of local capital. The privatization of present plants, i.e. the stock companies in the future holding, will be financed by means of manager buy-out of the debts of P-02 at a considerable discount. The present discount of the debt-equity swap at P-02 is about 35% and it is an important source of funds for the manager teams in the process of privatization.

#### **5.2.6. Assessment of adjustment measures and perspectives of P-02**

Regardless of the hard collapse of markets in the early 1990s, the enterprise has succeeded in adapting to the new conditions, though by a liquidation of two plants and a sharp reduction in production and personnel. As a whole, its survival strategy can be considered a success. According to the managers, a strategy of growth can be developed only after the enterprise is privatized.

It is interesting to analyze the evolution of managers' attitude towards privatization. At the start of reforms, the idea for privatization initiated by the manager team and with the support of employees was considered a good theoretical statement; no practical measures were taken, however. Four years later now, when the enterprise is already on the list of mass privatization, the managers have both the projects and the will to act towards privatization of P-02, yet after its restructuring into a holding. The idea is the same: privatization by a manager initiative. The reasons for the delay and the changes in managers' behaviour are hard to explain. Keeping in mind the existence of powerful private firms in the same sphere of activity, governed by the former communist directors of the enterprise and the presence of government officials in the board of directors with rather doubtful positions, the management of P-02, with its CL "Podkrepa" members, is certain to face a difficult balance of powers in the enterprise. The main problem the managers face since the start of reforms, i.e. about the financing sources of the privatization of P-02 – whether a foreign investor, Bulgarian financial groups, or managers' own and loan capital, is now getting its solution in the later two alternatives.

### **5.3. Electrical Engineering — A Hesitant Start on the Road of Reforms**

#### **5.3.1. General state of the sector**

In 1993, the share of electrical engineering and electronics in the total industrial production in Bulgaria amounted to 5.9 percent. The sector employed about 10 % of total

personnel in industry. Being in a deep crisis since the start of reforms in 1990, its production in 1993 decreased by 61.6% the level of 1990. The decline is due to both the collapse of markets in former CMEA-countries and problems connected with the new suppliers of raw materials. (In 1993, the share of material expenses in the enterprises of electrical engineering and electronics amounted to nearly 60% of total expenses).

The last data available give information for the third quarter of 1994. For this period, the decline in production continued, its level falling down by 12% as compared to that in 1993. The average machine loading in the sector as of 1 October 1994 was 52% (51% in 1993).

The market structure of enterprises in electrical engineering is strongly influenced by the liberalization of imports. The existence of foreign competitors, however, proved to be insufficient of the formation of a high-competitive market. There are rather cases of unfair competition instead, as the case study below will show.

### **5.3.2. Characteristics of P-03**

P-03 is a state-owned enterprise in the sector of electrical engineering. It is specialized in the following product groups: street illuminants (46% of sales), industrial illuminants (46% of sales), and transport illuminants (8% of sales).

The enterprise was established by the state in 1956. It was under the supervision of the Ministry of Industry. In 1991, P-03 was transformed into a single public limited company (PLC) under the Commercial Law (Art. 62).

The enterprise has one plant and for the years of its existence has been producing mainly for the domestic market.

P-03 can be determined as a middle-size enterprise. By end-1991, the average roll numbered 506 employees, in 1992-450, and in 1993 their number decreased to 400.

The volume of sales was 40 mln Leva in 1991, 61 mln Leva in 1992, and 78 mln Leva in 1993.

The pattern of ownership hasn't been altered at all and the enterprise is still stateowned.

### **5.3.3. Shocks of the reform**

Since the start of reforms in the beginning of the 1990s, P-03 has experienced the impact of the following shocks:

1. Higher prices of input resources. The greater part of materials used in the production of illuminants come from import. The fluctuations of the exchange rate towards devaluation of the Bulgarian currency result in a rise of prices. The sharp rise in the rate of the USD had a particularly negative effect as it produced an artificial jump of prices and worsened extremely the financial condition of the enterprise.

2. High interest rates on credits. The managers determine them as a scourge for the enterprise. P-03 is forced to use more short-term credits due to the decreased demand in its production and subsequent growth of production in store which entails freezing of financial resources.

3. Unfair competition from imports. This quite a specific shock for the enterprise came on the part of a private Bulgarian-Turkish firm selling low-quality and even hazardous products in the Bulgarian market. Anyway, P-03 lost a lot of its clients. Notwithstanding the fact that the action of unfair competition was proved by the Committee on Competition Protection, the inflicted damages were multiplied in bigger credits, reduction of production and forced leaves. The managers have claimed damages to the private firm in question in order to get some compensations.

4. Liberalization of prices and the rise in energy prices, in particular, which generate inflationary expectations and instability.

5. Changes in employment. The dismissals were particularly shocking at the very start of reforms. In the period of 1990-1993, the number of employees decreased from 1500 to 400, or by more than 70 percent.

Two groups of factors influence the adjustment of P-03 to the new conditions. The first group of factors hampering the process of adjustment includes:

- ✓ unclear ownership rights;
- ✓ unclear responsibilities of the management in the long-term development of the enterprise;
- ✓ shortage of financial resources.
- ✓ This is the way the managers rank the most unfavourable factors. In addition, they mention also the lack of investments in new technologies (a production factor stemming from the deficit of funds), the loss of markets and the higher expenses on input resources.
- ✓ The second group of factors favouring the adjustment of P-03 includes:
- ✓ higher independence in setting prices;
- ✓ higher independence in changing markets;
- ✓ more freedom in the hire and fire of labour force.

According to the managers, the reforms have created very small opportunities for the firm. The access to new markets is hard to achieve while the lack of new resources dooms the enterprise to stagnation..

### **5.3.4. Short-term responses of the enterprise**

**5.3.4.1. Under the Commercial Law, P-03 as a single PLC is governed by a management body in the person of the manager of the company. He was appointed at the beginning of reforms; no changes in the managerial personnel have taken place since then.**

The manager is an engineer in specialty, with long service at the same enterprise. He was appointed by a competition and on the basis of a contract of agency signed by the Minister of Industry.

The remuneration of the manager follows a system applied to almost all single PLCs in Bulgaria. The manager is rather a member of the personnel than a representative of the owner. His wage is connected to the average gross wage in the enterprise.

### **5.3.4.2. Organizational structure of management**

The enterprise hasn't changed its organizational structure since the start of reforms. After its transformation into a single PLC, the manager became the one and sole body of management of the company. The managers find this structure of management very inefficient.

The estimation of the managers was motivated as not directed against the personality of the manager himself but rather against the provisions in the Commercial Law under which the manager of PLC has very big rights. This is a deviation from the wellknown economic or management councils of the 1980s, with the participation of workers and incompetent party leaders, to a one-man decision-making on the part of managers of newly established public limited companies.

According to the managers, the formation of a management body including the heads of departments of finance, production and trade, and respectively rising their status, may be a solution to this problem.

### **5.3.4.3. Markets, sales, production**

Since the start of reforms in early 1990s, P-03 has undertaken steps on the search for raw materials and development of new products. These efforts, however, haven't proved to be much of a success.

The unfair competition and subsequent loss of clients have caused a reduction in the volume of production. There are some achievements in the diversification and improvement of the quality of products. Sales grow constantly in volume as a result of the rise in prices.

The amount of short-term bank credits is growing, too. To mitigate the hard financial situation, the enterprise is selling machines by auctions.

There is little enthusiasm shown towards negotiations with foreign partners for investments or establishment of joint ventures. Neither the cooperation and assistance of international institutions is searched for the solution of adjustment problems.

The manager of the company is looking for the assistance of the Ministry of Industry mainly.

In short, the short-term strategy of the enterprise includes the maintenance of employment, the development of new products and the penetration on new markets.

### **5.3.5. Long-term responses of the enterprise**

In the long run, the management strategy is directed at investments in new technologies, maintenance of employment and providing of liquidity. The maximization of profits is neither a middle-term nor a long-term priority.

#### **5.3.5.1. Enterprise management. Changes in ownership**

According to the managers, the failures in adjustment are mainly due to the unclear ownership rights and the unclear future of the managerial team. The managers, however, haven't undertaken any steps towards privatization of P-03. In addition, the enterprise is missing from the list for mass privatization.



The wait-and-see position of the managers towards privatization is an evidence for the postponed long-term adjustment of P-03.

### **5.3.5.2. Investments. Changes in the production structure.**

The shortage of financial resources, on the one hand, and the necessity of investments in new technologies, on the other, postpone the long-term adjustment of the enterprise.

The unfavourable interest and taxation environment is further worsening the financial condition of P-03, yet the managers are unwilling to search for foreign investors. The development of new products is made by the equipment available.

### **5.3.6. Estimation of adjustment measures and perspectives of P-03**

At present, P-03 is in a very hard situation, yet it is not close to bankruptcy. The later has never been on the agenda of the enterprise, according to the managers. The undertaken steps of adjustment to new suppliers and introduction of new products, however, are only short-term and they cannot solve the problems of the enterprise in the long run.

Ever since the start of reforms, for the coming year and in the middle 3-year term survival is the main goal of the enterprise. Since there are no important positive changes in the enterprise activity, no need occurs for changes in its goals.

The lack of long-term adjustment strategy in the sphere of ownership rights and investments makes the hard process of adaptation to new conditions even longer.

The demand in investments stemming from the specifics of production to adapt to new markets and the lack of reliable investors present insuperable obstacles to the managers.

The existing one-man management pattern (in the institution of the manager) and the old socialist mentality of administrative personnel characterized by negligence and shirking are additional barriers to real manager behaviour.

Given the four factors mentioned above, the efforts and personal qualities of the managers are to a large extent devaluated.

## **5.4. The Chemical Industry — Expectations for Intervention by the State**

### **5.4.1. General condition of the sector**

The pharmaceutical industry in Bulgaria is characterized by the same tendency of decline in production typical for the whole industry since the start of reforms in early 1990s. The production of perfumery and cosmetics in 1992 was 72.9% the level in 1991 and 60.0% the level in 1990. In the production of volatile oils and essences, the fall down was 94.6% and 74.7%, respectively. In 1992, the production of medicines and chemical-and-pharmaceutical preparations, decreased to 76.8% of the volume in 1991. For the period 1990-1993, production of humane antibiotics was down twice and of antipyretics 1.9 times. The only positive trend was witnessed in production of vitamins – a growth of 1.5 times.

The market structure of the sector is represented by several main Bulgarian produces and is characterized by rather oligopolistic competition than a competitive environment.

#### **5.4.2. Characteristics of P-04**

P-04 is a state-owned enterprise specialized in the production of three main product groups, namely: pharmaceuticals, perfumery and cosmetics, and volatile oils. In 1994, the product structure included 45% pharmaceuticals, 10% perfumery and cosmetics, and 45% volatile oils.

P-04 is located in a town with traditions in the branch and has been established in the place of former small-size rose-distilleries which existed till 1944. In fact, the enterprise has continued the traditions only in the production of volatile oils. As far as no crafts shops have been located on the territory of the newly built plant in 1945, no former owners exist as under the Law on Restitution. Therefore, the enterprise will be free of answering any claims for property compensations in case it is privatized in future.

The enterprise was transformed into a single public limited company (PLC) in 1991. Under the Commercial Law, the state is the only owner, with a 100% share. At present, it is an one-plant enterprise under the supervision of the Ministry of Industry.

During its existence, the production of P-04 has been directed at the domestic market and the ex-Soviet Union. The enterprise can be determined as a middle-size one. In 1992 and 1993 the average roll numbered 440 employees. There was a considerable reduction in 1994, when 153 people or about 35% of personnel were dismissed.

The volume of sales was 180 mln. Leva in 1992 and 220 mln. Leva in 1993. The products were realized in the domestic market though many of the firms trading in medicines actually export them in the former Soviet countries.

The pattern of ownership of P-04 hasn't been changed in the last years. For the time being, the enterprise is missing from the initially announced list for mass privatization. The managers don't expect it to happen in the near future.

#### **5.4.3. Shocks of the reform**

Since the start of reforms in the early 1990s, the enterprise has experienced the following main shocks:

1. The collapse of the CMEA market is the main shock for the enterprise. Till the beginning of 1990s, almost 100% of the exported production was directed at the CMEA countries which provided a very suitable and stable- market. Since then, however, it became harder and harder to win and fill orders at the Russian market, notwithstanding long-established contacts and traditions. For the export of medicines, the Russian partners offer barter which is quite unusual practice for P-04. The so-called 'structures' to be traded in the Russian market and the high degree of risks and instability they generate is another obstacle to the enterprise.

2. High interest rates on credits. Similarly to all other Bulgarian enterprises, their effect on the activity of P-04 is definitely negative. The managers point out that revenues

from sales are enough to cover just interest payments and wages, which, in its turn kills any possibility for investment and capital restructuring.

According to the managers, the weakened control by the Ministry and the higher autonomy of the enterprise since the start of reforms as well as the changes in the conditions of employment related to wages and dismissals haven't the effect of shocks on P-04's activity. The destabilization of the CMEA markets and the Russian market, in particular, is the main shock on the enterprise.

There are two groups of factors influencing the adjustment of P-04 to the new conditions. First, the group of unfavourable factors, including:

- ✓ unclear ownership rights,
- ✓ shortage of financial resources and the stemming barriers to capital restructuring,
- ✓ unclear responsibilities of the management with regard to the future development of the company.

The managers stress on the unclear ownership rights as the main factor hampering the restructuring and adjustment of the enterprise to the new conditions. This entails the unclear responsibilities for the future development of P-04. The attempts to directly connect remuneration in Trade Department to revenues from sales proved to be a failure not only because of the prevailing inclination towards equalization but also for the insufficient economic power of managers to impose their decision and the imaginary owner – the state.

Higher resource expenses, insufficient qualification and the necessity in rising the quality of production are not determined by managers as obstacle-factors to adjustment. Neither is the lack of investments in new technologies.

In short, according to the managers the loss of markets is the main shock and the unclear ownership rights is the main obstacle to the adjustment of the enterprise.

The group of factors favouring the development of P-04 since the start of reforms includes:

- ✓ the access to new markets,
- ✓ higher independence in setting prices,
- ✓ higher independence in changing the production range.

#### **5.4.4. Short-term responses of the enterprise 5.4.4.1. Changes in management**

After P-04 was transformed in a single PLC, its management body consisted of a manager and a controller. The controller is an official in the Ministry of Industry. The main characteristics of the top managers of P-04 are the following:

Manager: An engineer, with higher education in chemistry, appointed by a competition, with service at the enterprise before getting the position.

Sales Director: Higher education in economics, with long service at the enterprise.

Director of plant operations: An engineer, with higher education in chemistry, appointed by a competition, with service outside the system of P-04 before getting the new position.

In P-04, there isn't a specially developed system of manager remuneration. Similarly to the rest of personnel, their wages are not connected to profits and differ slightly from the average wage in the enterprise. Attempts were made to connect wages of staff in Trade Department to revenues from sales and profits. The reaction of the rest of personnel was rather hostile, however, and the managers were forced to give up the initiative. This is indicative of the socialism-inherent populationistic attitudes prevailing over economic rationalism.

#### **5.4.4.2. Organization and management structures.**

Since the start of reforms in early 1990s, the organization structure of the enterprise hasn't been changed with the exception of an workshop recently closed. As a result, 90 employees were fired. Some other changes in labour organization are connected with re-direction of staff from administrative department to the production shops.

The management structure was changed in the beginning of 1994 when a new member entered the management body, i. e. a controller appointed by the Ministry. His functions in real management are rather unclear, however.

Attempts have been also made to improve the information systems in the main management units, i.e. in trade and marketing and financial department, yet the managers are quite skeptic about the results achieved.

#### **5.4.4.3. Markets, sales, production**

Till the start of reforms, the production of P-04 was oriented mainly at the CMEA markets. The collapse of the later had a very unfavourable effect on the enterprise. Its main response during the years of reforms was the search for new customers. In its greater part, these are private Bulgarian firms which buy medicines from P-04 and export them in the Russian and other ex-Soviet markets. The exports are made on barter basis. In this way, P-04 is actually exporting its production abroad though formally selling in the domestic market. Given this and in compliance with state regulation of medicine prices, however, profitability of only 20% is calculated in producer prices of P-04. Any attempts of management to change the situation proved to be a failure. The claims of the enterprise are rejected by the government authorities by stating the necessity in strict state control on medicine prices.

For the time being, the search for outlets in West-European countries is not an item on the agenda. Direct exports to the Russian market (without the mediation of private Bulgarian firms-exporters) are considered nonbeneficial due to risk operations and barter deals.

The shrinkage of market resulted in a reduction of the production of P-04. The decline was especially grave in perfumery and cosmetics, for example, down to about 30 times since the start of reforms.

The main response of the enterprise is expansion of product range through diversification of production. According to managers, the quality of products is preserved while prices are growing continuously. Given the reduced volume of production and diversification of products, in value terms sales have increased in the recent years.

Yet no reduction was achieved in labour expenses per unit of production, and reduction in material and energy expenses was negligible. A retraining of labour force was not undertaken either.

The enterprise is not selling machinery but it is renting some of its stores.

Regarding negotiations with foreign partners, the managers consider their interest towards the enterprise rather 'unserious'. According to the managers, the foreign partners are far from any firm intentions but rather try to take advantage of the present situation.

In short, the main short-term strategies of P-04 include providing of resources, employment maintenance and preventing bankruptcy, which, though not fearing the enterprise directly is still a problem to solve.

#### **5.4.5. Long-term responses of the enterprise**

The main strategy of P-04 for the next three years and in the longer run is connected with the development of new products and penetration in new markets. At present, managers consider outlets at the Western markets rather unrealistic a goal to achieve.

##### **5.4.5.1. Enterprise management. Changes in the ownership pattern.**

According to the managers, the unclear ownership rights and unclear responsibilities with regard to the long-term development of the enterprise are the main obstacles to its adjustment to the new environment. Perhaps this is one of the reasons for the lack of clear-cut concepts on the future management structures. It makes no sense to develop strategies for the enterprise when other economic agents (a ministry, financial groups, etc.) make the decisions on its future.

There is a contradiction between the clear stand of managers on the issue of ownership rights and their attitude towards privatization. At present, the enterprise is missing from the list for mass privatization. It is on the list of enterprises to be financially recovered by the state. The managers are not quite sure, however, what do these measures of financial recovery actually mean.

##### **5.4.5.2. Investments. Changes in the production structure.**

Investments in new technologies are considered unnecessary at the present stage. The main goal is to use and eventually further expand the existing production capacities.

The rather conservative stand of managers towards investments is determined by their unclear responsibilities with view to the long-term development of P-04. For the time being and in the near future the expansion of product range within existing capacities is the main goal of the management.

#### **5.4.6. Assessment of adjustment measures and perspectives of P-04**

Since the start of reforms, P-04 has been transformed into a 100-percent stateowned limited liability company, with a manager and a controller as management bodies.

However, the remuneration of managers is still unchanged and the new form of organization doesn't differ considerably from the former one.

The attempts of managers to introduce a higher differentiation in remuneration proved to be a failure because of the strong resistance of the equalization-inclined workers' collective. "A lot of efforts and no reward as a result", to cite one of the managers.

The most important goal of the enterprise is its survival. The management is directed at a short-term adaptation to the new environment.

It is really a paradox that though managers consider unclear ownership rights the major reason behind the need of adaptation, they are afraid of any own initiative towards privatization and direct their efforts at solving only current problems. Such kind of managerial behaviour is sure to prolong the existence on the edge of survival. On the other hand, keeping in mind the strong influence exerted by economic agents like the branch ministry, financial groups, etc., the development of P-04 in the near future is hard to predict.

## **5.5. Textile — A Break-Through in the International Market**

### **5.5.1. General condition of the sector**

In 1993, the textile and knitwear industry produced 4% of total industrial production and employed about 7.5% of industrial personnel in Bulgaria. Since the start of reforms, the sector fell in a crisis caused mainly by the collapse of CMEA markets, unfair competition from imports and changes in the macroeconomic environment connected with high interest rates on credits and unfavourable exchange rates. Compared to 1990, the volume of production in 1993 decreased by 46.2 percent. The decline in production was gradually overcome, however, down to 11% in 1993 against 1992, and 7% in the three quarters of 1994 against 1993 same period.

The production of woolen cloth and yarn is showing a trend of declining rate of decrease. There is a great number of producers in the Bulgarian market, the half of them from abroad. The enterprise under study is one of the biggest producers of woolen cloth and yarn in Bulgaria. It holds 40% of the woolen yarn and 25% of the worsted cloth market. Notwithstanding the presence of a lot of contractors since the start of reforms in early 1990s, the market structure is inefficiently competitive due mainly to unfair competition from imports.

### **5.5.2. Characteristics of P-05**

P-05 is an enterprise in the textile branch. Its main product groups in 1994 included cloth (95% of sales) and yarn (5% of sales).

The enterprise was established in the place of a private factory nationalized in 1947. A general reconstruction took place in the 1960s. The enterprise is under the supervision of the Ministry of Industry. In 1991, it was transformed into a single public limited company (PLC) as under the Commercial Law.

At present, the enterprise has one plant. For the years of operation, P-05 was selling

its production mainly in the domestic and ex-CMEA markets.

With nearly 2000 employees in 1994, P-05 belongs to the group of large enterprises.

The enterprise is on the list for mass privatization. The Ministry of Industry has made the decision without consulting the managers. As a result, they are not only rather displeased to know the fact but also fear a probable destroying of an enterprise built in the course of many years.

### **5.5.3. Shocks of the reform**

Since the start of reforms, P-05 has faced two main shocks: first, the collapse of the CMEA market, and second, the high interest rates on credits. They, however, have not effected the enterprise in the way some other sectors, like machine-building for instance, suffered it. The reason behind is the specific place and role of textile and woolen textile, in particular, which has a wide network of consumers producing clothing.

The branch peculiarity of textile mitigates the unfavourable changes in the economic environment influencing P-05. The competition from imports and mainly that of lowquality goods imported from Turkey is not of considerable importance to the enterprise. The domestic demand in woolen cloth, mainly on the part of small firms, has also decreased; still, it is not a shock for the enterprise.

To a certain extent, problems have arisen related to the supply of raw materials, wool and polyester, yet with insignificant effects on P-05. The rise in energy prices is another burden the enterprise manages to bear so far.

The devaluation of Bulgarian currency in the recent years has had a favourable effect on P-05 as it is constantly expanding its orientation abroad, thus rising the prices of its production. As a whole the movement in the exchange rate is a positive factor for the enterprise.

It the course of adjustment to new conditions P-05 has faced the influence of two types of factors, i.e. impeding and favouring its efficient behaviour. According to the managers, the first group includes:

- ✓ the big scale and respectively large enterprise capacities for cloth production, with long production cycle, which is not suitable for volumes exceeding certain level, while the free market economy in Europe is more flexible and P-05 has difficulties in meeting its requirements;
- ✓ the higher labour expenses due to surplus labour force employed and, on the other hand, the lack of key knowledge, qualification and inclination to work in a market environment where the customer is the determinant;
- ✓ the insufficient quality level of production which hampers the invasion in new market niches;
- ✓ the higher expenses on raw materials imported at international prices.

The lack of financial resources, the unclear responsibilities of management with regard to the future development of the company and the unclear ownership rights, however, are not mentioned as factors limiting the process of adjustment.

The second group of factors favouring the company's adjustment includes the following:

- ✓ access to new markets stimulating the development of new skills of personnel and market orientation in improving the quality of production;
- ✓ access to new resources;
- ✓ bigger independence in setting prices and determining the sort of cloth produced;
- ✓ higher level of qualification and skills of new-coming employees.

The difficulties connected with the increased requirements of new West European customers to the quality and assortment of products have a surprisingly positive effect on the personnel. The production is connected with certain customers and certain orders and this, according to managers, is the main factor for the changes in the socialist-type mentality of workers to produce independently of market demands.

However, P-05 is still missing another favourable factor, i.e. the access to foreign investments.

#### **5.5.4. Short-term responses of the enterprise 5.5.4.1. Changes in the management**

After the transformation into a single PLC in 1991, P-05 has been managed by the Board of Directors and the Executive Director. The members of these bodies were entirely changed in 1992 under the pressure of CL "Podkrepa". The new-appointed executive director formed a new management team. Since then, the management of the company remained unchanged.

Unlike other enterprises where "Podkrepa"-dictated staff changes have proved to be rather inappropriate or purely cosmetic, the new director of P-05 has manifested competence and activity and has made a very proper choice of managerial staff with marketoriented behaviour.

Main characteristics of the top managers of P-05:

*Executive Director.* An engineer, appointed by a competition, with very rich experience within the same enterprise.

*Director of Market Policy Department',* a Specialist with two university degrees, in economics and philology, with rich international experience. Previous service – outside the system of the enterprise.

*Director of Plant Operations:* An engineer, appointed by a competition, with long service at the same enterprise.

*Director of Marketing and Development Department:* An engineer, appointed by a competition, with long service at the same enterprise.

*Chief Expert at Economic Department'.* A specialist with higher education in economics, with long service at the enterprise, dealing in the problems of finance and personnel.

The enterprise hasn't developed a special top manager remuneration system. The remuneration of the members of the Board of Directors was 1.6 times the average gross wage in the enterprise in 1993; the same level was maintained in 1994, too. For the periods in consideration, the remuneration of the Executive Director was 2.1 times the average gross wage. The conclusion is, therefore, that the remuneration of managers differs very slightly from that of personnel as a whole.



### **5.5.4.2. Organization and management structure**

Under the initiative of the Executive Director, an operative bureau has been formed for the day-to-day management of P-05, including the executive director and the deputy-directors of departments. Apart from traditional departments on finance and production, two new management units have been formed, i.e. on market policy and on marketing and development. The later are in compliance with the main efforts of the management directed at the investigation, penetration and holding of new markets.

Problems and contradictions still arise, however, between the units of management as they work in different worlds, to cite one of the managers. Managers dealing in market policy try to implement the style and requirements of the West European and American markets; at the same time, however, the managers in the production department face the former mentality and socialist-type attitude towards work with minimum efforts and regardless of customer requirements. In order to change the situation, the managers see a great potential in the development of a remuneration system stimulating the whole personnel towards working on orders from West European and American customers.

### **5.5.4.3. Markets, sales, production**

The start of reforms and the collapse of the CMEA markets have brought about a decline in production. The response of the management units on marketing, development and market policy was the search for new customers in Western Europe. Their efforts proved to be a success.

At present, the volume of production is growing. What is more, in summer 1994 the demand exceeded the supply of products of P-05.

Production has been diversified as a result of own design projects and orders from abroad. The requirements of the new customers have made for the improvement of quality of production. There is a slight rise in prices as well.

Finding new suppliers from abroad is another specific response of the enterprise. Attempts have been also made to find foreign partners for joint ventures, yet without any particular results.

There is no reduction in the expenses on labour, raw materials and energy. Machinery is not sold, facilities and equipment are not rented either.

The enterprise hasn't increased its debt to banks but hasn't made new investment either thus relying only on the efficient use of production capacities available.

In short, P-05 has created a network of customers in the new markets thus providing export opportunities for 80% of its production and, on the other hand, importing 20% of its raw materials. The entry and holding of new markets means a lot of efforts and struggle for the improvement of quality which, in its essence, means a struggle against old socialist attitude towards labour, neglecting of customer requirements and shirking from work.

### **5.5.5. Long-term responses of the enterprise**

Asked about the long-term strategy of P-05 and even within the mid-term of three years, one of the managers gave the following question-reply: "Who knows in this country?". This skepticism of managers is easy to understand under present conditions of high instability and changeability of the environment. A very recent example of that was the news that P-05 was entered into the list of enterprises for mass privatization.

Though not in the long term, managers define as permanent strategies of the company the following ones: new market entries, development of new products, increase of the market share.

Establishing contacts with new foreign partners is another strategic goal. The aim is cooperation and selling the enterprise production abroad.

Maintenance of employment is a strategic goal, too, meaning a maximal utilization of working time and growth of production with the same number of personnel employed. According to an expert manager assessment, this will be a tedious process.

#### **5.5.5.1. Enterprise management. Changes in ownership.**

At present, P-05 is a profitable enterprise. The managers estimate this result as to a great extent owing to their efforts both under the Ministry's withdrawal from the management of state property and in the lack of investments. On the other hand, the relaxed ministerial supervision, the bigger autonomy of the enterprise and the unclear ownership rights are not considered factors impeding the adjustment of P-05 to new conditions. On the contrary, manager actions and behaviour prove to be quite successful under the existing pattern of ownership rights.

Given the short-term adjustment of the enterprise, its privatization is an issue of rather odd manager attitude. Stressing on enormous efforts made in the most difficult times and the success and stabilization achieved in coping with new challenges, the managers are rather suspicious about present plans and appetites from outside, which can easily spoil the fruits of their hard work. These fears are further nourished by the mysterious way P-05 entered the list of enterprises for mass privatization, without any preliminary consultations with the management. The mass privatization scheme is therefore suspected to serve interests rather opposite to those of managers and personnel. Now, the Executive Director has to find a solution to the problem by an alternative project promoting a more active managers' participation in the future management and ownership structure of the enterprise.

#### **5.5.5.2. Investments. Changes in the production structure.**

With no investments made since the start of reforms, possibilities are now searched for investments in new technologies. A new workshop has been built equipped with old machinery. The problems of restructuring in compliance with customer requirements are solved within the existing equipment, both outdated and modern. Nevertheless, new investment is not a permanent strategy of the enterprise. According to the managers, the market positions of P-05 in the near future will be maintained on the basis of present equipment and by putting in operation non-utilized reserves.

### **5.5.6. Estimation of adjustment measures and perspectives of P-05**

For the three years of its functioning, the new management of P-05 has succeeded in stabilizing the enterprise and finding new outlets in Western Europe. At present, P-05 is a profitable enterprise with good prospects to hold the market positions it has won and for its personnel to adapt to the requirements of West European market economy.

Thanks to their managerial skills and high creative potential, the new managers have achieved considerable results in coping with new environment, without privatization and changes in the ownership pattern.

Given this, the suggested scheme of mass privatization looks rather intrusive and the managers question the need in privatization. Moreover, they have developed their own privatization project envisaging a wide manager and personnel participation which, obviously, contradicts certain group interests.

It can be concluded, therefore, that the passive managers' behaviour towards privatization and, on the other hand, their high activity in adapting to the requirements of market economy, proved to be a disadvantage in the new conditions. The underestimation of the issue of ownership rights, which seems even non-existent in a single PLC, has suddenly come to the surface and turned into the major problem asking for very quick manager initiatives towards privatization.

## **5.6. Tailoring Industry — A Day-to-Day Management without Manager Strategies**

### **5.6.1. General state of the sector**

In 1993, the share of textile and knitwear industry amounted to 4% of total industrial production in Bulgaria. The sector employed about 7.5% of industrial personnel. Since the start of reforms, the sector fell in a crisis resulting from the collapse of CMEA markets, unfair competition and changes in the macroeconomic environment connected with high interest rates on credits and unfavourable exchange rate of the Bulgarian currency. Compared to 1990, the volume of production in 1993 decreased by 46.2 percent. The decline is however gradually overcome, down to 11% in 1993 compared to 1992, and further to 7% in Q3 of 1994 as compared to Q3 of 1993.

### **5.6.2. Characteristics of P-06**

P-06 is a state-owned enterprise in the knitwear branch of light industry. It is specialized in two product groups: knitwear, including outer clothes and underwear, and tailor's goods such as training suits, dressing gowns, sportswear, etc.

The company has six shops. Of them, four are located in the production site in the town of Stara Zagora, including a knitting shop, a finish shop, and two shops for readymade clothing. The remaining two are also ready-made clothing shops, one located in the town of Radnevo and the other in the village of Glavan.

P-06 is a middle-size enterprise. The average payroll numbered 1032 employees as of December 31, 1990; their number then decreased to 847 in 1991, and further to 788 in 1992.

In value terms, the volume of sales was 25,938 thousand Leva in 1990, 73,548 thousand Leva in 1991, and 98,991 thousand Leva in 1992. The growth in sales' volume in the studied period was due to the rise in prices, though considerable reduction in production.

P-06 was established as a state-owned company under the Law on Nationalization of December 23, 1947 on the basis of formerly existing dye-house. Since then, it was under the supervision of the Ministry responsible for light industry. At present, this is the Ministry of Industry.

On October 4, 1991 the company was transformed into a single public limited company (PLC) with 100-percent state capital.

The pattern of ownership has not been changed recently. The company is not on the initial list of enterprises to be privatized. Claims have been announced by former owners of the nationalized factory to participate in the privatization of the company. Managers have no clear idea about the privatization scheme that should be applied. They rather fear an immediate dismissal provided the former owners acquire property rights over the enterprise.

### **5.6.3. Shocks caused by the reforms**

Since the start of reforms in early 1990s, the rise in interest rates has been the greatest shock to the company. In 1987 P-06 took a loan of 5 mln Leva to cover the construction of new facilities. The drastic rise in interest rates since early 1990s has made the company re-direct its profits at covering interest payments on former loans as well as on turnover credits for the normal course of production.

Liberalization of prices is another significant negative factor. The rise in raw material and fuel prices resulted in a sharp growth of product costs, which, in its turn makes produced goods hard to sell.

The collapse of the distribution system is yet another shock to the company. The liquidation of whole-sale trade enterprises has destroyed the connections of the company with its customers. Production thus remains beyond consumers' reach. Small-sized trading firms have recently emerged, yet their orders cannot cover the production capacity of the enterprise.

The competition from imports is also an important shock to the company. These are mainly goods from Turkey and China, which are inferior in quality as compared to P06 products but are offered at lower prices. According to the managers, this is unfair competition as these goods are of rather doubtful origin (illegally imported) and therefore with non-paid customs duties. On the other hand, they are distributed mainly by small private firms which often fail to strictly fulfill their obligations towards taxation authorities, social security payments, etc.

The shocks to P-06 can be ranked as follows:

1. High interest rates
2. Price liberalization
3. Collapse of the distribution system
4. Decline in domestic demand
5. Competition from imports (Turkey and China mainly)

#### 5. Competition from imports.

Managers do not consider the changes in ownership rights (relaxed ministerial control, changes in ownership, higher degree of autonomy, changes in the management) a considerable shock to the enterprise. The same applies to changes in the terms of employment, including remuneration, benefits, or dismissals.

Changes in the economic environment engender a lot of problems to P-06. The major of them are connected with higher expenses on resources and capital equipment.

The expenses on dyes, mazut and water have resulted in a sharp rise of the production costs. As far as fixed assets are concerned, the main problem is connected with the possibilities for their renewal given the high interest rates on credits.

Next to mention are the second-class problems stemming, to a certain degree, from the first group of problems. These include the need in changing the information system and especially that in the sphere of marketing, the loss of markets which is considered a consequence of high production costs and subsequent fall in orders, etc.

The shocks and difficulties faced by P-06 provoke relevant responses of the company so as to adjust to new conditions.

One of the measures is connected with the development of new assortment policy based on new collections and designer projects.

Another measure is connected with a policy aiming the reduction of production costs. In practice, this means economizing of raw materials, fuels and energy spent which count for about 70% of production costs.

Last but not least to mention is the creation of a distribution system, and finding whole-sale distributors in particular..

What are the opportunities for the company that have emerged since the start of reforms in early 1990s? Managers estimate them as rather small.

Among more significant opportunities managers point to the greater independence in setting prices and changing the range of production. Access to new markets is considered just a potential factor; for the time being there is only a process of searching yet without concrete results achieved.

Access to new investors is not mentioned among the favourable factors. The higher independence in making investment decisions is determined as a theoretical possibility which is hard to turn into reality due to the shortage of financial resources.

The bigger independence in the hire and fire of labour is considered a factor quite insignificant and non-decisive for company's adjustment to the new conditions.

### **5.6.4. Short-term responses of the enterprise**

#### **5.6.4.1. Changes in management**

The managers have developed both an organizational and management structure of the company.

Under the Commercial Law, the company has one-tier system of management, with the Board of Directors being the management body. The members of the Board have been appointed by an order of the Minister of Industry and related contracts of agency

concluded between the Minister, on the one side, and each of the members – on the other. The competences of the members of the Board of Directors are regulated by the relevant provisions of the Commercial Law. The members of the Board have not been changed since appointment.

The management structure of the company includes an executive director and director of plant operations. There are no directors in finances and in marketing.

The present executive director has a university degree, specialty textile engineering, and has graduated from the Higher Machine and Electrotechnical Institute in Sofia. He has a long non-interrupted service with the company and has passed through all stages of hierarchy to reach the post of the executive director.

The director of plant operation is a textile engineer, too, and has graduated from the same higher institute. He has a 20-year service with the company. He was appointed to the present position without a competition.

The Board of Directors has four members. Of them, one is the executive director of the company. The other three work with different institutions as the Ministry of Industry, the Committee on Quality, a commercial bank.

No changes have taken place on managerial level recently.

Remuneration of managerial staff is determined under the provisions of Decree 265 of the Council of Ministers of December 28, 1992. The salary of the executive director is 350% the average gross wage in the company. The director of plant operations gets 150% that sum, and the members of the Board of Directors 130% respectively. The salaries of managerial staff depend on the profitability of the enterprise. For example, a rise or fall of 1% in quarterly profitability as compared to figures in the previous quarter generates a rise, or respectively fall of 10% in managerial staff salaries.

#### **5.6.4.2. Organizational and management structure**

P-06 has undertaken steps to answer the challenges of new economic environment, the main of them being the following:

First, reorganization of the company. P-06 has implemented a new management structure, with two director positions, i.e. an executive director and director of plant operations. There are five main departments: economic and legal-and-administrative, financial, technical, marketing, and trade and design.

Second, improvement of information systems and computerization of accounting in particular, which is under implementation.

Third, intensification of negotiations with foreign partners for the establishment of joint ventures, without particular results yet achieved.

#### **5.6.4.3. Markets, sales, production**

Another response of the company was related to reduction of material expenses, determined by managers as a policy of 'squeezing out resources'.

The next step was the reduction of the physical volume of production. There is an increase of production in value terms due to the rise in prices; it should be mentioned, however, that the company applies a minimum rate of profitability, i.e. about 5% so as to make its products sellable.

The company has not applied for getting subsidies, neither before nor in the course of reforms.

Managers find it difficult to range the responses according to their significance to the company. Though rather conditionally, managers point to management structure reorganization and improvement of the information system as the main responses of P-06. The main limiting factor faced by the responses of the company is the shortage of funds.

Managers give a negative answer to the question of whether the company has asked for some specialized assistance in solving its adjustment problems. This applies to both domestic and international sources. The only assistance asked from the Ministry of Industry was related to the transformation of company's capital investment credits into state debt.

### **5.6.5. Long-term responses of the enterprise**

Since the start of reforms, survival has been the main goal of the company. This applied especially to maintaining the number of staff and preserving the funds available. It was to a certain extent successfully achieved since the reduction in personnel resulted only from retirement or free-will resignation and not dismissals. Production machinery and equipment was also preserved and the need in partial selling had been avoided. Yet, the degree of depreciation is more than 90 percent.

Keeping the present situation is the main goal for the coming year. Production capacities are not fully loaded, the enterprise applies one-shift instead of three-shift scheme of working. Loading of existing capacities is the target of the company in the short run. Growth and restructuring is the main goal of the company in the next three-year period. The search for new markets will be a priority yet with a higher volume of production.

The short-term one-year strategy of the company is connected with the maintenance of employment level. Next in priority come the penetration into new markets, the development of new products and the expansion of market share.

The long-term three-year strategy of P-06 envisages the penetration into new markets and the finding of foreign partners.

Profit maximization is not considered a strategic goal in the near future.

#### **5.6.5.1. Enterprise management. Changes in ownership.**

The problem of ownership structure hasn't been openly stated by the managers. According to them, the changes in ownership rights, i.e. relaxed ministerial control, changes in management, etc. which were undertaken following the start of reforms in early 1990s had no shocking effects on the enterprise.

On the one hand, managers have no clear-cut views on privatization as a form of ownership restructuring. On the other hand, however, privatization is considered a danger for their director positions. This unannounced fear explains the underestimation of ownership rights by managers in their interpretations of company's behaviour since the start of reforms.

The main shocks to the company are related to the changes in macroeconomic environment, i.e. interest rates, prices, collapse of wholesale trade, competition from imports, low solvent demand in the domestic market. The main problems are high production costs and old equipment. The main limiting factor is the shortage of financial resources and not unclear ownership rights. The present and planned future responses of the company are not related to privatization but rather to management restructuring, reduction of expenses and negotiations with foreign partners, yet customers not investors.

Apart from managers' fear from privatization, there are some other factors determining the place of the issue of ownership rights.

### **5.6.5.2. Investments. Changes in the production structure.**

At present, no investments in new technologies are planned. The fuller loading of existing capacities and the expansion of product range are considered priorities for the time being.

### **5.6.6. Estimation of adjustment measures and perspectives**

P-06 is a single PLC with the government, the Board of Directors and the managers being its main economic agents. In the structure of ownership, the residual risk is carried out by the owner of assets, i.e. the government (state officials) and the management function is carried by the managers under the supervision of the Board of Directors.

Since the start of reforms in early 1990s, the risk of shocks on P-06 should be met by the owner, i.e. the government. Actually, however, the state officials transfer all responsibilities regarding the transition to the new economic system to the enterprise. The latter is given the so-called autonomy, i.e. a hypothetical ability to independently determine products, investments and markets. This is a pseudo-autonomy, however, because: first, the state continues to fully possess the assets, while the company carries the risks of the reforms; second, the state does not perform regulation, and therefore a normal economic environment is not created for the functioning of the company.

The state is failing to efficiently fulfill both its role of owner of the assets and its functions on regulating the economic environment. The problem is more complicated as it concerns not only the structure of ownership rights in the company. At this initial stage of transition, the role of the state in economic life as a whole is far more important than its owner's rights.

Since the start of reforms P-06 has faced the following main shocks, namely: interest rates, price liberalization, commercial network collapse, and imports competition. From the viewpoint of the two functions of the government as owner and regulator, two types of attitudes emerge on the part of the company, i.e. to the owner of its assets and to the regulator of its activity in the entire economic system. In this sense, the residual risk of different types of shocks should be distributed between the company and the government. From the viewpoint of economic rationality, for example, the company is overloaded with the burden of high interest rates while these should be met by the owner, i.e. the state.



Liberalization of prices and the collapse of wholesale trade network are shocks which the company cannot neutralize by its own efforts. While the creation of a new distribution network can to a certain extent result from greater managers' activity and initiative, the burden of higher prices of raw materials is transferred to the customers and the company operates at minimum rate of profitability.

This, however, is a short-term adjustment. It cannot provide the financial resources necessary for capital restructuring and production expansion which are of key importance for the survival of the company in the emerging market environment.

The shock stemming from unfair imports competition is the most severe one to the company. The irrational and rather irresponsible behaviour of the government in state regulation puts P-06 in unequal positions as compared to private firms-importers.

The latter prove to be more flexible in applying the laws on taxation, customs duties, and social insurance thus reducing their expenses and respectively the prices of goods offered in the market which finally means unfair competition for P-06 and subsequent loss of customers.

Actually, and this is a partial conclusion of the analysis, the present state regulation acts against P-06 as a state-owned enterprise and in favour of the private business in the branch considered.

The long-term strategy of P-06 includes the search for new outlets and the finding of foreign partners-customers. Growth is the priority goal for the next three-year period. How can this be achieved without ownership restructuring, i.e. privatization?

For the time being, managers follow the wait-and-see position, they have no plans for privatization nor seem to be inclined to initiate it under Art. 4 of the Law on privatization and restructuring of state-owned and municipal enterprises.

Given the inefficient behaviour of the government in the field of state regulation, they focus mainly on the problems of the macroeconomic framework. Provided active state protectionism of light industry is applied or equal conditions are at least guaranteed for the operation of the state and the private sector, the greater part of problems of P-06 connected with unfair competition will disappear. Similarly, if loans for capital investments are transformed into state debt, the burden of credit and interest servicing will disappear and funds will be provided for the renewal of equipment.

These, however, are merely manager expectations and hopes for a more efficient behaviour on the part of government as both regulator of economic processes and owner of company's assets. In the new conditions and with former state ownership structure preserved, managers will keep on searching customers and loading the existing capacities so as to secure the fulfillment of their one-year strategy, i.e. the maintenance of present number of personnel.

In the long run, however, growth in production is impossible to attain without capital restructuring and renewal of equipment, i.e. without fresh investments. To this end, funds can be attracted through loans and therefore privatization of assets is not absolutely indispensable.

Evidently, managers are rather inclined to follow such a way of solving the company's problems. Provided the state behaves as a rational economic agent and the company succeeds in finding markets for its production with the existing ownership

pattern, it can adapt to new conditions without necessarily restructuring the ownership. The first condition is rather improbable to accomplish.

As far as the second is concerned, it can be attained, yet the problem will sooner or later arise about the quality of products, high production costs, worn-out equipment and, finally, about the efficiency of management. For the problem of company's adjustment is not privatization as a change of nominal owner but rather the efficient manager behaviour.

Which are the mechanisms that can make managers behave efficiently? At P-06, there is a conflict between the single-person shareholder, i.e. the government, and the managers of the company. In the case of P-06, incentive mechanisms which operate in mixed economies and make managers work efficiently are either applied in a very peculiar way, or do not exist at all.

The institutions of the capital market, the manager labour market, and the corporate control market have insignificant effect on manager behaviour and on limiting manager obstruction, in particular. The potential control mechanisms, therefore, remain concentration of ownership in the single-person owner, manager participation in ownership, the board of directors, and the manager compensations package.

Up to now, the single-person owner, i.e. the government has obviously manifested a very irrational behaviour by transferring to the company all the risks of on-going reforms. In the case of P-06, it is the very owner who behaves in a opportunistic manner regarding capital utilization. It is yet another illusion to expect, however, that other economic agents, e.g. tradeunions, etc. will be able to more efficiently control the managers of the company.

As far P-06 is a single PLC, the managers cannot participate in ownership. The Law provides no preferential conditions for manager participation in the privatization of the company. Privatization through competition is a hypothetical possibility under which the managers who are best acquainted with the situation of the enterprise can have some relative advantages. Anyway, this opportunity was not mentioned as a probable privatization scheme.

The Board of Directors is the institution to protect the interests of the owner, i.e. the state, in P-06. With the irrational behaviour of the owner and the wait-and-see position of the managers, the Board has a rather strange role to play. As a result, it is quite inactive in the adjustment measures of the company.

Manager compensations adopted by Decree 265 of the Council of Ministers of Dec. 28, 1992 are directed at connecting manager remuneration with company profitability. At present, it is only the remuneration of the executive director which is relatively higher than the average in P-06. Anyway, there are no other incentives applied. Given the general high level of unemployment and difficulties in establishing private business in the region, in this case the provisions of Decree 265 are related rather to a "satisfactory" level of remuneration of managers than to a more efficient use of capital.

With all the specific mechanisms of manager control mentioned above, the managers of P-06 behave in a rather peculiar way. Though the issues of new markets and capital renewal are of key importance, there is no policy of active marketing pursued nor a marketing for potential investors. Capital attraction is not put to the floor either. This is

easy to understand as a would-be new investor can bring new requirements and regulations of management and work. Here interests of managers and workers coincide totally. That is why the main strategy of P-06 at the present stage is preserving the number of personnel employed. In their behaviour, managers are guided rather by the idea to preserve the labour force and their own governing positions than by a more aggressive management strategy aiming an independent solution of problems and attraction of new efficient owners.

## **5.7. Foodstuffs Industry — A Stable Branch Position**

### **5.7.1. General state of the sector**

Foodstuffs industry is ranked second in importance in the structure of Bulgarian industrial production. In 1993, its share was 21.6% against 21.9% of the chemical and oil-processing industry, and it employed 12% of total industrial personnel.

Compared to 1990, the decline in production in 1993 was about 45 percent. The last data available relate to the third quarter of 1994 and point to a decline of 10% as compared to 1993 same period. Regardless of general trend of decline, some of the enterprises in the branch reported positive results. Out of one hundred enterprises which accounted for 73% of industrial revenues in Q3-1994, 24 operated in the foodstuffs industry.

The enterprise under study is in the milling branch. As a whole, the branch is characterized by a decline. The statistical data, however, are not precise as far as information collected excludes production with raw materials of clients. There are several large producers in the market, yet the latter is segmented by regions and competition is therefore oligopolistic rather.

### **5.7.2. Characteristics of P-07**

P-07 is a state-owned enterprise in the foodstuffs branch. In 1994, its production structure included flour (80% of sales) and bran (20% of sales).

P-07 was established as a state-owned enterprise in 1962. Since then, it has been under the supervision of the Ministry of Agriculture. The enterprise was transformed into a single public limited company on September 1, 1991. At present, it consists of two units: a flour-mill in the town of X. and a flour-mill in the town of L.

The production of P-07 is oriented at the domestic market. It is among the five biggest producers in the branch and occupies a 25-percent share of the regional market.

P-07 can be classified as a middle-size enterprise. Its average payroll numbered 114 employees as of 31 December 1992 and 120 employees by end- 1993. This number remained stable during 1994.

The volume of sales was 101476 thous. Leva in 1992 and 125911 thous. Leva in 1993. The total volume of production was sold in the domestic market.

Since 1991, no changes have taken place in the pattern of ownership. At present, the enterprise is on the initial list for mass privatization. Managers have not been consulted

prior to this decision and have completely negative attitude towards this scheme of 'offered from top' mass privatization.

### **5.7.3. Shocks caused by the reform.**

Since the start of economic reforms in early 1990s, the following changes have caused the most severe shock to P-07, namely:

1. High interest rates on credits. The basic interest rate of Bulgarian National Bank has been continuously growing in the period 1990-1994 to reach the level of 72% (September 1994). Due to seasonality in raw material supplies, and wheat in particular, P-07 has increased the amount of short-term credits. To this, two main reasons should be mentioned:

- ✓ first, the seasonal irregularity in wheat supplies;
- ✓ second, the maintenance of excessive grain reserves due to high inflationary expectations.

2. A speedy rise in raw material and energy prices. This is a factor destroying the stable operation of the enterprise and making managers feel insecure.

3. A downfall in domestic demand. The constant rise in prices of P-07 products since the start of reforms has brought about a shrinkage in domestic demand

Managers do not point to other changes in the economic environment as having shock effects on the enterprise. The factor of subsidies, for example, has never existed for P-07. The changes in the terms of employment (new wages, benefits, dismissals) are not of considerable importance. Neither have the changes in ownership rights (relaxed ministerial control and higher autonomy of the enterprise) effected to a great extent the situation of the enterprise. On the contrary, managers consider present freedom of action a factor favouring its more efficient adjustment. There are two groups of factors influencing the adjustment of P-07 to new conditions. The first of them are these hampering the adjustment, namely:

- ✓ shortage of financial resources;
- ✓ non-guaranteed raw materials supply, including low quality of wheat;
- ✓ higher expenses on raw materials.

Managers are optimistic with regard to capital equipment available, the quality of production, and the loss of markets. In their opinion, the enterprise has outlets for its production.

The second group of factors favouring the adjustment of P-07 to the new environment includes:

- ✓ access to new markets (mainly in other regions of the country);
- ✓ access to new resources (new domestic suppliers of grain).

However, the access to foreign investors is missing from optimistic manager estimations. The same applies, however, to the higher independence in setting prices. The government has fixed a 12-percent rate of rentability in setting prices on flour, which is a limiting factor according to the managers.

## **5.7.4. Short-term responses of the enterprise**

### **5.7.4.1. Changes in the management**

Under the Commercial Law, after its transformation into a single PLC P-07 is governed by a manager. The present manager has been appointed without a competition. In fact, this is the former director of the enterprise. He has worked at the enterprise for long years and has never had considerable contradictions with trade-unions.

P-07 has no director of finance and a sales director. These two departments are headed by chief experts. Both of them have long service at the enterprise and have been appointed without competition.

The relatively simplified top-management structure of P-07 corresponds to its size. Given the lack of considerable difficulties connected with outlets, an intensification of marketing activities is not indispensable. The maintenance of employment level, regular wage payments and relatively small in number personnel stabilize the position of the manager. Interests of managers coincide with those of the employees. Managers share the idea of initial privatization of P-07 through transfer of ownership rights to the personnel.

P-07 hasn't developed a special system of remuneration of the managerial staff. The wage of the manager is connected to the average gross wage in the enterprise. In 1994, it was 2.8 times the average level. The relatively low nominal level and slight differentiation in manager wages do not create incentives for more active adjustment to new environment.

### **5.7.4.2. Organization and management structures**

Since the start of reforms, no changes have been undertaken in the organization structure of P-07. There was only an expansion of production capacities by the construction of a new flour-mill.

The management structure has not been changed, too, the departments of finance and sales remaining the main management units.

### **5.7.4.3. Markets, sales, production**

Till early 1990s, the production of P-07 had been oriented mainly to the domestic market. The economic reform entailed a certain shrinkage in demand, yet due to the nature of production (flour) the effect on the enterprise was not that negative as compared to other industrial branches.

P-07 has managed to find new customers and new suppliers of wheat in the domestic market.

The relatively stable markets of P-07 helped the maintenance of volume of production. The specificity of production does not suppose its diversification, and P-07 keeps on producing three types of flour.

The management attempts an improvement of production quality. Prices, however, rise constantly as a result of the general inflationary situation in the country. Labour expenses per unit of production are not reduced since the staff has not changed in number while wages grow continuously. There hasn't been attained a reduction in material and

energy expenses as well.

The preserved market share, although with new customers, and the maintained physical volume of production at growing prices have resulted in a continuous increase of volume of sales in price terms.

Given the favourable market situation, P-07 is not forced to apply measures typical of the behaviour of other enterprises in the new conditions. It is not selling long-term assets, nor renting machinery or facilities.

According to the managers, a retraining of the staff is not necessary at the present stage. Negotiations with foreign partners for attracting investments and establishment of joint ventures have not been initiated either.

In summary, meeting the credit payments, resource supply and maintenance of employment are considered by managers the main short-term strategies of the enterprise.

### **5.7.5. Long-term responses of the enterprise**

Managers do not consider the unclear responsibilities for the long-term development of the company a factor limiting its adjustment responses. In their opinion, the main long-term strategy is connected with employment maintenance and resource supply. Though looking strange but regardless of existing unclarity of ownership structure the managers act efficiently, keep the enterprise away from bankruptcy and adapt themselves to the new conditions.

#### **5.7.5.1. Enterprise management. Changes in ownership.**

The managers of P-07 estimate its functioning successful under the new conditions and with 100-percent state ownership preserved in the single PLC. Though having developed a privatization project, the managers haven't initiated privatization steps till now.

Following the amendments to the Law on transformation and privatization of stateowned and municipal enterprises and the new provisions for mass privatization included, the managers were surprized to find the enterprise on the preliminary list for mass privatization by the voucher scheme. They consider this act too high a 'reward' for their efforts in the recent years to save and adapt the enterprise to the new environment. Moreover, the managers haven't taken part in the preliminary consultations with the Ministry of Agriculture as representative of the owner, which is quite indicative of the strange owner-manager relations.

The way out of this enforced and undesired mass privatization is seen through active steps towards a speedy implementation of the managers' project for privatization envisaging an employee ownership scheme. In more operative aspect, this means efforts for creating a favourable lobby at the local and district administrations, the Ministry and the Privatization Agency, so as to promote the idea for market and not mass privatization of the enterprise.

### **5.7.5.2. Investments. Changes in the production structure.**

After the construction of the second flour-mill the managers do not plan further investments. The maintenance of new outlets is connected rather with more efficient utilization of existing capacities. To this end, however, there hasn't been developed a special programme and managers rely on the favourable trends in the growth of sales volume and relatively good work of the personnel.

A restructuring of production in the near future is unrealistic to expect, too, due to limited range of produced goods.

### **5.7.6. Estimation of adjustment measures and perspectives of P-07**

P-07 has accomplished a successful short-term adjustment in the last years. This, however, is due rather to preserved positions in the domestic market than to new managerial structures or new management of the enterprise.

Maintaining the current situation is considered both short and middle-term strategy of the enterprise. Managers tend to prefer this strategy to any other alternatives of survival or growth and restructuring. They motivate their position by the nature of production, i.e. flour, which a controlled balance item.

Till now, the managers' behaviour has been directed at short-term adjustment and passive preparations for privatization. The moment they got informed about the presence of P-07 on the list for mass privatization, managers suddenly gained a strong impetus for speeding up a privatization procedure initiated by the enterprise.

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# **Part II**

## **Restructuring State Enterprises in Romania**

*GHEORGHE ZAMAN,  
IOAN BRATU*

# Restructuring State Enterprises in Romania

## 1. Specifics of The Romanian Economic Structure at The End of The '80s

Prior to the 1989 Revolution, the Romanian economy suffered from a deep-seated imbalance between the consumer goods production sector and that of the means of production; between raw materials and energy production sector and those consuming and/or employing such resources; between industry and agriculture; between goods producing branches, services and the infrastructure, a.s.o. Such phenomena had determined a profound economic crisis, induced by the socialist property and its complementary super-centralised command, planned economy.

### 1.1. Ownership Structure

In the assessment of the general condition of the Romanian economy, the starting point should be the nature of ownership, since this is what has had a major influence over the results, the efficiency of the economic activity, at macro-, medium- and microeconomic levels<sup>1</sup>.

Characteristically, in the former totalitarian, communist regime, the socialist property (state and cooperative) was the form of ownership in all branches of the national economy, without exception.

The state monopoly system would be characterised by the following forms of ownership over the national wealth (estimated land value and that of other natural resources excluded): state units: 77.4%; cooperative and common property units: 3.4%; private property: 19.2%.

In 1989, the state and cooperative sectors provided 88% of the GNP, employed 70% and 3.3%, respectively, of the active population, held 94.7% and 3.4% in investments, 100% in sales, commercial services to the population, exports, imports, 48.4% and 52%, respectively, of the economic agents. The private sector would supply 12% of the GNP, employ 26% of the active population and hold 1.9% in investments<sup>2</sup>.

In agriculture, in 1989, as an aftermath of the extensive cooperativisation basically

<sup>1</sup> Postolache, Tudorel, (Coord.), Romania's Economy in the 20<sup>th</sup> Century, (in Romanian), Editura Academiei Romane, Bucuresti, 1991, p. 770.

<sup>2</sup> Chief Statistical Indexes of the National Economy Development during 1989-1992, (in Romanian), in Adevărul Economics, № 11, March 21-27, 1993, p.2.

executed by means of ideological, political, economic and administrative coercion, out of the total land area, 54.7% would belong to cooperative agricultural units, 29.7% to state agricultural units and 15.6% alone to private farmers (primarily, in mountainous areas)<sup>3</sup>.

The bulk of the national real estate fund had been socialised in production agricultural cooperatives and state agricultural enterprises, between which there were no essential differences, in terms of centralised planning and subordination towards the central state and party apparatus. Due to the state monopoly over the real estate property, there took place a fast land deterioration and villages lost most of their population, the peasants abandoning their rural areas, especially the young ones.

In industry, in the '80s, a high level of concentration had been reached, which generated and consolidated the monopoly of the producers in most productive branches.

In 1989, there were 2102 enterprises, of which 73.3% were state units and 26.7% were agricultural cooperatives<sup>4</sup>. Under the circumstances, the phenomenon of property depersonalisation occurred, irrespective of its type: state, cooperative or private. The most remarkable manifestations of the phenomenon were an economic activity restricted by a huge network of administrative bureaucracy, hyper-centralised planning, excessive budget dependency of the economy, an erratic intervention of the party bodies in enterprise operation. Free initiative and the individual's right to property had been squeezed close to quasi-disappearance.

## 1.2. Enterprise Structure and Subordination

The organisational structure was represented by the assembly of bodies functioning as managers of the economic system and by their interrelations<sup>5</sup>. The hierarchy of the economy management system would stand for the basis of the enterprise subordinating relationships. The enterprise subordination relationships would have as a chief coordinate the distribution of decision-making competencies on a scale of hierarchies in the planned management system of the national economy. The backbone of the management pyramid would consist of the ministry, central and the enterprise.

The ministry stood for the **first organisational link**, in charge of administering, counselling, coordination and control. It was a central body of the state administration, carrying out the state and party policy in a branch or a field of activity.

The ministry would direct, advise and supervise the activity conducted in centrals, in pertaining units, in subordinate institutes and enterprises, being responsible, as plan originator, for the plan being carried out in its branch or field of activity.

The **second organisational link**, the central (group of enterprises), would have an important position in the social and economic development, standing for the union link between microeconomic and macroeconomic objectives. The industrial centrals were

3 Constantinescu, N. N., Current Economic Conditions of Romania and Ways Out of the Crisis, (in Romanian), in *Adevrul Economic*, № 37, October 2-8, 1992, p. 8.

4 Romania's Statistical Yearbook, 1990, p. 428.

5 Enciclopedia of Enterprise Management, (in Romanian), Bucuresti, 1981, p.31

conceived as large production units authorised to manage, counsel, coordinate and control the activity of member enterprises.

Enterprise integration within the framework of the centrals was conducted on the basis of the following criteria: product manufacturing or technology homogeneousness; cooperation in goods production or in carrying out a certain activity; integration based on the finite product; territorial.

The central used to be an autonomous economic production unit, including subordinate enterprises and pertaining units, such as: factories, works, exploitations, building sites, sections, workshops and such likes. It could also include scientific research and technological engineering units, design units, foreign trade units, supply and sales units, data processing, staff training and specialisation units, service units or other units as it was required to fulfil its obligations. Usually, the central would be built over the structure of a large, representative enterprise.

The **third organisational link** was represented by the enterprise as a basic unit of the economic system. Its object of activity, function of its specifics, would be goods production or services, product supply and selling.

The enterprise would satisfy the role of basic cell of the national economy through a whole range of responsibilities legally assigned to it, most of which were subscribed to its character of a directly productive economic and social organisation.

The organisational structure of the centrals and enterprises used to be established on the bases of structure unitary norms and would comprise production, design and operational departments. Complexes and large enterprises could also accommodate a research-design department or centre striving to introduce technical progress in the respective unit.

The immediately hierarchically superior body would be the Planning State Committee. Ultimately, there came the central and local executive bodies of the communist party, that, although officially would declare its democratic principles of collective leadership, had become mono-personal or, at best, a self-contained group.

### **1.3. Enterprise Financial and Economic Autonomy**

Enterprise independence or autonomy in decision-making and operation was intimately connected with the issue of ownership.

Under the circumstances of the predominant socialist property, severe restrictions manifested within the framework of enterprise management, organisation and operation. Thus, the plan became the absolute regulator of the financial-economic mechanism, which led to the considerable decrease of the enterprise autonomy, to its shifting to a position of performer, executor, deprived of the right to modify the size of certain targets and correlate them with the specific possibilities, necessities and existing conditions. The typical consequence of the reduced enterprise involvement in plan elaboration and founding consisted in an inappropriate application of many financial and economic instruments.

Prices, interest, credit loans, salaries, income taxes and fees, etc. - were centrally

controlled, through the unique national plan, failing to actually render evident, by their level and evolution, the real demand and supply ratio on the product and goods markets, enterprise efficiency. Adopting the principle of general compensation, the Romanian economy would include enterprises with planned benefits and losses. The market was seen-as passive element of the economic system, its function being reduced chiefly to the mere processing of the buy-sell documentation, required by material and technical supply and product selling, according to planned assignment and share.

Also, mention must be made of the state legal monopoly in the field of credits and prices, of foreign trade, hard currency, in science and technology; that caused a significant decrease in enterprise autonomy and changed it into a mere operator within the larger framework of the national economy.

The capital belonging to an enterprise would amount to a low ratio (20 - 30%), the rest being supplied from bank loans, as the enterprise was deprived of the needed autonomy to be able and use its own means.

The revenue was not the actual result of each team or employee work efficiency, but of the global, undifferentiated efficiency, which kept the direct producers of economic goods farther and farther away from the results of their activity. Consequently, the individual and collective behaviour was that of indifference and absence of commitment, with negative effects on work motivation.

The bureaucratic and administrative facet of enterprise management became more apparent, following the considerable involvement of social, administrative and political factors in decision making, motivation and application of decisions concerning microeconomic activity; parallel and frequent controls would almost block any enterprise independent initiative.

Certain legislative measures on uniform procedures to be mandatory applied were also deterrent, being inadequate to the operational parameters of various enterprises.

#### **1.4. Management Principles**

An excessively centralised economy management was the effect of the concept on the determining capacity of the unique political party, of the state property, the cooperative property being just another form of state property.

The communist party was the leading power of the entire social and economic activity. All existing institutions and organisations were under its direct political leadership, operating as one body, as per the party programmes and directives. Party-designed objectives would be reached through the agency of the state as the socialist proprietor of the major production means. As the people's representative, the state, through its specialised bodies, would manage the society resources, would organise and direct, based on the unique national plan, the entire reproduction process, taking the necessary measures towards the application of the party social and economic policy.

The democratic centralism was designed to combine the unitary management of the general economic and social activity with the "autonomy" of the basic links, to stimulate their initiative in decision making and implementation of the fundamental objectives

concerning the development of the society, in the efficient utilisation of available resources, in solving the issues connected with their assigned duties. Combining these two aspects of the principle was just a theoretical goal, since actually, in practice, it was annihilated by the overwhelming force of an exacerbated centralism, an insurmountable obstacle in the way of autonomy and free initiative of any enterprise.

The workers' self-management was considered a form of the "economic democracy". According to this principle, the working people, as owners, producers and beneficiaries of the national wealth, were called to participate, directly or through their representatives, in the management of their economic unit, to efficiently utilise and be responsible for the means of production supplied by the society, to be administered to the general interest, of each working organisation or individual. During the later half of the '80s, the plan would fail to be implemented in most of the economic units, but no conclusion would be drawn as to its realism, methods of organisation and management of the concerned enterprise.

The financial and economic self-management formally introduced in the '70s, presupposed such an activity that, the plan having been fulfilled and contractual obligations carried out, too, the concerned unit would maximise its net profit that would have to facilitate both the set up of the enterprise own funds and its significant contribution to the state centralised net income, meaning to "harmonise" individual, collective and general economic interests.

Actually, over 95% of an enterprise income would go to the state centralised budget that was to compensate bankrupt economic units. The balance of the profit would be divided among the employees, without taking too much into consideration their actual individual contribution to it.

The amortisation system, also top-down generated, would plan for reduced amortisation standards of the tangible assets, which hindered their modernisation. The amortisation fund was centralised at the ministry level and used in investments, according to the plan.

Collective labour and management were conceived to render evident the employees' theoretical and practical knowledge, experience and initiative, as well as that of the experts and executives, through their direct participation in decision-making and implementation. This had been the purpose of setting up collective decision-making bodies at all levels.

When principles such as that of the collective management were to be applied, selfwill, the conventional and bureaucracy would stifle any enterprise inner initiative. All attempts towards a democratisation and reform of socialism in Romania, during the '70s, proved to be mere parade gestures, while, in effect, totalitarianism had reached unprecedented limits.

As early as the first days of the December '89 Revolution, the principle of the unique leading political party was to be disavowed, and the nation declared in favour of the multiparty political system. Also, the concept on economy management was soon to be changed, the older principles, methods and techniques employed in economic activities having been given up. Consequently, the plan was assigned a guiding nature, while

certain new principles came to be applied: the decentralised management of economic activities; an increased social and economic efficiency; economic freedom of action; more diversified ownership forms; a size-justified structure of the economic unit etc. They have been envisaged to accelerate the country's transition to the market system economy.

## 2. Macroeconomic Changes and The Development of The Market Environment After 1990

During the 1990-1995 transition period to market economy in Romania it has been recorded the most impressive decline in GDP and output in the years 1991-1992 under the circumstances of influence of specific internal and external factors. Since 1993 one can notice a slight growth relaunching especially in industry, agriculture, investment and foreign trade. As a consequence of drastic economic recession, the restructuring of industrial SOEs had to be automatically compelled, more or less chaotic and conducive to a huge volume of under/unused production capacities, part of them economically and technically depreciated.

During 1994 inflation fell from a yearly rate of 295 percent to 61 percent simultaneously with an increase in GDP and maintenance of quasi-constant unemployment. Foreign exchange reserves substantially increased and dollarisation of economy came to a halt being even reversed, thereby reflecting the restoration of people's confidence in the national currency.

**Table 1.**

*Evolution of Romania's Main Macroeconomic Indicators (in%)*

	Years						
	1989	1990	1991	1992	1993	1994	1995x
GDP	-5.8	-5.6	-12.9	-8.2	1.3	3.5	4.2
Industrial output	-1.9	-23.7	-22.8	-21.9	1.3	3.3	4.5
Agricultural output	-	-	0.8	15.3	12.8	0.2	5.4
Total investment	-	-	-25.8	-1.2	8.4	15.3	10.5
Export FOB	-	-78.6	-37.5	2.3	12.1	25.7	12.2
Import CI F	-	8.9	-40.0	8.1	4.2	9.0	6.9
Unemployment rate	-	-	3.0	8.4	10.4	10.9	12.7
Average monthly rate of inflation	-	-	10.3	9.6	12.1	4.1	2.2
Internal devaluation of Leu	-	-	-	-	263.5	155.5	-

x - estimations

Source: National Commission for Statistics

## 2.1. Financial Stabilisation

### 2.1.1. Price Liberalisation and Inflation

After December 1989, Romania was faced with a double economic objective: liberalisation cum stabilisation. Price liberalisation, a sine qua non condition of Romania's transition to the market economy was one of the target of the government programs; a gradual price liberalisation was agreed upon, in order to align, in time, the negative impact of higher prices.

The first step was made in early 1990, when buying prices offered by state wholesalers dealing in agricultural products to private agricultural producers started to gradually go up.

On April 1, 1991, food products and consumer goods prices were liberalised, except for twelve basic food items.

The third phase of price liberalisation was implemented in July 1991. Only a few goods and services of vital importance for the national economy and for the population were kept under the state control and supervision.

**Table 2.**

*Monthly Average Rate of Inflation (%)*

	Total	Food products	Non-food products	Services
1991	10.3	12.0	8.9	8.6
1992	9.6	10.2	9.3	8.4
1993	12.1	11.6	12.9	11.8
1994	4.1	4.2	3.7	4.7
Jan.- July 1995	1.6	1.4	1.5	2.3

Source: National Commission for Statistics

In 1993, the average monthly inflation went up to 12.1 %, as against 9.6% in 1992. In 1994, the monthly inflation rate was 4.1%, which means an improvement, as compared to the previous years.

One of the most important goals of the monetary policy agreed on with the IMF, in the Memorandum, is the decrease of the inflation rate. At the end of 1995, the calculated monthly average inflation rate was less than 1.6%. A plausible inflationary pressure with multiple effects could stem from: the revenue tax, that might suffer the influence of price increase reflected in the company turnover; the income tax, including the price indexation impact, as a result of negotiations with the trade-unions which fails to take into account the production growth index; customs duties influenced by the exchange rate evolution.

The relatively favourable trend of the inflation rate during the first half of 1995, could be an incentive for the macrostabilization of the national economy, for the acceleration of privatisation and relaunching production and investments.



Romania is still in the early stages of its stabilisation process. In the first 6 months of 1995, inflation was successfully brought down. However, it is too early to set forth the achievement of sustainable price stability, the most difficult task in the process of transition. As it results from the experience of other countries, the low level of inflation can be maintained at the cost of an overvalued exchange rate, very high interest rates, low real wages or unfounded expectations regarding sustained cutbacks in government expenditures or the increase in tax revenues.

### **2.1.2. Liberalisation of the Foreign Exchange Regime**

Since June, 1992 till April, 1994 the exchange rate in Romania has been determined by daily auctions where authorised commercial banks and the National Bank of Romania alone would participate. The banks participated on behalf of their clients or on their own account. Any legal person could participate in the auctions if authorised by a commercial bank; transactions under USD 2,000 may be performed by the respective banks, outside the auction, within a spread of 2% relative to the auction rate.

All regulations related to the foreign exchange transactions all over Romania, are issued by the NBR which also authorises all transfers of capital abroad.

NBR can authorise domestic commercial banks to perform foreign exchange operations abroad for current international transactions. At the same time, banks are also licensed to have correspondent bank networks and borrow directly from abroad, with the NBR approval. Any natural and legal person is allowed to open and maintain foreign currency accounts, with authorised commercial banks. As authorised by the NBR, any resident natural person is entitled to the free use of foreign currency to make international current and capital payments, if such payments are authorised by NBR. Legal persons are not permitted to open and maintain foreign currency accounts abroad. Their foreign currency accounts abroad must be repatriated within 90 days since contract conclusion.

On April 8, 1994, in a press letter<sup>6</sup>, NBR declared that the liberalisation of the exchange rate of our national currency, i.e., Leu, is an accomplished task relying upon "soft landing" without economic shrieks. The pillars of the economic stability and exchange rate liberalisation mechanism were: monetary policy, fiscal-budgetary policy, restructuring and privatisation of economic units and external financing.

The full liberalisation of the exchange rate represents a further step towards the market economy in Romania, offering the industrial state-owned enterprises opportunities for a more rapid and effective restructuring, according to the requirements of free competition and profitability. For the future, the most important problem should be the maintaining and consolidation of the exchange rate liberalisation on a healthy economic basis.

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<sup>6</sup> See The Romanian Banking World, (in Romanian), Supplement to Flacăra Magazin, dedicated to the Crans-Montana Forum, Bucuresti, 21-24 April 1994, p 3.

### **2.1.3. Money and Credit in Romania: New Structures and Opportunities. Legal and Institutional Framework**

The Banking Law (Law 31 / 1991) and the Central Bank Law (Law 34 / 1991) created in Romania a new legal framework for the development of the two-tiered banking system, by the Western model, envisaged to encourage restructuring, competition and free initiative.

The **National Bank of Romania (NBR)** acquired a full range of activities associated with central banking with three **major functions**: to conduct the monetary policy and preserve the stability of the national currency; to negotiate short-term loans; to monitor the commercial bank sector, on behalf of the Government. The set up and development of a **system of commercial banks** has been the second facet of the 1990-1995 banking policy. The new private commercial banks have been set up to compete freely with the major state-owned banks such as the Romanian Commercial Bank, the Romanian Foreign Trade Bank, Agrobank, the Romanian Development Bank etc. In Romania, there are 11 domestic-incorporated operating banks, of which 6 are major state-owned banks, one is partly state-owned and 4 are private banks; in addition, there are 2 foreign bank branches, 5 joint-venture banks and one representative office in operation. Other 2 joint-venture banks and 4 local banks are envisaged to start up soon. The share of total credit to non-government offered by the above mentioned four state-owned banks declined slightly.

As far as deposits are concerned, the aggregate share of the four major state-owned banks and the Savings Bank amounted to 55.1%, in 1993, as against 55.4% at the end of December 1992, in the case of foreign currency deposits, the respective share accounting for 77% of the total. We can notice an increased importance of foreign and joint-venture banks in attracting deposits. Although important deregulation measures have been undertaken, the banking system in Romania still remains concentrated within the limited competition among banks. Service delivery has not improved very much (it still takes 12 and 24 days for check clearing, if payment is made at all).

During the last two years, banking and finance restructuring and modernisation were focused on the payment system, legislation, human resource training and privatisation options. Under the circumstances, an important role is played by foreign financial assistance through specially designed adjustment programs.

By the end of 1994, Romania counted 26 commercial banks, as compared with only 3 in 1989. The banks have a general character, for the time being. An intense need for **specialised** banks - by sectors and type of activities - is expressed by an increasing number of economic agents. The banks are not allowed to deal in real estate and their participation in social capital of other firms (insurance, leasing companies, industrial enterprises) can not exceed 20 % of the total shares without special permission from NBR.

#### ***The IMF Memorandum and Financial Reform Measures***

The Romanian Government has agreed with IMF over a strong reform program for 1994 - 1995, under a loan arrangement, including 16-month standby credits plus new fund facility designed to support reform. The program has been passed through the Romanian

Parliament.

The cutback in the inflation rate, from 295.5% at the end of December 1993, to an annual 75% in 1994, and over 35% in 1995 is one of the main objectives of the joint monetary, fiscal and wage policies and of the firmer enterprise discipline.

NBR ensure a **flexible interest rate structure** to improve efficiency of credit allocation and provide incentives for savings. Interest rates are to become positive in real terms. The situation of the last months in this respect seems to confirm the fulfilment of such an important goal. The NBR and the Government encourage major banks to develop work-out units that could facilitate enterprises restructuring and act towards strengthening the financial discipline among them. As the scope of the large loss-makers restructuring is defined and the implementation of this operation is under way, banks left with bad loans will be fully provisioned and the provisions will be tax-deductible no later than the 1995 FY.

The balance sheets of the state-capital commercial banks will be restructured in time, by an appropriate mix of government bonds and new capital, private capital injection included, to bring about their capital adequacy to international standards.

By May 1995, implementation of the first stage of the restructuring and recapitalization plan is expected, privatisation of the two state-owned banks included. The measures taken in the field of monetary policy in the last two years were designed to enhance the attraction of Lei deposits with the financial, bank and non-bank institutions for economic agents and the public by increasing the interest rates and differentiating them, according to several efficiency criteria. The growing financial indiscipline with negative effects on economic activity involves the severe intervention of both the Government and NBR to reduce arrears, accelerate bank payments, introduce the bill of exchange and the promissory note and reduce the volume of unprofitable credits by regulating the financing of stocks resulting from cessation of investments and to monitor to a greater extent inefficient enterprises.

#### **2.1.4. Budget Restrictions**

By the end of 1993, Romania's state budget deficit amounted to Lei 335.3 billion (s. Table 10), less than half of Lei 729.3 billion previously heralded by the Ministry of Finance, and well within the limits agreed on with IMF. The 1993 budget deficit accounts for the 1.78% of the estimated Lei 18.835 billion GNP.

The unsatisfactory economic evolution and inflation during 1990 - 1993, yielded a 1993 state budget deficit higher than the 1992 one. In 1991-1993 period consumer contribution to the state budget is higher than the revenue tax contribution. As to expenditures, economic actions are to be remarked, amounting to 36.5% in 1993, which explains the important role played by the state during transition and contradicts certain expert opinion on the inefficient, sometimes counterproductive state interference in economy. In the economic sector, state subsidies are mainly spent in industry (over 20% of the total, chiefly in the extractive industry, in energetic and metallurgy and other industrial branches); in **agriculture** (about 13%), in **transportation** and

### **telecommunications.**

State budget expenditures at the end of 1994 were lei 10,930.4 billion, 5 percentage points less than targets. Expenditures earmarked to economic activities (lei 3,648 billion) accounting for one third of the state budget expenditures. Expenditure intended to economic activities included subsidies granted to some industrial subsectors (mining, energy and metallurgy) totalling over lei 1,210 billion (2.5 percent of GDP). Expenditures for agriculture amounted to lei 1,168 billion and for social and cultural activities totalled lei 3,217 billion (29.4 percent of budgetary expenditures).

The interest payments as public debts accounted for about 6 percent of total budgetary expenditures for 1994. Local budgets recorded a lei 34 billion surplus at the end of 1994. The consolidated budget deficit at the end of 1994 accounted 2.3 percent of GDP. To conclude, the state budget revenue and expenditures reveal the severe limitations in restructuring state-owned enterprises, limitations imposed by insufficient funds and the feeble process of rehabilitation of the production of goods and services. The optimum allocation of expenditure funds continues to remain a problem to be solved depending on the combination of social and economic criteria as per the principles of the market-oriented economy.

## **2.2. Opening the Economy**

Romania's reform policy after 1989, has been oriented towards the opening of the national economy to the European and world markets and structures. The most important steps in this field aimed to abolish the state monopoly over foreign trade, to set up and consolidate a liberalised, foreign trade regime and an adequate legal framework and economic environment able to attract foreign direct investment.

### **2.2.1. Liberalisation of the Foreign Trade Regime**

Since December '89, Romania's export and import regulations have undergone essential changes. Consequently, at present, all economic agents (state or private) have unhindered direct access to export or import activities, while the vast majority of goods no longer need an export license. Only for certain transactions non-automatic authorisation is required (e.g. exports of goods with limited domestic supply; trade using clearing accounts; barter transactions; transactions using government lines of credit<sup>7</sup>).

At present, customs duties are the major instrument of the government commercial policy. Romania adopted the harmonised system of the tariff nomenclature of the new customs tariffs schedule, in force since January 1993: the weight average duty is 11.7% and the maximum rate is 60% (for luxury items). Romania applies *ad-valorem* customs duties. There are a few non-tariff restrictions on prohibited products including: firearms, ammunition, illegal drugs and other items that might affect national security, public health or good morals.

Romania's customs duty draw-back system allows a refund of import duties

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<sup>7</sup> For more details see Government Decision 215/1992.

previously collected at the time when the concerned goods are exported from Romania, in either the same condition or after having been transformed, processed or repaired, or after having been incorporated into the goods being exported.

In 1992, to protect her companies from goods being dumped or subsidised, Romania introduced anti-dumping duties applied to goods imported at very low or dumping prices and countervailing duties for subsidised goods. Under the guidance of Ministry of Commerce safeguard measures can also be applied to assist domestic producers adversely affected by imports (additional customs duties or quantity restrictive quotas).

Restrictions on exports have been dropped in order that Romania's current account for trade meets governmental and international lender requirements. Quantity export restrictions are subject to a roll-back process. Non-automatic authorisation is required for items with export ceilings, including lubricating oils, chemical fertilisers and copper alloys, or subsidised products. Non-automatic licenses are issued on a case-by-case basis, by the Ministry of Commerce. There are also goods temporarily prohibited for export (basically, food produce, fuels, unfinished wood products etc.).

By a special Law (no. 84 / 1992), Romania has a several **free trade zones** (e.g. Sulina and Constanloa-Sud) extending specific trade facilities, such as: unrestricted goods imports and re-exports; customs duties and VAT exemption; exemption from profit tax for the duration of a company's operations in a free trade zone. In these zones, real-estate long-term lease or title transfers, up to 50 years, are also legal, irrespective of the party's nationality.

With regard to **Romania's international trade agreements**, the following aspects are worth mentioning:

- as a GATT contracting party since 1971, Romania has ratified most of the standards of the Tokyo Round and actively participated in the Uruguay Round;
- Romania is a signatory member of the conventions on Preferential Trade among Developing Countries ("The 16") and Generalised System of Trade Preferences among Developing Countries;
- on February 1, 1993, Romania signed an Association Agreement with the European Community, to come into force after its ratification by the European Parliament and the Parliaments of the EC member countries; an Interim Agreement is in place, permitting the application in advance of certain commercial aspects of the Associations Agreement, considered as an important first step in Romania's longterm plan on EC membership;
- Romania concluded a free trade pact with EFTA, based on a bilateral implementation, as it is ratified by individual EFTA member countries;
- Romania has been granted the Most Favoured Nation (MFN) status in a new commercial agreement; the MFN status has been ratified and the bill passed by the US Congress;
- also, Romania concluded other bi- and multilateral international agreements, in the field of economic, commercial and financial organizations.

The Romanian foreign trade legislation is intended to answer the demands of transition to

market economy and of the integration of the national economy in European structures. Employing its natural and human resources, and the comparative advantages offered by the world trade mechanisms, Romania has embarked on the restructuring process that also entails the promotion of export and mutually advantageous economic cooperation with its external partners.

### **Foreign Trade Readjustment**

During 1990-1994, the Romanian foreign trade underwent important changes, even suffered of dysfunctions, yet it also recorded some favourable trends, all this being the result of the complex interference of a series of internal and external factors.

The most relevant internal factors are related to the foreign trade demonopolization, which has enabled:

- ✓ **an increased number of economic agents** to be involved in a more diversifying range of foreign trade activities;
- ✓ import and export **liberalisation**;
- ✓ **restructuring of the national economy**, that due to production decrease has negatively influenced export volume and structure.
- ✓ The chief external factors strongly affecting the Romanian foreign economic evolution, thereby causing the loss of important external markets, were:
- ✓ COMECON disintegration that resulted in the steep decrease of foreign trade with the ex-member countries;
- ✓ disintegration of the USSR and emergence of new states with a different behaviour towards ex-commercial partners;
- ✓ the **Gulf War** and the embargo imposed by the United Nations on Iraq, a major partner of Romania, both for its raw material imports and manufactured export products;
- ✓ the conflict in **Yugoslavia** and the embargo imposed on Serbia

### **The Trade Deficit and External Debt**

Although the trade deficit persists, it has taken an upward trend in the last two years, due to export production in some sectors and also due to the private commercial sector, contributing over a quarter of the total volume of foreign trade.

The main causes of Romania's sustained foreign trade deficit are: the decline of production, raw materials and energy supply scarcity; the energy-intensive structure of the national economy; increasing inflation and low efficiency level of most economic agents; underemployed production capacity; growing enterprise indebtedness and high interest rates on arrears; low investment propensity, microeconomic disequilibrium that contributed to macroeconomic imbalance.

The new measures in the field of foreign trade are intending to narrow the trade deficit by encouraging exports rather than by curbing imports which anyhow could not be reduced over a certain low limit. The aim is accelerate exports, yet without slowing imports. Romania's current exports are below its potential.

**Table 5.***Exports and Imports by Groups of Countries (million US\$)*

	1990	1991	1992	1993	1994
1. Total exports (FOB)	5,775.4	4,265.7	4,363.4	4,892.2	6,151.3
%	100.0	100.0	100.0	100.0	100.0
• European Union	1,956.7	1,575.7	1,538.0	2,032.2	2,965.5
%	33.9	36.9	35.2	41.5	48.2
• Central and East Europe	2,102.0	1,458.0	1,093.3	755.2	853.2
%	36.4	34.1	25.0	15.4	13.8
2. Total imports (CIF)	9,202.5	5,793.4	6,259.6	6,251.7	7,109.0
%	100.0	100.0	100.0	100.0	100.0
• European Union	2,004.6	1,663.6	2,584.0	2,955.0	3,427.0
%	21.7	28.7	41.3	47.3	48.2
• Central and East Europe	3,456.3	1,679.7	1,659.0	1,409.1	1,661.0
%	37.6	28.9	26.5	22.5	23.4
3. Trade balance					
• Total	-3,427.1	-1,527.7	-1,896.2	-1,359.5	-957.7
• European Union	-47.9	-87.9	-1,001.0	-922.8	-462.0
• Central and East Europe	-1,354.3	-221.7	-565.5	-653.9	-807.9

Source: Calculations on the primary data from Foreign Trade Statistics, No. 1, 1995, p10-15, National Commission for Statistics.

A broader access to Western markets under an association agreement with the European Union and resumed trade privileges with the USA, last November, could result in additional exports worth. Another Romania's export earnings are expected from trade growth in former COMECON countries. The growing links with China as well as exports to South American states, an increased output of Romania's manufacturing industries, this is expected to increase 1995 exports.

Romania's foreign debt amounted continuously since 1990 reaching around US\$ 4,800 million in 1995. Almost half of Romania's debt consisted of credits from the IMF and World Bank. In 1992, the total foreign debt reached USD 2,354 billion, up from USD 1.1 billion in 1991 and a mere USD 211 million in 1990. About 70% of statedrawn credits were used to support the country's balance of payments.

Among specialists, the relatively reduced size of Romania's medium and long-term external debt has at least a double representation. Some consider that this amount of foreign debt might be an advantage, in the sense that further credits for restructuring the national economy could be still secured. On the other side, there is an opinion according to which it is preferable to increase the external debt at a slower pace and to encourage a partial inflow of direct foreign investment, with a more beneficial effect on the domestic economic environment, production of goods and services.

#### **2.2.4. Foreign Investments**

Post-'89 Romanian legislation on direct foreign investments has been designed to promote and stimulate the inflow of foreign capital into the national economy. As such, it offers a range of facilities similar to those offered by the most advanced countries' legislation.

As an essential feature, mention must be made of the fact that there are no legal restrictions on the amount of foreign equity participation in a commercial company registered in Romania. Moreover, except for some sectors in environmental protection, national security and defence, all economic sectors are available for foreign capital investments.

Further on, in terms of convenient facilities, capital and revenues could be converted in hard currency or Lei, for transfers abroad. Foreign investments enjoy certain tax advantages, while imported equipment and means of transportation ranking as company assets are customs duties exempt.

Although as natural persons denied the privilege, the commercial company registered in Romania as a legal person of any foreign investor is granted the right to purchase real estate in the country.

Without any reservation, foreign direct investment is a factor of consequence in Romania's economic restructuring, particularly in the sector of state-owned enterprises that need to be privatised or converted into joint ventures.

By the end of June 1994, the total volume of foreign investment amounted to USD 1,267.8 million. The branch distribution of foreign investment by the end of the same year would have the following structure: mining - 17.6%; machine-building industry 18.6%; electrotechnics and electronics industry - 10.8%; light industry - 9.5%; food industry-31.7%.

The large majority of investors are coming from Western Europe (67%), North America (18%), Middle East (6%) and Asia (5%).

South Korea is on top of the list of foreign investors (USD 156.8 million), followed by USA (USD 113.3 Million), Germany (USD 11.9.6 Million) and Italy (USD 111.5 Million). Germany leads the list of countries with the highest number of joint-ventures (since 1990 5,833 venture companies were set up in Romania), followed by Italy (4,650 companies), Turkey (3,306 companies), Jordan (2,015 companies) and the USA (1,571 companies).

Significant, in point of foreign investment quality growth, is the fact that foreign companies with a capital over USD 1 million account for 69% of the total foreign investments recorded in Romanian by the end of 1993. Companies with over USD 500.000 represent about 75% while the share of those with a capital over USD 100.000 is about 85.5% of the total foreign invested capital.

Despite the modest dimension of the direct foreign investments in Romania, their contribution to the introduction and employment of the free market mechanisms, behaviour, to improved management schemes, operation techniques, employee training, labour efficiency, financial discipline and savings policies is obvious.



In the coming period the mass privatisation is expected to be an important incentive for direct foreign capital investment because of peculiar facilities awarded to strategic investors.

### **2.3. Development of The Private Sector**

In Romania, the most developed private sector is in agriculture, where it holds about 80% of the arable land. Romanian agriculture knows three forms of production organisation:

- individual family business, representing the small property and accounting for 34% of the arable land;
- agricultural production units organised as simple associations - with/without a legal status - or as legal farming associations;
- agricultural commercial companies originating in the former state agricultural units.

In 1994, the main further steps made concern:

- an estimated 1.3 million issue of land property titles;
- the endorsement of the inter-cooperative farming association' legal status;
- further concentration of the production process, following the Parliament passing the Lease Law and with the support of the Agency for Rural Development and Planning.

The more advanced position of the private sector in agriculture is explained, first of all, by the fact that this sort of activity does not require a very high capital, unlike, for example, building constructions. A second reason is the relatively higher profit rate, as compared to other economic sectors.

In development of private sector in non-agricultural sectors has begun with the small and medium SOEs enterprises. According to the existing estimations in industry more than 15% of social capital of SOEs has been privatised up to mid July 1995. In transportation and construction, the contribution of the private sector is relatively reduced, due to privatisation complexities and also to the lack of capital.

In Romania, a development prerequisite of the private sector was the rapid increase of the number of economic agents, having a diverse legal status (private or joint ventures), and the decrease of the number of state-capital companies.

There are certain disparities between the growth of the private sector and its contribution to the GNP and state revenue. While the private sector employs about 60% of the active populations, its contribution to the GNP amounts to only 50%.

The State Ownership Fund (SOF), established as an independent body reporting to the Romanian Parliament and involved with privatisation and restructuring issues, classifies the aggregate portfolios of state enterprises in three categories, according to the size of the commercial companies (small, medium and large). SOF proceeds to the privatisation of the three categories of enterprises on parallel courses, since, to accelerate privatisation, adequate methods in each case should be applied.

Small enterprises, concentrating less than 4% of the social capital held by the stateowned commercial companies, are to be privatised by standard procedures

(management and/or employee buy-out) or at auction<sup>8</sup>, similarly to asset sales, where Romanian investors will have pre-emptive rights.

In the case of an important group of medium-sized companies, SOF and POFs have been jointly assigned the responsibility of privatisation. Privatisation of banks and large commercial companies is to be dealt with on a case-by-case basis.

The privatisation programme for 1993 failed to be fulfilled, as 244 state-owned enterprises were turned private, as compared to the targeted 550 small- and medium-sized enterprises, in the food, construction and services industries. The 244 privatised enterprises currently amass a total nominal capital of Lei 66.5 billion (USD 50.5 million) and they have sold 8.3 million shares, Lei 84.4 billion worth (USD 66.1 million) to a number of 74,000 employees.

The dividends paid to SOF in 1993 (about Lei 60 billion) were allocated to modernisation of the tractor plant in BraDov, a pump factory (Aversa, Bucharest) and also to the restructuring of state-owned poultry farms. For 1994, the estimated dividends are of about Lei 100 billion and part of them would be allocated to the restructuring of the manufacturing industry, based on more rigorous selection criteria.

In 1994-mid 1995 period have been privatised more than 1500 SOEs especially in trade, construction, tourism, food and light industries. The MEBO method of privatisation was applied to the majority of cases. Other forms taken recourse to with a view to expanding the private sector of the Romanian economy involve asset selling and direct foreign investments.

In 1995, a set of new measures are to be taken in order to accelerate the privatisation process, which, alongside adequate efforts - savings and investments - made by the private sector itself- would significantly contribute to its expansion, control, observance of the financial discipline and its competent management as per the free market system rules and regulations. Simultaneously with the case by case privatisation, in 1996 should be completed the mass privatisation process.

As one can see, besides agriculture, the most advanced sectors in Romania from the privatisation point of view are: retail trade, services and foreign trade. The most difficult problems for privatisation in the future are raised by the large SOEs which account for more than 50% of total social privatizable capital in Romania

### **3. National Economy and The Institutional Framework of Restructuring State Enterprises**

#### **3.1. Restructuring and the Legal Framework**

During the post-Revolution period, the Romanian Parliament and Government passed a considerable number of laws and especially decisions with direct or indirect reference to the global restructuring of the economic activity, and specifically, of that of industrial enterprises.

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<sup>8</sup> In the case of units with special evaluation criteria, i.e., reputation, goodwill, trade-marks, intangible property, know-how, etc.

**Table 7.**

	Years		
	1992	1993	1994
Gross Domestic Product			
• private sector	26.0	32.0	36.0
• state sector	74.0	68.0	64.0
Employment"			
• private sector	40.9	43.8	47.4
• state sector	54.2	51.6	48.0
• mixed sector	1.8	2.0	2.2
• cooperative sector	3.9	2.6	2.5
Retail trade			
• private sector	45.8	56.0	67.7
• state sector	54.2	44.0	32.3
Services for population			
• private sector	45.6	51.4	45.8
• state sector	54.4	48.6	54.2
Export			
• private and mixed sectors	27.5	25.2	29.1
• state sector	72.5	74.8	70.9
Import			
• private and mixed sectors	32.8	23.7	29.7
• state sector	67.2	76.3	70.3

Source: Le Gouvernement de Roumanie, Deux ans de gouvernement, Bucarest, 1994, Annexe 1.

*Structural Changes of Property in Romania in The Period 1992-1994 (%)*

### ***Reorganisation of State Enterprises***

The process of restructuring the economic activity has been inaugurated by **Law no. 15** / August, 1990 concerning the reorganisation of the state economic units in regies autonomes and commercial companies. The law institutes a new arrangement, on commercial bases, in terms of operating autonomy of the state sector, a structure fully compatible with the market system principles. The socialist state sector was converted into a public sector designed to operate under the new political and economic conditions. This law has drawn on the Romanian legislation regarding the organisation and operation of the public sector in pre-war Romania, that had contributed to the extensive set up of Romanian corporations.

**The regie autonome** is an economic unit and legal person, employing and utilising the state property with a view to profit-making; this type of economic unit is not intended to be privatised in the near future. The regies autonomes were set up in the strategic branches of the national economy.

By **Government Decision no. 266** / June, 1993, concerning the economic branches

and fields where regies autonomes of national interest are to operate, the economic activity where such units were organised was restricted. The strategic branches are: electric and thermal power production and distribution; exploitation of serviceable minerals and their transfer in view of processing in specific forms (except for common rock, building material quarries and peat deposits); the postal system and telecommunications; the railway and subway systems; arms, ammunition, explosives and production of combat techniques.

Regies autonomes were also organised in some other economic branches: harbour, airport, road and maritime channels authorities, in the field of air transportation.

**Government Ordinance No. 15** / August 1993, on some restructuring measures in the set up of regies autonomes, provides for the following criteria to be observed: to be a natural monopoly; to perform an activity of public interest; to produce goods and/or offer services essential for the country's defence and national safety; to be able to cover expenditures gradually, out of their generated income.

The same Ordinance decided for the regies autonomes to restrict activity to basic assignments. The pertaining ministries and the Ministry of Finance were to institute the managerial control of these enterprises and, during a first stage, they would demand efficient financial plans from 50 significant regies autonomes<sup>9</sup>.

The law prevents inefficient enterprises from collecting budget allowances. It also contains certain provisions that have helped the government programme of privatisation start, defining the rental, concession and exploitation of the state-capital company assets.

**The commercial company** is an economic unit and legal person, financially autonomous, consisting of one or more stockholders having put together their capitals in view of profit making. When such units have the state as their sole stockholder, they are subject to the process of privatisation.

According to this Law, in branches and fields of activity of national interest, the commercial companies have been set up by Government decisions, while in fields of local interest, commercial companies were set up by a decision of the local state administration.

Also, the same law lays out the procedures to be resorted to in the administration, decrease or increase of the social capital, and also merger and clearance procedures.

These rules and regulations are not discriminatory in point of ownership nature, all types of enterprises - be they state, private or joint ventures - being subject to the same rules of organisation and operation. In point of competition, this fact confers the state company an equal status with that of the private company both on the internal and external markets. Formally, the enterprise has been reinstated in its right place within the framework of the national economy.

### ***Basic Rules and Regulations on Enterprise Operation***

Economic relations among enterprises are based on the provisions of the Commercial Code adopted in 1887, and its subsequent modifications.

According to **Law no. 15** /1990, the regies autonomes and the state-capital

<sup>9</sup> Memorandum Concerning the Economic Policy of the Romanian Government (in Romanian), № 6/ Feb. 11, 1994, p. 39.

commercial companies may practice a price policy as this is dictated by the market supply and demand, except for the case when the Romanian market lacks three economic agents at least who should offer the same type of goods or service; state-subsidised prices, according to government decision, are also an exception to the rule. In the latter case, the government should establish the price level by negotiations with the economic agents. Currently, over 95% of the prices are liberalised. The Law has thus established antimonopoly regulations.

To encourage competition, **Law no. 11** / January, 1991 on subversive competition was adopted, while **Law no. 12** / August, 1990 had in view customer protection against illegal commercial activities.

In point of financial and labour regulations, the more than ten laws were passed.

### ***Development of The Private Sector***

The chief regulations fostering the development of the economic and commercial relations based on private property are: **Law no. 18** / February, 1991, on real estate; **Law no. 58** / August, 1991, on the privatisation of commercial companies; **Government Ordinance no. 25** / August, 1993, on the set up and development of SMEs.

According to the **Real Estate Law**, about 80% of the total arable land has been returned to original landowners. Law implementation though is a quite complex process, given the variety of interests playing the game, as well as the necessity of subsequent regulations, especially those on the railway traffic.

The **Law on the privatisation of commercial companies** regulates the transfer of state property to the private sector, be it represented by physical or legal persons, Romanian or foreign citizens.

**Government Ordinance no. 25** /1993 is conceived to foster the development of the private sector and SMEs are granted certain financial and economic facilities:

Law no. 77/1994, on the associations of employees and management of companies to be privatised, granting a series of facilities for the acquisition, distribution and transfer of stock, such as: getting shares against property bonds or money; payment of stock by instalments; distribution of stocks is made as per : length of service with the relevant company, position, wage and other objective criteria agreed upon by the general meeting.

The State Ownership Fund allows the relevant associations to pay by instalments, provided:

- a minimum 20 percent of the negotiated price advance payment is made;
- there is a maximum 10 percent negotiable annual interest rate.

The general balance sheet of the current Romanian modernised legal system is far from being satisfactory; it still represents a stringent matter. The multitude of issues arisen due to the absence of synchronism between the slow rhythm of the legislative process and the need to adjust, "on the spur of the moment", certain rules and regulations no longer adequate to the current conditions. The issues are highly intricate, demanding an in-depth study, the commitment of a wider range of experts, preparatory debates.

### 3.2. The State Industrial Policy and the Restructuring-Privatisation Link

The restructuring of the national production system takes place along several medium- and short-term directions.

**The increased weight of the tertiary economic sector** refers to the rehabilitation, development and modernisation of its vital sectors, objectives that could be attained by paying special attention to public investment in the following fields:

Another crucial direction of the national economy restructuring is the **in-depth reorganisation of industry**, that is to be detailed further on, in this study.

**Agriculture modernisation and development** is a third major restructuring direction, focused on food supply for the entire population; this is to be backed by adequate procedures, such as: liberalised product prices; settlement of the land property status in agriculture; the development of the product market; appropriate institutions; reorganisation of the large state monopolies within the system of product acquisition, distribution and processing; grant subsidies and access to credit lines for farmers and agriculturists.

Given the tendencies to internationalisation and globalization in economy, science and technology, the restructuring of the national economy entails **substantial changes in the orientation patterns of the Romanian foreign trade and economic international relations**, with special emphasis on the opportunities of integration in European and world structures.

#### ***Background of Industrial Restructuring***

A vital sector of the Romanian economy, in 1993, industry accounted for 45% of the GDP and for over 40% of the active population. Part of the Romanian Government's economic and social strategy for 1992 - 1996, the industrial policy of the period is focused on the conversion of the most important industrial structures with a view to increasing their efficiency.

The bearings of the Romanian industry restructuring program, including emergency corrective adjustments, and designed for the first stage to be completed in 1994-1995, are as follows:

- **strategy updating and studies in sectorial and branch restructuring** - over 60 studies, of which 22 alone have been drawn by foreign consultants, and most of them PHARE financed, using data supplied by economic forecasts in various sectors;

- **continued supervision** of inefficient production capacities, to be winterised or closed; joint programs of the Ministry of Industry and the Agency for Restructuring targeted on the reconversion of unproductive enterprises, chiefly in the field of machine building, engineering, chemical and petrochemical industry, metallurgy (around 150 — 200 economic units);

- **environmental protection** by monitoring enterprise compliance with the pollution regulations in force, special attention being given to critically polluted areas; facilities exceeding the admitted pollution emission might be even shut down, for population health safety reasons;

d. **stimulation of foreign investments and credits** aimed at the technological restructuring of potentially viable business through the promotion of priority projects of interest to businessmen abroad.

### ***Industry Restructuring***

Although as early as 1991 - 1992, there was a manifest concern as to the elaboration of the industrial policy, a more coherent policy has been drawn up and started to be applied starting with 1993<sup>10</sup>.

A component of Romanian industrial policy, industrial restructuring is a time-consuming complex process and involves a reorganisation of the inherited communist structures, a shift of emphasis in point of branches and sub-branches and of their interrelations, adequate to the market system. These complexities are augmented by the concurrent country's transition to the market economy and the deep economic crisis.

The overall strategic objective of the Government's policy on industry restructuring is to abate and ultimately eradicate inter-sectorial imbalance, and thus be able to achieve a modern, efficient and competitive industry.

The current condition of the industrial system and also the legal status of the Romanian state as owner of an overwhelming share of the industrial capital circumscribe both its involvement procedures and its specific targets in the country's economic, short- and long-term, policy on restructuring and privatisation.

The starting point was the government's awareness that industrial production restructuring in a double-faceted process: on one hand, a **process of discharging** inefficient production units and capacities, and, on the other one, a **process of building, modernising and development** of new capacities.

The restructuring of state-owned or major state-capital enterprises takes place at three distinct levels, institutionally and organisationally interrelated:

- at the **macroeconomic level**, the structural adjustment of the weight carried by different economic branches and activities conducted by the Council of Coordination, Strategy and Economic Reform;
- at the **ministerial level**, the sectoral and sub-sectorial restructuring applied to those economic activity fields that are subject to far-reaching changes in point of volume, structure and quality of products and services, number and form of organisation of the involved economic agents, programs of labour force reconversion and social assistance;
- **microeconomic restructuring** conducted by the State Ownership Fund (SOF), based on sectorial or sub-sectorial restructuring studies, aiming the observance of certain performance criteria in agreement with enterprise adjustment to the market economy requisites, under the combined action of a changed economic environment and local specifics.

<sup>10</sup> The Strategy of Industrial Restructuring, (in Romanian), in *Economistul*, № 176 / 20-23 March 1992, pp. 3-4; also, Strategy of the Economic Reform and the Governing Program, (in Romanian), Bucharest, February 1993, pp. 45-57.

State restructuring support takes different forms: investment financing from the state budget or from the restructuring fund created from the SOF revenues; SOF-guaranteed commercial credit loans granted for restructuring projects; debt resettlement; state participation as investor, alongside private investors, in financing viable projects otherwise abandoned for lack of funds; moderate protection granted to national interest sub-branches or to those of high quality potential. A series of programs related to the restructuring and privatisation policy have been drawn up and are under implementation.

The short-term **emergency corrective adjustment program** is focused on immediate cutbacks in the relative consumption of energy and raw materials, in general, in all material expenditures, per value-added unit. The program operates on passive adjustment only, a discharge of inefficient production and excessive capacities, the first in line being those exhausted morally and physically, of enviable enterprises.

The medium-term **branch structure adjustment program** (1993-1996) aims at the improved activity in industrial branches and sub-branches by increasing the raw-materials highly efficient capacities and reducing the importance of the raw materials processing capacities (basic metallurgy, high-tonnage chemistry, heavy-duty machinery industry), as a prerequisite of increasing labour productivity and efficiency.

The program involves an "offensive" adjustment, constructive, of rehabilitation and development implemented through the investment policy.

The restructuring process is viewed in close connection with privatisation. For instance the large size SOEs with difficult problems are restructured (financially and technologically) prior the privatisation while for a lot of enterprises restructuring is achieved after the privatisation is fulfilled. From many points of view privatisation is considered as the most important part of restructuring process

### 3.3. State Institutions for Restructuring

Currently, state intervention in the organisation and operation of the regies autonomes and commercial companies, partially or entirely state-financed, consists of the following:

- ✓ direct action, specifically, decisions, counselling and direct control, according to its prerogatives as a proprietor, and
- ✓ indirect action, by ensuring the legal framework, rules of the game; elaboration of the strategic options and the applications of financial and economic leverages, meant to develop the adequate social and economic environment, promoting restructuring and reform, as a general direction.

The ways and the proportions these two types of actions combine differ, function of the sector the concerned company pertains to (public or private); function of the branch it belongs to, of company size, a.s.o. During transition, state institutions should be involved in developing the prerequisites of reorganising former state enterprises in a new economic system and in preventing and helping overcome negative phenomena liable to occur in the process.

**The Government** is invested by the Parliament with the full social and economic authority and power, in its position as Romania's first managerial institution. Its activity



embraces a wide range of issues and all sectors of the social and economic life.

The major economic objectives of the Government and of its institutions are: to develop the country's economic strategy; to draw up reform guidelines or reform-oriented programmes; to establish and apply its social and economic policy, instruments and leverage, in order to attain the assigned objectives; to foster an adequate climate for the transition of its enterprises to the new economic system.

During the last four years, the Government of Romania has developed a vast institutional network, with a view to attaining its objectives while discharging its attributions and responsibilities: ministries, departments, national agencies, social, financial and economic committees and councils".

Further on there follows a concise presentation of the chief state institutions supposed to have a significant impact on the evolution of enterprise restructuring process and transition to the market economy.

**The Coordinating Council for Strategy and Economic Reform (CCSRE)** is a central special body pertaining to the Government of Romania. Its objectives consist of:

- ✓ acceleration of the reform process, for the reform to take place in the shortest possible time and at the lowest social costs possible;
- ✓ elaboration and implementation of the reform strategy;
- ✓ to ensure reform coherence with its previous, initial stages, as started off by the previous administrations;
- ✓ to ensure a logical order in the development of the reform processes already initiated.
- ✓ The main attributions of the institution are:
- ✓ designing the Government reform programme according to the current demands of the Romanian society and economy;
- ✓ to correlate, advise and control the implementation of the government reform strategy and programme;
- ✓ to conceive economic policies with a view to the implementation of the economic reform in Romania;
- ✓ to advise on the programmes, recommendations and projects of rules and regulations concerning the economic restructuring process.

For the last period, CCSRE has been directly involved in the reform, starting from the design and ending with the implementation of the elaborated measures, to ensure the adequate course of reform. Also, CCSRE has organised a series of workshop meetings with the decision-making factors in various enterprises invested with attributions in the sphere of sectorial restructuring strategies, foreign relations, induced foreign investment, a.s.o.

**The Romanian Agency for Development (ARD)** is a specialised body subordinate to the Government of Romania constituted to foster an attractive climate for foreign investment and for the development of SMEs.

To implement the privatisation process in Romania, there have emerged a series of

institutions<sup>11</sup>, among which **the National Agency for Privatisation** (ANP), a specialised central body by the Government of Romania, assigned the task of directing, advising and controlling the privatisation process, at the administrative territorial level and at the national level.

Its chief attributions are:

- a) to implement the privatisation program of state-capital commercial companies;
- b) to correlate the privatisation programme with the strategy for economic restructuring and with the foreign technical assistance in the field of privatisation;
- c) to coordinate - in close cooperation with the SOF and the POF - the privatisation of commercial companies;
- d) to elaborate the adequate methodologies on asset evaluation and on asset and stock trading;
- e) to control the evolution of foreign technical assistance;
- f) to insure dissemination of information at home and abroad, with a view to promoting the process of privatisation, a.s.o.

**The State Ownership Fund** (SOF) is a legal person and public institution, of a commercial and financial nature, headed by a council of administration. Initially, it owned 70% of the stock and social capital of all commercial companies.

The State Ownership Fund emerged as an institution invested by the state with the task of privatising by selling its stocks and social capital. Enjoying full decision-making autonomy, SOF is free of any administrative hierarchy and/or executive administrative control, although its activity is monitored - politically - by the Parliament<sup>12</sup>.

Practically, SOF implements the operational, technological and financial restructuring of the state-capital commercial companies, that are allocated credit loans or reinvestment capital funds out of the credit reimbursements made by the already privatised units. As a rule, the restructuring funds are granted to commercial companies in view of rehabilitation and subsequent privatisation.

The SOF grant allocation policy envisages the close cooperation with all reform involved institutions. Special advice offered by pertaining ministries and the government Agency for Restructuring is permanently resorted to. A special SOF department is dedicated to the restructuring of commercial companies.

11 Law № 58/1991, on the privatisation of commercial companies, (in Romanian)

"Government of Romania Decision № 823/27.07.1990 on the Set up of the National Agency for the Privatisation and Development of Small and Medium Enterprises and "Government of Romania Decision № 858/31.12.1991 on the Reorganisation of the National Agency for the Privatisation and Development of Small and Medium Enterprises" (in Romanian).

"Government of Romania Decision № 4/13.01.1993 on the Organisation of the National Agency for the Privatisation" (in Romanian).

12 Zaman, G. Privatisation of State Enterprises, (in Romanian), *Trubuna Economic*, № 29 of 17.07.1992, p.5

**The Private Ownership Funds** - five of them - are organised as limited liability companies, based on economic principles. Initially, they held 30% of the social capital of any commercial company.

The Funds discharge the following functions:

- ✓ they issue property titles to Romanian citizens;
- ✓ they try and maximise stockholders' revenue;
- ✓ they facilitate property title owners' becoming stockholders in a commercial company;
- ✓ when appropriate, after having reorganised the stock portfolio, they proceed to new capital investments, aiming to maximise the market value of their stock.

As a result of their activity, today Romania boasts about 308,795 new private companies and about 215,345 entrepreneurs (family associations and sole owners)<sup>13</sup>.

Currently, both the SOF and the POF are able to discharge their prerogatives unhindered and with absolute commitment. Proof of the above statement is the elaboration of the Privatisation Programme for 1994.

**The Restructuring Agency (AR)** came into being at the beginning of 1994, within the CCSRE framework. Its activity is focused on the restructuring of state-capital commercial companies of major consequence in the national economy<sup>14</sup>.

In an initial stage, the Government approved of a monitoring programme for 30 commercial companies, some of which were anticipated to be dissolved. Subsequently, 20% of the 30 companies have demonstrated real amelioration and their supervision is to be discontinued; for 60% of the companies, rehabilitation projects were estimated and drawn up, considering that financing depends on the feasibility studies already submitted to various banks and financial authorities. In the case of some companies nearing bankruptcy, it was decided that they were no longer viable and self-rehabilitation was impossible.

**The Securities National Agency<sup>15</sup>** operates within the framework of the ministry of finance and its responsibilities involve the Romanian capital market monitoring and control. Two are its chief objectives:

- 5.7.5.1 monitoring securities issues and their market release; imprinting the adequate behaviour of the direct and indirect participants in this type of market;
- 5.7.5.1 controls and advises on the public information released by stock issuers and addressed to potential public investors whose savings are envisaged.

**The Consumer Safety Bureau<sup>16</sup>** is a specialised body pertaining to the central public administration, subordinate to the Government and assigned the task of implementing the government policy in the sphere of consumer protection. Its attributes are:

13 Statistical Bulletin for Public Information, (in Romanian), № 12/1993, p.4.

14 Government of Romania Decision № 780 of December 30, 1993, on Setup of the Restructuring Agency.

15 Romanian Government Decision № 552/14.09.1992 on securities issues.

16 Romanian Government Ordinance № 21/1992, endorsed by Law № 11/14.03.1994

- ✓ elaboration of the strategy, policy and regulations on the field;
- ✓ unannounced periodic market controls and inspections, aimed at checking on the observance of all rules and regulations concerning produce packing, labelling, stocking, transportation and marketing, as well as service quality; appropriate measures are taken, as the case may be.

**The Economic Advisory Council** came into being at the beginning of 1993 and was to focus attention on the major issues of a coherent economic policy able to help and stop production decline and create the adequate conditions of a thorough restructuring of the national economy. The council members are the Prime Minister, state ministers, the ministers of Industry, of Agriculture and of Commerce, the Governor and the Vice Governor of the National Bank of Romania, and the President of the Romanian Banks Associations representing the commercial banks. As a rule, the Council meets twice a month<sup>17</sup>.

**The Social and Economic Consultative Group of the President of Romania** was constituted at the beginning of 1994, its members being prominent Romanian experts, famous through their contribution to the theory and practice of economics<sup>18</sup>. Its size and structure are flexible, function of the nature and characteristics of the approached issues at various moments. The Consultative Group helps the Presidential institution develop an independent capacity of analysis, evaluation and preparation of the social and economic policies via an independent and objective approach, meant to ensure the harmonious consensus of the society as a whole and strengthen people's confidence in the historical process of reform and economic restructuring.

During the studied period, there took place a structural change of the Governmental institution in favour of the financial and economic institutions yet detrimental to the administrative ones.

As a mere convention, we could appreciate that the macroeconomic and sectorial restructuring is the major prerogative of certain synthesis state institutions (the Government, CCSRE, ministries, ANP, a.s.o.) while microstructural restructuring is the prerogative of the SOF, AR, of ministerial departments and of the commercial companies themselves.

The close study of such state institutions involved in the restructuring process has evidenced that the primary purpose of their activity is the **rehabilitation and increased efficiency** of the commercial companies, which does not mean that extremely inefficient, enviable companies are not liquidated. This purpose, in its turn, takes on a multitude of variants, function of the specifics of each individual company.

The main restructuring procedures are primarily concerned with the financial resources, that could be: finances belonging to the company itself, SOF funds, allocations from the state budget, foreign capital investments, external credit loans and assistance (in

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17 The Economic Consultative Council<sup>1</sup> (in Romanian), in *Tribuna Economic*, № 4/29.01.1993.

the case of joint ventures).

The estimation of the results in the restructuring of industrial enterprises will always be an estimation, given the fact that the process is just beginning. Anyhow, mention must be made that a series of commercial companies succeeded to improve their economic performance, and offer a better answer to the incentives extended by the domestic and/ or foreign markets.

A permanent inter-institutional cooperation, based on well-defined attributions and competence, could represent an attractive incentive in restructuring the Romanian economy. Basically, it would mean a complex approach and interdependence of the regimes autonomes restructuring - which is a ministerial and departmental attribute, and of restructuring the state-capital commercial companies - a responsibility assigned to SOF and AR. In this context it should be mentioned the necessity for further improvement of interinstitutional relations for a better deployment of restructuring.

### **3.4. Other Institutions of Authority in the Restructuring Process.**

The development of certain diversified networks of non-governmental institutions, equally distributed in the territory represents an important component of the restructuring process taking place in the Romanian society.

Among the most influential institutions in this respect we should mention the labour unions, or the patronage.

At present, the unions and the professional associations are well-organised and powerful elements of the Romanian society, in close interaction with the state administration; they exert a major influence over any form of social or economic policy promoted at the central or local level<sup>18</sup>.

The government has acknowledged the role of the unions as employee representatives, their potential and contribution to the identification of the appropriate solutions as demanded both by the social production - according to existing possibilities - and the success of reform.

Irrespective of the form and level of organisation, the unions prove their catalytic merits in the restructuring of state enterprises along a sequence of directions, namely:

- \* employee involvement in the privatisation of commercial companies, according to diverse procedures, the unions being the catalyst or indeed the employees' envoy to such negotiations;
- \* the unions are also involved in the restructuring of the labour force, in terms of social and professional protection, reconversion and specialisation;
- \* the unions are consulted in cases of restructuring and modernisation of their unit management at various levels;
- \* as stockholders, union members are directly involved in decision-making, in the management of their unit, and profit distribution, which grants them a high potential

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<sup>18</sup> Government Programme Strategy of the Social and Economic Reform (in Romanian), Bucharest, February, 1993, p. 113.

in controlling, on a larger scale, the economic restructuring:

- e. unions are also consulted and they actually take an active part in the elaboration of certain rules and regulations directly or immediately concerned with the restructuring of the national economy.

Progressively, while being organised, the **Patrons' Union**<sup>19</sup> also came to be integrated in the dialogue with the Unions, both as a partner and as a decision-making factor. The Patronage represents the interests of private and public company holders, defends national or group legal, technical and economic interests in front of the public authority, of other social and economic institutions and organizations.

The progress of the restructuring and privatisation process has prompted the development of a structure able to defend the private sector and, naturally, the latter's reaction was quick, resulting in the set up of a series of patronage organizations.

The regies autonomes and the state-capital commercial companies were aware of the evolution-imposed necessity of a unanimity of interests; the result consisted in the development of some branch patronage organizations; further on, the National Confederation of the Romanian Patronage was instituted.

The government encouraged the set up of such structures and also supported the development of a direct communication system with the unions, especially when collective bargaining had to take place, at branch and national levels.

The **Patronage Conference of the Romanian Industry** (CONPIROM) carries out a sustained activity through its 30 sub-branch patronage organizations, representing all the industrial sub-branches and branches<sup>20</sup>. Up to now, the patronage has participated in the elaboration and bargaining of the collective labour contracts, at the national and branch levels, as well as in the debates on the salary policy and salary indices, and on the customs protection policy. It has also advanced relevant proposals with reference to industry relaunching<sup>21</sup>, such as:

1. the set up of group structures that should enable free competition and oppose monopoly tendencies, fully autonomous in the management of the state industrial capital, free of administrative interference;
2. the steps to be taken with respect to commercial companies found in financial difficulties need to be determined based on pertinent diagnoses alone, their final objective being the resumed efficiency of such units;
3. an articulate asset appraisal methodology should be elaborated, for the interested unit to be able and apply it independently, employing its own local forces;
4. the current financial blockage in industry needs to be reduced and gradually suspended, by reconciling the causes having induced them;

19 Government Decision № 5037/26.07.1991, on the patronage organizations of the regies autonomes and state-capital commercial companies

20 The Romanian Patronage in the Resumed Social Dialogue, (in Romanian), in Tribuna Economic, № 48/1993, p. 36

21 Opri Silviu, The Goodwill of the Romanian Industry Patronage, (in Romanian), in Adevrul Economic, № 13, 4-10 April, 1993, p. 9 and A Chance to Relaunch Industry, (in Romanian), in Adevrul Economic, № 1051, 9.09.1993

5. the stimulation of the build up and use of indigenous capitals, under an equal and loyal competition with the foreign capital;
6. sustaining the relinked productive cycles in viable companies, etc.

As a consequence of the worsening economic conditions, of the vast union movement and of an initiative belonging to the patronage, the executive resolved for the social dialogue to take part, in its tripartite variant, i.e., government, patronage, unions; the meetings having taken place during the last months stand proof of the above.

A highly important role hold the **National Council of the Small and Medium-Sized Enterprises**<sup>22</sup> and the „**Romanian Centre for the Small and Medium-Sized Enterprises, Foundation**”<sup>23</sup>. These are non-governmental organizations aimed at promoting and defending the legislative, financial, commercial and production interests of the small and medium-sized enterprises in the latter's relationship with the state authorities and administrative bodies, or with similar bodies abroad.

**The Romanian Chamber of Commerce and Industry** and its local branches, through its legal entire activity constitutes a direct incentive of the restructuring process, as it facilitates contacts among potential economic agents at home and abroad, offers economic data and information on diverse commercial companies; it also sets up fairs and exhibitions at the local, national and international level, that have a direct impact on the restructuring of industry through foreign capital investments, or exports of Romanian goods and services.

## 4. Structural Changes in The System of State Enterprises

### 4.1. Ownership Structure

The comprehensive changes having taken place within the legal and institutional framework of the Romanian economy also entail ownership structural changes with a view to rescinding the state monopoly and foster private ownership expansion in diversified, yet complementary, forms and types of organisation and operation.

At present, in all branches of the national economy, the state is the major holder of the social capital, except for agriculture, where private ownership over the arable land is as high as 80%.

*De jure*, 70% of the current assets of any commercial company pertains to SOF (state ownership); the balance of 30% belongs to POFs (a special form of private ownership, represented by property certificates distributed to the adult population and legally administered by POFs).

As non-privatizable economic units, the regies autonomes pertain to the realm of public infrastructure or to some other fields of strategic importance for the national economy. Their operation and management observe the principles of economic efficiency

22 Blaga, Lucian, The National Council of the Small and Medium Sized Private Enterprises, (in Romanian), Tribuna Economic, № 33, August, 14, 1993, p. 23.

23 Government of Romania Decision № 86/February, 26, 1993, on the set up of the "Romanian Centre for the Small and Medium Sized Enterprises" Foundation (in Romanian).

and autonomy. For the last two years, the share of potentially privatisable and privatised social capital has been expanding owing to a series of beneficial influences:

7. a number of activities conducted within the regies autonomes have been transferred to privatizable commercial companies;
8. state assets were transferred to private companies by auction or selling;
9. direct foreign investments in kind or cash;
10. expansion of the private sector supported by its own inner resources.

In the absence of reliable statistical data and information, under the constantly changing circumstances - as state ownership is being transferred to the private sector it is highly improbable to identify the precise size of the predominant state share in the total capital. According to the Ministry of Finance estimations, at the end of 1993, the private capital quota of the total underwritten social capital (land value excluded) exceeded 10%, against the 19915%, in non-agricultural branches. Obviously, the figure is approximate, since it ignores the underestimated value of most the fixed assets, formerly state ownership. More important, though, in our opinion, is the growing importance acquired by the private sector in the process, even if the pace of the reform is so slow.

The analysis of the ownership structure, from the standpoint of the shareholder's status and the relative size of the underwritten capital of each private company, has an additional relevance in the characterisation and implementation of restructuring, and, in general, in the decision-making process regarding the efficient operation of the market mechanisms, optimum public and private choice and allocation of resources.

The most important elements of ownership structure, at the macro-level approach, are the following:

**The regies autonomes** (100% state ownership, with a specific operation regime, in the case of concessions, leasing and management contracts) represent less than half of the total social patrimony of the Romanian economy. Concession rights are granted by public auction alone and on condition that the state receive an annual fixed income equal to the net average profit generated over the last five years.

**Commercial companies** with joint state and private capital, have a variety of forms:

- ✓ *commercial companies* as the exclusive ownership of two shareholders alone: the State Ownership Fund owner of 70% of the stock, and the Private Ownership Fund, owner of 30% of the stock; this form of commercial companies represents the major part of the social capital in our economy;
- ✓ *commercial companies* owned by several shareholders: SOF, POFs, legal and natural persons, native and aliens; holding the bulk of the stock, the state, through its SOF representative, also holds a prominent position on the company managing team;
- ✓ *commercial companies* based on private capital (domestic or foreign);
- ✓ joint ventures, with state and private capital in diverse complementary proportions.



- **100% private capital commercial companies;** their number and importance in the Romanian economy is on the rise.

- **Private ownership commercial companies.**

The forms of the commercial (trading) companies currently operating in Romania are: the general partnership, sleeping partnership, sleeping partnership by shares, jointstock companies and limited liability companies. Among them, the joint-stock companies hold the bulk of the social capital and play a decisive role in the economic system, although a minority among the rest of the forms of commercial companies.

For objectivity reasons, the existence of other intermediate types of commercial companies in the Romanian economy should be mentioned, contributing their share to the general effort of discontinuing production decline, relinking investments and stimulation of economic development.

As far as profitability is concerned, its transient character, in some cases of state or private companies, results from a certain state of confusion, and from a deliberate disregard of the laws in force, as well. In many such cases, the managers run their companies to the detriment of the state property, seen as being both everybody's and nobody's property. In such instances of corrupted conduct, market mechanisms operate abnormally and no real market signals are offered in the absence of relevant competition.

Despite the imperfections and impediments of transition during the last four years of economic and social reform in Romania, a modest, but enduring process of **strengthening the competitive environment**, its core being liberalisation.

The different economic sectors operate with a different degree of competition. In agriculture and trade, sectors where the number of private entrepreneurs and companies is relatively high, competition is more and more forceful. In other branches, still dominated by the state ownership, with an insignificant number of private enterprises, the competitive climate is ineffectual, while monopolist action cannot be avoided. The current monopoly of state enterprises in the Romanian economy originates in the high concentration of capital in industry, that was only partially mitigated by the set up of corporations immediately after 1989.

The producer's monopolist control or dictatorship is frequently met with, in either sector; such phenomena ask for sound rules and regulations on competition. This is a perverse type of competition and it could be eradicated by the access of outside/external competition to the Romanian market and, from the inside, by an accelerated privatisation process, alone.

The multi-faceted, upstream and downstream interaction between state and private enterprises, based on a strong and long-lasting structural and technological foundation has imposed the acknowledgement of a complementarity among small-, medium- and large-sized enterprises and between the public and private sectors. Yet, the misunderstood **complementarity** and the juxtaposition of the private and state enterprises are not only counter-productive, but even damaging to the success of reform. The diminishing share of the state sector in a formerly highly centralised economy is far from being tantamount to the irresponsible annihilation of the state patrimony. As a matter of fact, and the

experience of developed market economies could substantiate this, the mixed ownership (state and private) with many companies proves to be an efficient cohabitation able to meet several economic and social needs, including that for an enhanced general climate that facilitates profit-generating private initiative.

The issue of complementarity, considered in terms of structural organisation, also arises between foreign direct investments, on the one hand, and state or private domestic partners, on the other hand. While the foreign partners convey technology, know-how, management expertise and hard currency (cash), the Romanians offer the needed infrastructure, machines, equipment, buildings and land. Generally, the cooperation between the Romanian and foreign capital is satisfactorily carried out. Which does not eliminate various types of corruption, such as the case of foreign companies trying to take illegal and unjustified advantage, by claiming unrealistic, overestimated values for their contribution to a joint venture.

The ownership rights structure between the SOF and POFs institutions, representing the state and private interests, respectively, in an economic unit is another cause of contention in the restructuring process. A permanent interaction between the two types of institutions with the view to reach a mutually beneficial agreement on privatisation and restructuring issues is the general layout, not unafflicted yet of transient states of conflict or contradiction, on issues pertaining to:

- ✓ as a major shareholder, SOF could rule in favour of decisions detrimental to POFs interests;
- ✓ SOF declines to agree with the privatisation of its most efficient companies, that actually represent a stable dividend resource; a position that significantly delays privatisation;
- ✓ while SOF-drawn dividends are spent with restructuring mostly state-owned enterprises, POFs-drawn dividends are indirectly connected with this important goal of reform;
- ✓ enterprise selection for privatisation also occasions differences of opinion and interests with SOF and POFs, and settling them takes a longer time than it normally should;
- ✓ there is a significant discrepancy between the securities real value and their price, as well as between the securities price on the official market and that on the black market.

Such institutional interrelationship issues and similar others occurring in the process of restructuring may and can be settled by improving both the existing regulations and institutional operation and management procedures.

A particular ownership structure issue concerns personnel participation in the privatisation process. Small-sized state-capital enterprises (up to 500 employees) could be sold, according to a **standard procedure** (a MEBO variant), to its own managers and employees, who may benefit from a series of facilities.

Special facilities are also offered to the staff of medium- and large sized enterprises to be privatised.

All the above calls for some other, different techniques of privatisation to be employed, making it possible for a strategic investor, with available capital for the further development of the company, to participate in the process.

#### **4.2. Enterprise Management and Organisational Structure**

During the transition period, the Romanian enterprise underwent cardinal mutations, i.e., the decision-making and responsibility centres have been shifted from the macroeconomic level, to the microeconomic, enterprise, level.

Public enterprises would hold the overwhelming percentage in the Romanian economy and are permanently challenged by the complex issues of the transition to the market system: restructuring, privatisation and a new technology in production; and the imperative of an increased economic activity efficiency.

Directly or indirectly pertaining to the organisational and managerial structures of the *regies autonomes* and commercial companies in the transition economy, the Romanian legislation in force offers the appropriate milieu for the manifestation of the free functional initiative and organisational flexibility within an enterprise. During this period, yet, law application and observance remains a partially unsettled problem, due to lack of experience, on the one hand, and to the insubstantial coherence and divergent interests at distinct organisational and managerial levels, on the other hand.

In Romania, the reform of state-capital enterprises has reached the time when the speed of the transition to the market economy depends on the performance and expertise of their managers, on the latter' material drive through salaries and a proportional profit share.

A recent study on management behaviour has revealed the reluctance of some managers towards the new practices and procedures characteristic of the market economy<sup>24</sup>. The main forms of the Romanian managers' resistance to the market economy transition involve inertia, dread of change and absence of commitment. Such reluctance is explained by their obsession with current positions, relations and material privileges.

To make transition less painful, a new managerial concept is needed, as well as a new type of organisational culture, in which the prevailing standard should be respect for one's performance.

##### ***Organisational Structure***

The reorganisation, in 1990, of the Romanian state enterprises in *regies autonomes* and commercial companies also envisaged the appearance of new organisational and managerial structures. There are many similarities in the organisation and management of a *regie autonome* and in those of a commercial company; the discrepancies arise from the specifics of their activity, from the different legislation applied and from the social and economic importance ascribed to a unit.

In the case of the **regies autonomes** the obligations and workload entailed by

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24 Catanu, Doina, Catanu, Alexander, Managerial Behaviour, (in Romanian), in *Economistul*, № 446/ April 132, 1994, p. 3.

organisation and management fall within the competence of the council of administration exclusively.

*The Council of Administration* of a regie autonome consists of 7 to 15 individuals, of which one is the executive manager or the general manager. The Council is designated by order of the related ministry or by decision of the local administration chief executive. One representative of each of the following institutions is a Council member: the Ministry of Finance, the Ministry of Industries, the Ministry of Commerce and the concerned ministry. The rest of the Council members are selected from the experts/ employees of the regie autonome. The Council conducts its activity according to its own internal rules and regulations and decides in all problems regarding the operation of the regie autonome except for those legally pertaining to other institutions.

Half of the members of the Council of Administration can be supplanted after two years' membership. The members are not allowed membership in more than two councils of administration; they may not be members of the commercial companies with which the concerned regie autonome deals or has conflicting interests; they retain the status of employees of the institution or unit they are employed by and associated rights and obligations; for their activity as Council members they receive an indemnity.

In the first month of the year, the Council of Administration submits to the pertaining ministry a report on the activity of the regie during the preceding year, accompanied by the program of activity for the current year; this is when inefficient members are also proposed to be discharged.

The day-to-day activity of the regie autonome is directed by a manager or a general manager appointed by the Council of Administration and endorsed by the concerned ministry. In the case of the **commercial stock companies** (the form taken by most reorganised state enterprises), the managerial responsibilities reside with the same Council of Administration.

Council members are appointed and discharged by the stockholders' general meeting, that is by the commissioned representatives of the State Ownership Fund and those of the Private Ownership Funds. The State is the sole stockholder of the commercial company for a period not longer than 4 years, as endorsed by the concerned ministry.

No individual is allowed to be simultaneously a member on more than three councils of administration in other commercial companies, except for the case when the appointee holds at least one fourth of the entire stock or is the administrator of the company having issued the respective stock.

For the decisions of the Council to be valid, the personal presence of at least half of the total number of stockholders at the general meeting is required, unless the charter stipulates a higher number. Decisions are voted for and reached based on the absolute majority of the present quorum.

The Council of Administration may delegate part of its prerogatives to a Board of Directors made up of appointed and remunerated administrators. The President of the Council is the general manager or the manager, position which entitles him/her to head the Board of Directors. The decisions of the Board of Directors are made with the absolute

majority of the voting quorum. At each meeting of the Council of Administration, the Board of Directors presents its registry of deliberations and informs on abatements detected while carrying out its supervising assignment.

**The Stockholders' General Meeting** represents the highest decision-making body in a commercial company. The SOF and POFs representatives conduct their activity based on the clauses stipulated in the representation contract.

In September 1993, an agreement was signed according to which SOF and POFs<sup>26</sup> function as proprietors of a concerned commercial company. Consequently, the SOF Council of Administration endorsed the representation contract according to which its envoys could be selected both from among its own employees and from among the experts from the Ministry of Industries and the Ministry of Finance, or other bodies. Currently, the project is being finalised to have the SOF and POFs representatives take over the prerogatives of the commercial companies' General Meeting. SOF and POFs representatives are expected to proceed as stockholders and proprietors and make all efforts towards an efficient management of the private and state capital involved.

**Within their structural framework**, public enterprise managements could create: factories, works, workshops, services, branches and suchlike, as demanded by the objective of their activity. The procedure of setting them up and their interrelations and with third parties are regulated by the charter elaborated by the Council of Administration and endorsed by the concerned bodies. Caused by misunderstanding democracy as an expression of rights alone, no obligations attached, a severe crisis of authority in terms of enterprise managers has occurred.

### ***The Managerial Crisis.***

The managerial crisis is evidenced by employees' distrust in their managers' competence and consequently, by the partial or total contempt of adopted decisions. It is perceptible in the disregard of many obligations stipulated by the labour legislation, in the deteriorated order and labour discipline, in the indifference to equipment and installation care taking, towards product quality, in the injudicious management of raw materials, power and fuel, in the decreasing production and labour efficiency, etc.

The managerial crisis is first of all due to the transfer of the state company titles over to the *regies autonomes* and commercial companies, as per Laws no. 15 and no. 31 /1990, without clearly specifying neither the settlement procedures of state liabilities nor the attributions and responsibilities assigned to the managers of the units this way privatised.

A second explanation is the ambiguous status of the unit executive officers in their relationships with the state-owner and the absence of the adequate incentives and control prerogatives reserved to the managers of a state-capital unit.

Under these circumstances, to satisfy their economic demands, the unions forced the

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<sup>26</sup> Law № 58/August 14, 1991, on the privatisation of the commercial companies, art. 39, item 1, stipulates: "The stockholders general meeting of the commercial companies consists of the representatives of the State Property Fund and those of the Private Property Funds" (in Romanian).

substitution of the general manager and other management staff. Under the pressure of the employee mass, valuable staff, was replaced by less competent and demanding managers, prone to compromise.

The new managers would rather avoid direct conflicts with their employees, and accept unjustified demands, or tolerate labour discipline be disregarded. Thus, inside fraud expanded, and so did illegal capital transfers to private companies where the newly appointed managers of the state-enterprise would be directly interested. No prompt chastisement or reparation for caused prejudice and damages took place.

The manager of a Romanian enterprise acts corresponding to certain general management principles, in an environment of opportunities and restrictions fundamentally different from those generally recognised in countries with a modern and relatively stable market system. Among the restrictions in industry, we could enumerate: untitled property; more often than not low-quality technologies; in contradiction with resources; absence of competition; relatively poor financial resources; low quality products. Among opportunities, we could count: high demand; good human and material resources; poorly paid labour force.

The managers of public enterprises find themselves in an extremely unfavourable position, subject to the pressure of divergent interest exerted by the state administration, political forces, unions, a.s.o.

A managerial reform, that appears as necessary and highly topical, would ensure a rigorous selection of managers, their competencies and precise prerogatives and responsibilities, an incentive system according to the managed enterprise efficiency. The elaboration and application of the Manager's Charter and of the Management Contract is highly needed.

### ***The Management Contract***

During transition, the Manager's Charter and the Manager's Contract are meant to confer the manager a double incentive: one side regards the professional security, which means that the manager could be promoted or discharged by the Council of Administration alone, decision that requires the owner's endorsement; the second incentive is of a material nature, since the managerial position presupposes a correspondingly high remuneration.

In Romania, the Law on the management contract has been adopted<sup>27</sup> as a step towards the improvement of the country's organisational and managerial structures. The law regulates the Romanian manager's abilities and responsibilities during the transition period. The law is applicable both to state- and private-capital enterprises and is designed to accelerate transition, and to maintain in position the most competent managers, at the same time.

The management contract is concluded for a maximum period of 4 years and stipulates: the names of the contracting parties, the object and duration of the contract, the

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27 Law № 66/August 7, 1993 on the Management Contract.

manager's rights and obligations, the rights and obligations of the owner-legal person, reference indices and performance criteria, special clauses, etc. The most intricate issues arisen from the application of this law are: the selection of professional managers; ascertaining the index level and the performance criteria.

Selection criteria should include: the candidate's decision-making abilities; his knowledge in international economic relations, as proven by taken tests; graduation of institutionally-organised managerial courses or expertise in enterprise management; experience in the elaboration of proposals concerning restructuring, relinking and privatising commercial companies, immediately applicable; professional higher-education. The reference indices, objectives and performance criteria, quantitative and qualitative, reflecting the main company results that the new manager plans and intends to achieve are determined based on the financial year foregoing to contract conclusion. The performance criteria are based on reference indices and their dimensions are negotiated by the two parties. During the entire duration of his mandate, the manager enjoys the following prerogatives: he conceives, initiates and applies the company's development strategy and policy; he may select, hire or dismiss personnel; he negotiates the collective and the individual labour contracts; represents the company. The manager receives a monthly remuneration and he also enjoys participation to profit distribution.

#### **4.3. Enterprise Size Structure**

Transition to the market economy also involves the issue of the relationship among small-, medium- and large-sized enterprises. For the last four years, diverse opinions occasioned by a series of debates have been expressed by the Romanian expert. Thus, the existence of a large number of in the advanced countries has led many Romanian decision factors and even economists to the false impression that it is such enterprises that make up the basis of the market economy, causing them to doubt the role of the large enterprise in Romania. It is not our intention to minimise the possibilities of the small- and medium-sized enterprises to adjust much easier to the demands of an everdiversifying market, or the fact that it attracts a large amount of qualified and even less qualified labour force; yet, they cannot raise to the level of a large-capital enterprise.

In Romania, the millions of low- and medium-income buyers take recourse to the mass production or large- and medium-series market; the small-series market is rather inaccessible to them. An increased number of small- and medium-sized enterprises is important in satisfying the general consumer demand for goods and services. The coexistence of small-, medium- and large-sized enterprises results from the necessity to answer the ever-diversifying demand and from the fact that some market segments are not attractive and inefficient enough for the large enterprise. There is a complementary relationship among the small-, large- and medium-sized enterprises and it is based on interdependence, cooperation, competition to the general and mutual advantage and development. There is no advanced country with exclusively small- and medium-sized enterprises; the large and very large enterprises represent the backbone of the modern market economy.

The concentration process is not a negative process in itself, but a modern economy adapted to the market dynamic demands presupposes the existence of a large number of small- and medium-sized enterprises.

From the totalitarian regime, Romania has inherited large-sized industrial and agricultural enterprises that failed to benefit from the "scale economies". The data indicate that large and very large enterprises would include 74.5% of the total number of industrial enterprises, 95.9% of the active population and 94% of the industrial production, while the small- and medium-sized enterprises would hold a relatively low quota.

The concentration process of the industrial production is also evidenced by the fact that national interest enterprises are the largest in size, followed by those of local interest and those in the cooperative industry. Small- and medium-sized enterprises are mainly concentrated by the local state industry and the cooperative industry.

**Table 1.**

*End-of-1989 Industry Structure by Number of Employees and Industrial Production (%)*

Enterprise size	Number of enterprises			Number of employees			Industrial production		
	Total	State	Coop.	Total	State	Coop.	Total	State	Coop.
Very large (over 500 employees)	6.8		9.7	32.9	37.4		33.8	35.4	
Large (between 510 and 5000 employees)	67.7	70.6	60.8	63.0	60.2	80.8	60.2	59.2	79.7
Medium (between 201 and 500 employees)	18.8	13.7	32.6	3.6	2.0	17.8	4.8	4.2	18.8
Small (up to 200 employees)	6.7	6.0	6.6	0.5	0.4	1.4	1.2	1.2	1.5
TOTAL	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

*Source:* Romania's Statistical Yearbook, 1990, p. 428.

Relatively large units also existed in the rest of the economic branches: constructions, commerce, services. After 1989, many large enterprises perceived as inefficient were divided and reorganised in commercial companies, the economic and technical benefits of the larger enterprise being neglected. Consequently, the number of managers increased considerably, and so did administrative expenditures and product and services prices. Currently, the complementary commercial companies started to merge based on a common background of process technologies or production factors.



**Table 2.***End-of-1992 Dynamics and Structure of Industrial Enterprise and Employees (%)*

Enterprise size	Number of Enterprises' 92/'89	Enterprise structure by number	Employee structure
Very large	48.6	2.4	32.3
Large	82.2	40.0	57.3
Medium	165.3	22.4	7.1
Small	729.0	35.2	3.3
Total	138.9	100.0	100.0

Source: Calculation based on Romania's Statistical Yearbook, 1990, p. 428 and Romania's Statistical Yearbook, 1993 p. 481.

Between 1989 and 1992, the total number of industrial enterprises grew by 38.9%. Yet, important structural mutations took place. Thus, while the number of very large and large enterprises decreased by 20.9%, that of the small- and medium-sized enterprises increased by 213.6%.

Unlike other countries in Central and Eastern Europe, in Romania, private initiative commenced with the Decision-Law no. 54 / February 1990, on the organisation and development of economic activities based on free initiative, the legal framework ensuring the emergence of private economic agents.

During 1991-1993, a substantial growth of the number of private commercial companies, family associations and private ownerships was recorded. The most significant growth was recorded in 1992. Their expansion has been supported directly or indirectly by the state to ensure their competitiveness on different market segments, at home or abroad. The state support rationale is the high potential of new job places and increased production in industry, construction, tourism, as well as the stimulation of R&D in the private sector, and it consists of a system of advantages and facilities<sup>28</sup>.

Although there has emerged a multitude of SMEs, due to the development of the private sector and corporatisation, the Romanian industry is dominated, by 75%, by large and medium-sized enterprises, in terms of social capital and number of employees. For example, in 1994, enterprises with over 300 employees represent about 90.4% of the total number of the active population employed in industry. In chemistry, metallurgy and some machine building branches, the concentration is higher, while in the textile industry, food and leather industries it is lower.

<sup>28</sup> Government Ordinance № 25/ AUGUST, 1993.

**Table 3.***Number and Dynamics of Private Small and Medium-Sized Enterprises. 1991 -1993.*

Form of organization	End of year			Dynamics(%)		
	1991	1992	1993	92/91	93/92	93/91
COMMERCIAL COMPANY	75917	199902	308795	263.3	154.5	406.7
FAMILY ASSOCIATION	53506	67385	73028	125.9	108.4	136.5
PRIVATE OWNERSHIP	101467	128921	142317	127.1	110.4	140.3
TOTAL	230880	396208	524140	171.6	132.3	227.0

SoMrce:Romania's Statistical Yearbook, 1990 - 1993.

In correlation with the SME stimulation, the government reform programme, through budget, hard currency and banking-financial policies, also promotes the restructuring of large and medium-sized enterprises, most of which are under-capitalised and subutilised in point of productive potential.

The size structure of state-enterprises in Romania is undergoing a permanent change, characterised by at least the following trends:

- ✓ increase of the number of SME, but its dynamics is decreasing;
- ✓ while the new SMEs are being set up, there takes also place the liquidation (bankruptcy) of the larger enterprises; numerically, the former process surpasses the latter;
- ✓ the size of the large enterprises is being permanently modified, a process imposed both by efficiency reasons and the necessity of adjustment to the market economy and introduction of the scientific and technologic progress.
- ✓ compared to similar sized-enterprises in advanced countries or to trans-national companies, the "large-sized" Romanian enterprises enter the category of "mediumsized" enterprises, being significantly outclassed by the former;
- ✓ a rehabilitation of the large enterprise efficiency and viability has been lately established, now that the decline of the Romanian economy has been stopped;
- ✓ scale economies (the technical economic optimum) are actually the result of the complementary small-, medium- and large-sized enterprises, in their interdependence in terms of cooperation, specialisation and competition.
- ✓ during transition, not exclusively though, the key trend of the enterprise size dynamics is given by the inherent development of an efficient small enterprise and its becoming a medium-sized and then a large-sized enterprise, based on its everimproving economic and technical performance.

In the first years of transition a lot of large enterprises have been broken into smaller units more or less according to individual wishes of the existing staff or other personnel to

occupy a high leadership position, neglecting the need of optimality from economic and technologic point of view. The split out of large economic units without having a meaningful foundation and justification had at least two negative consequences:

- ✓ rising in managers number and implicitly in bureaucracy procedures (more functions of managers, deputy managers, chief-accountants, etc.) with direct pressure on salaries, production costs then on prices and inflationary state of economy;
- ✓ breaking off the normal production, economic and technological links between the different sections and compartments of the former enterprise with negative impact on production planning and necessary achievements at micro-, mezzo- and macrolevels, from where losses, inefficiency and long lasting crisis phenomena, shortcoming and dysfunctions.

On the other hand, there were many cases for which the braking out of large enterprises into meaningful smaller autonomous units was and still is a precondition for the increase in efficient functioning and, more than this, for divestment and privatisation.

From the existing in Romania so far experience it resulted undoubtedly that divestments of petty assets is much easier and more operational than those of large enterprises where the degree of complexity is very high.

The relationship between necessary decentralisation of SOEs, safeguard of their 1 from economic and technological viewpoints size and concentration still remain an unsolved problem of the transition since driving market forces are not normally functioning clearly with ex-ante known rules of game as it is the case of mature market economies. In any case the adoption of an extreme solution, be exaggerated oversplit out, be hipercentralization further maintenance, from the very beginning are counterproductive and distorting.

A case by case approach inserted into a mezzo and macroeconomic environment seems to be the most reasonable solution which could successfully support the objective economic and social costs of transition and restructuring. In this context it shouldn't be forgotten the principal agent problem which is inherent in all organizations, maybe excepting the family-run firms where management and ownership coincide.

#### **4.4. Enterprise Structure in Terms of Financial Status (Liabilities, State Subsidies).**

At the moment, enterprise restructuring strategies are targeted on the financial disorder and payment blockage.

Between 1990 and 1993, the aggregate arrears of the Romanian industrial enterprises towards their creditors (suppliers and banks alike) reached an unprecedented extent. Most of the companies having started 1994 with a considerable bank loan portfolio failed to try and promptly reimburse their banks; consequently, the insolvency of such economic agents is being aggravated by an ever-rising interest rate.

Bank debts and inter-enterprise debts though grow at different paces, a fact partially explained by the fact that enterprises have not been able or willing to relinquish surplus assets, cut down on all costs, payroll included, develop marketing.

High interest rates, relatively low profits and increasing insolvency of some economic

agents have also contributed to the financial blockage *lato sensu*.

There are various estimations as to the size of delinquent amounts owed by the Romanian companies. In June, 1992, the gross arrears of state-capital economic agents amounted to Lei 1,266 billion (about 26.7% of GNP); in September, 1993, it went up to Lei 4,212 billion (34.4% of GNP). The main reasons of such a critical economic condition is the persistent economic crisis and the confused structural, organisational, legal and technical framework. An overall estimation in September, 1995 exceeds Lei 10,000 billion.

In the process of restructuring, slimming down or closing of a significant number of companies recording large losses and/or arrears, the Government, in cooperation with SOF, POFs and the Restructuring Agency, performs an important role by reinforcing the financial discipline and correcting resource allocation; it also develops the prerequisites to accelerate the transfer of ownership especially by the application of the Law on Management Contract.

Large state-owned enterprises, exerting a broad sectorial and social impact, carry the most substantial debts; they are too large to be adequately managed by private shareholders or by specially consecrated divisions of the commercial banks.

The Ministry of Finance and the National Bank of Romania have jointly declared the bankruptcy of some state-owned enterprises with outstanding arrears, while SOF started the liquidation procedures in other state-owned enterprises. 30 companies with sizeable arrears owed to various banks, have been "isolated" from the banking system and placed under the "surveillance" of experts from the Ministry of Finance, Ministry of Industries, National Bank of Romania and SOF. A special committee was assigned the task of identifying the amount of credit loans, state and SOF subsidies should be made available, based on restructuring programs designed for each enterprise separately.

In case that, subsequent to the application of devised measures, the concerned units fail to improve significantly, economically and financially, they are either winterised or recommended for liquidation. According to expert opinion in the case of six enterprises, liquidation was the only solution.

A number of 250 commercial companies and 50 *regies autonomes* account for about 30% of the arrears owed to bank and non-bank creditors and for about 50% of the net losses by the state-owned enterprises. In their case, SOF and the Restructuring Agency, in close cooperation with the Government, have started the process of amelioration of their economic and financial situation, management contracts having been resorted to.

To some extent, the financial resources used in restructuring insolvent enterprises would be supplied from external credits and state budget allocations. As a second restructuring fund, SOF expenditure funds - fed from dividends and privatisation proceeds - should not exceed 0.8 of GNP, in 1994; SOF is not intended to issue warranties. A limit of 0.5% of the GNP will also be set on warranties provided by the government on domestic bank loans made for restructuring inefficient enterprises. The restriction will also cover any assumption of enterprise bank debts, as adjustment relief procedures.

The Romanian *regies autonomes* that having not been set up as joint stock companies

and not envisaged to be privatised in the near future represent an important category of high liability economic agents. By Government Ordinance no. 15 /1993, regies autonomes have been restricted to their core activities.

Consequently, the actual strategic activities and assets of former regies autonomes have been transferred to independent commercial companies. Some 50 major regies autonomes have been put under the management control of the Ministry of Finance and other involved ministries and are required to submit efficiency-oriented financial plans. The drastic reduction of the number of regies autonomes - in March, 1994, there were 79 units of national interest - was accompanied by hard budget restrictions, while operating and capital costs were matched to enterprise revenues.

In 1994, the regies autonomes recorded heavy losses, closing to 65% of the total state sector losses, while receiving 98% of the overall state subsidies. In April, '94, the Government examined and diagnosed the activity of 59 regies autonomes in the fields of: industry, agriculture, food, transportation and communications, water, forestry and environmental protection. Accordingly, 34% of the regies of national interest were proved as having recorded profits in the previous year and no longer needed to be subsidised. Nevertheless, 4 regies autonomes, although profit-making, would still benefit from state subsidies. The most significant losses were recorded by regies autonomes in the primary industry.

In industry, the regies autonomes in lignite, copper, lead zinc and rare metals proved inefficient and losing for the entire period of 1991 - 1994; recorded losses were covered from state subsidies. With a view to ameliorating the economic efficiency of many regies autonomes, chiefly RAL, RAH, RACu, RAPbZn, a.s.o., the Government has taken certain emergency measures concerning the restructuring programme and the management contract.

The reorganisation and restructuring of the regies autonomes is focused on the following targets:

- ✓ a number of regies are to be changed into commercial companies or in other institutional or organisational bodies with the aim to be privatised;
- ✓ certain sectors in the regies autonomes activity are to be reorganised as commercial companies;
- ✓ in some case, the activities of the regies are envisaged to be extended (e.g., telecommunications, agriculture, environment protection, a.s.o.);
- ✓ rules and regulations concerning organisation and operation of various public sector activities are to be updated, while those on the legal status of public and private property are to be further expanded, those on natural monopolies included;
- ✓ the application of the methodological norms on management contract conclusion should be expedited;
- ✓ local regies autonomes are also to be restructured, some turned into commercial companies; their capitalisation is also another target.

To promote efficient enterprise management, a series of actions are also taken recourse to, such as rigorous penalties applied to enterprises failing to observe the

financial discipline. By **Law no. 76 /1992**, creditors are legally entitled to seize their debtors' assets to try and cover their debt. An amendment to the same law stipulates interest applied to arrears of major enterprises; similarly, tax-payment arrears are to be penalised. These interest rates were raised and rewritten as a percent margin over the NBR auction refinance rate by end-January, 1994.

Meanwhile, in the case of the creditor state-enterprises, that still sell yet fail to be reimbursed by their debtors (that would rather incur arrears), a substantial penalty is levied on the salaries of the enterprise managers.

At present, under the current commercial code, the interim creditors may initiate bankruptcy cases. As an inherent component of the legal framework designed to impose the financial discipline, the draft of the Law of Bankruptcy is expected to be passed in Parliament.

Another Government priority is the set-up of commercial courts, conceived to implement the bankruptcy legislation and simplify the creditor relief procedures under Law no.76 /1992. In 1994, the NBR is developing the proposal to encourage a commercial bills market to render inter-company credit transparent and more efficient.

The Ordinance 13/1995, in its first stage of application is trying to reduce the volume of arrears (more than Lei 1,000 billion) for 43 large SOEs, by different ways. In case of further arrears build-up, the financial penalties on aggregated arrears are to be increased.

A comparative analysis of the economic efficiency for the period during 1991-1994, reveals that the private companies' profit rate is higher (2-3 times) than that of the state-owned ones, although with numerous exceptions, from where it results that private property being more efficient and has more possibilities to pay its potential debts, and insolvency of many state-owned enterprises could be explained, inter alia, by the low rate of their revenue.

Relatively lower profits in the state sector, as compared to the private and mixed forms of property, proves the latter's better adjustment to the market system and their higher ability to build up capital, despite modest resources. Yet, mention must be made that private entrepreneurs enjoy a period of grace from the start up of their business and are tax exempt for that same period; so, their cash payments are much lower and the fiscal burden is moderate, if related to that on the state sector.

The degree of subcapitalization with the Romanian economic agents during transition is on the increase, which entails difficulties in relaunching the production. On the other hand, many investors are of the opinion that the market is not fair to them. They are reluctant to invest and companies find capital raising a more difficult task. Moreover, the Government is not able to use the adequate set of mechanisms that should enhance bank solvency.

**Table 4.***Profitability Rate in Romania by Forms of Property (%)*

	Years			
	1992	1993	1994	1995x
The whole national economy, of which:	4.5	4.4	4.7	5.6
State ownership	2.7	1.3	2.3	3.2
Private ownership	11.3	12.5	9.5	8.4
Mixed ownership	7.5	10.3	9.0	10.0
Cooperative ownership	2.2	2.9	4.0	4.8

x - data estimate

Source: Ministry of Finance

While state-owned enterprises undergo an increasing decapitalization process, despite negative effects of the financial obstruction, the private sector has managed to enhance its working capital funds.

Enterprise bank debts are much lower as against inter-enterprise arrears, which reveals a more judicious bank credit policy and high interest rates. As yet, the increasing indebtedness of the economic agents failed to be put a stop to. The financial obstructions involve more and more private sector units as well as profit-making state enterprises through the increasing number of inefficient enterprises and also as a consequence of insufficient bank capital.

It is not only the state enterprises that have reached insolvency, but a number of state-owned banks have also recorded large debts.

**Table 5.***Arrears by Form of Ownership (%)*

YEAR	STATE OWNERSHIP	MIXED OWNERSHIP	PRIVATE PROPERTY	OTHER FORMS
1992	82.7	2.5	13.1	1.5
1993	80.5	3.2	15.4	0.9

Source: Ministry of Finance

In 1993, the share of the state, mixed and private enterprises in the total amount of debts (bank loans and inter-enterprise debt), amounted to 55.8%, 6.6% and 35.7%, respectively. The high debt of the state-owned enterprises in Romania has been caused by their poor adjustment to the market system. Reluctant to cost cutbacks, they also opposed to the introduction of technological progress.

Solving the issue of bad debts, on the current background of financial and banking policy in Romania, could pursue a series of alternatives, the most feasible of which are: the partial write off of debts dating from prior to 1989; suppliers should suspend their services towards their debtors in arrears; bad debts should be segregated from bank portfolios and transferred over to institutions financed from the state-budget in well-justified cases only; debt rescheduling agreements should be drawn up; debt liquidation through a public tender, a.s.o.

High enterprise indebtedness and inflation are the most critical obstacles in the way of restructuring and privatisation. For an initial stage, during a coherent reform sequence, the prerequisites of macroeconomic stability consist of the substantial remission of these two contrary elements.

## **5. Case Studies of Romania**

### **5.1. Manufacturing — Mining and Oil Equipment**

#### **5.1.1. General features:**

The company E1 carries on its activity in the manufacturing subbranch of mining and oil equipment, being one of the main producer of reducers used in the Romanian industry.

Its activity is diversified and includes design, manufacturing and selling of:- reducers and motorized speed reducers with cylindrical, tapered and worm gears;- lift hoists; - pumps and electropumps for fluid handling;- actuators for industrial fittings;- hydrodynamic clutches;- special tools;- spare parts, castings and forgings;- technical assistance and service in Romania and abroad.

In 1993 the nominal capital of E1 was of lei 38 thousand million and the staff included over 2600 employees. As a result of the Government Decision Nr. 500/1994, the nominal capital increased several times and this fact involves now difficult problems for reorganization and amortization, particularly, for privatization by direct negotiation with cash payments.

The company is also shareholder at a private foreign trade company in Bucharest holding 3000 shares of 15 millions lei. This participation is specially explained by the interest of E1 to develop the economic relations, particularly export and import ones, with the go-between foreign trade company whose experience in the external economic relations is well-known. Until recently it held the monopoly of the exports and the imports related the mining and oil equipment as well as other industrial products from the manufacturing activity of the E 1.

Most of technical endowment of the enterprise was made between 1970 and 1980 when 67% of the total technological equipment was purchased mainly from abroad. At present E1 is characterized by:

- a. a high degree of physical wear and obsolescence of main machines and equipment;



- b. the need of a technological reorganization by renewal and upgrading of the equipment;
- c. the change of the methods and ways of amortization and renewal of the fixed assets.

The company performs now about 300 types of products classified in 11 groups, what signifies a relatively high degree of diversification and the strategic importance of E1 for development of several down-stream branches.

The main new products - assimilated or in process of assimilation in the present manufacturing - requested by home and foreign end users are:

lift hoists - new type, in keeping with the present international requirements;  
 special traction reducers for trams;  
 reducers for belt conveyers specifically to the mining field;  
 hydraulic clutches with variable charging.

The company serves mainly the investment processes in the mining and oil industry as well as in other industrial branches and, consequently, it depends on the market position of the investments in these branches.

Ever since its reorganization, E1 became the owner of the goods from its patrimony. That meant implicitly an enlargement of the decision-making autonomy and responsibility in its economic activity development.

### **5.1.2. Market of the company products**

The market of the products is characterized by:

- ✓ a larger opening on the home and foreign market and a stronger competition especially on the part of the foreign companies;
- ✓ a relatively low demand because of the investments recession but there is an improved perspective to market again in the last years;
- ✓ a demand of new technologies and production equipment in order to improve the ratio quality/price;
- ✓ a deficiency of available cost estimates as a result of the application of low prices for exports.

The company is concerned in the upgrading of the manufacturing equipment and technologies in order to be competitive, to keep the home and foreign markets and also to penetrate on new markets. Taking into account its present and future situation, the company focuses its whole strategy of reorganization and development on the priority investments to increase the quality and the competitiveness of its products.

At the same time, the company gives a special heed to the marketing-selling function in order to accomplish as good as possible the following:

- ✓ a close identification of market demand relative to size and structure;
- ✓ segmentation of the market, analysis of the offer on the part of the competition;
- ✓ participation at the selection and definition of products (design of new products and upgrading of the products which are already in the present manufacturing);
- ✓ setting the price and the terms of delivery;

- ✓ carrying out of some promotional policies of products in accordance with modern marketing requirements.

### Home market

In 1989, about 90% of the internal production of reducers was produced in 11 enterprises from the machine-building branch. E1 enterprise delivered a third from this production demand of reducers on the home market.

After 1989, the company extended its market segment, taking into account such a quality/price ratio that had to stand to the competition. On the home market, the company succeeded to improve its position delivering high quality products at prices comparable to competitors' product prices.

Between 1993 - 1994, the main market segments for the said company are listed in table 1, page 5.

Concerning the participation obtained by E1 company on the home market it can be seen its important position specially on the mining, energetic and oil equipment market which is still entirely state-owned property and this fact acts on the operation of the market mechanisms. But, its lower position can be noted on the equipment market for chemical, petrochemical, electrochemical and food industry where, hereafter, the company will try to develop its penetration power, due to a diversified request in these branches.

For mining and energetic equipment E1 has a quasi-monopoly position and can successfully face so far the competition from other producers. In the future the demand for the main E1 products will exceed the offer, a part of this demand being sustained by the state orders.

**Table 1**

Field	Participation of E1 company at the total volume of respective production (100%) in Romania
Mining industry	41.0
Energetic sector	11.8
Oil sector	8.1
Chemical and petrochemical industry	5.4
Electrotechnical industry	6.1
Food industry	4.0

*Source:* First evidence information of the enterprise

### Foreign market

Until 1989, the company exported only to the CMEA market. Since 1990, the company has tried to develop the few former connections with partners from West-European countries, and so it has succeeded to penetrate on the market of more countries exporting small amounts.

The company intend to increase its export from a mean value of under 10% between 1991-1993, at 16% between 1996-1995, estimating an annual average amount of two percentage points concerning the participation in the total turnover, so that this participation could reach about 22% in 1998.

This trend related to the reorganization of the export production emphasizes the efforts of the company to increase its specialization degree and consequently to decrease the diversification.

Thus, next years, according to the estimations, the reducers on demand, the standard-type reducers and motorized speed reducers, the screwed mechanisms and pumps will have an increasing participation.

The commercial relations established for some years with partners from France, Germany, Israel, South Africa has already been traditionally. The export rise is directly connected to the increase of the product quality and technical level and also to the conformity with the international standard ISO 9001, referring to the quality system.

The company is concerned with the implementation of the respective quality system because this assures:

- ✓ consistency of the action;
- ✓ strictness and discipline;
- ✓ emphasis of the prevention factor in reaching the quality;
- ✓ consolidation of responsibilities in the quality field;
- ✓ setting of communication channels and interfaces among compartments;
- ✓ opportunity of re-analysis of the existing jobs and establishment of the evaluation criteria for the quality control staff.

Applying this system, the company tries to avoid the bureaucracy, redundant loops included, and also to assume clearly its responsibility.

The quality improvement within the enterprise is a permanent process that implies the participation of all managerial levels - functional and executive ones.

### **5.1.3. Economic - Financial status**

The analysis of the development of some factors concerning the activity of the company between 1989 - 1994, points out that its production followed generally the same trends as the whole industry. In 1990, 1991, 1992, the production lowered, so that in 1993 the production evaluated in comparable prices reached 55% of the production of 1989. At the end of 1994 the production didn't exceed 60% of that obtained in 1989.

In 1994, the productivity of labour calculated in comparable values per employee was estimated at about 95% of the achievements of 1989. A sharp decline of the volume of production was determined by the following:

- a. cutting down of demand of equipment for investments because of the production lowering in the mining, energetic, oil and chemical sectors;
- b. loss of CMEA market;
- c. difficulties concerning supply of power, raw materials, other materials and semiproducts;

- d. outcomes of the financial tie up and undercapitalization of the enterprise;
- e. cut of the effective working time.

The data for 1994, as compared to the achievements of 1993, points out the following important aspects:

- ✓ 11% reduction of employed staff;
- ✓ 1.2% increase of financial incomes;
- ✓ reduction of the share of material expenses from 65,1% to 58,9% in the total volume of the costs;
- ✓ holding of 32% of staff expenses;
- ✓ 54,9% increase of gross profit;
- ✓ 2,6% decrease of own financial sources;
- ✓ 20,1% increase of external financial resources;
- ✓ renunciation at bank credits;
- ✓ 32,2% increase of claims, debts reduction by 13% and arrears decrease by 16,5%;
- ✓ decrease of the rate of profit from 8,77% to 6,51% (calculated as a ratio of gross profit and turnover);
- ✓ rise of the financial autonomy index from 2,7% to 11,33% (calculated as a ratio of own capital and debts).

On the whole, it can be seen an improvement of the economic-financial status of the company in 1994 as compared to the last year. Although, the economic-financial results of E1 company indicate a favourable tendency for the last two years, except the rate of profit, the machines and equipment, as a result of their physical wear and economic depreciation, will not meet the market requirements and international standards for a longer. As for instance, from the equipment having a decisive part on the manufactured product quality, 72% are 11-20 years age and only 24% are 0-10 years old. In this group there are the following: gear cutting machines, lapping grinding machines for bevel and cylindrical gears cutting, housing machining equipment (drilling machines, machining centers, specialized aggregates), heat treatment equipment.

To meet the increasing technical and quality level requested on the market, it is necessary to upgrade the main base machines and equipment and also to endow the enterprise with new machines (specially for new products). This is in fact the key issue of restructuring process, irrespective the form of property. All other forms of restructuring (financial, managerial, functional, etc.) in the opinion of specialists, have to be subordinated to the technological one which could guarantee the greatest potential of rehabilitation and profit increase in the long term. Of course, between different types of restructuring there are close links, interferences and time scheduling combination. However it has been pointed out that the financial, organizational and management restructuring could have only a limited short term effect without inducing the necessary technological change.

The upgrading of the product ranges is carried out in accordance with the fabrication structure that represents the demands of the internal and external beneficiaries. In this respect, during 1994, more products were redesigned (ranges of worm reducers

and motorized speed reducers).

Finally, it has positively been appreciated that E1 is and could be profitable and viable especially by reorganization, despite its present economic-financial difficulties. A condition sine-qua-non of rehabilitation of the production volume, in the future, is the carrying out of a comprehensive reorganization process specially both in the quality manufacturing technologies field and financial and management reorganization. If the organizational restructuring doesn't involve some important funds, the technological one needs a high volume of financial means that the enterprise can only in part get from its own sources.

#### **5.1.4. Reorganization of the company activity**

The reorganization of the company represents an extensive process, specially a technological one, implying a lot of causes and effects. It is characterized by a gradual change of the present structures, in accordance with the dynamics of the market requirements, the availability and turnover of the factors of production.

For the next years, the company proposes an ambitious and broad program concerning an organizational and technological restructuring taking into consideration the following :

- ✓ the company is the main producer of mechanical transmissions on the home market supplying a wide range of actuators (lift hoists, screwed pumps, hydraulic clutches of 1.4 and 72.2 MW), ones of them exclusively produced and at lower prices than the foreign suppliers' prices;
- ✓ the internal competition can't cover the demand of traditional customers of the company neither as assortment nor as technical-technological requests;
- ✓ the existent technical endowment allows to carry out other kinds of mechanical transmissions, too;
- ✓ the company disposes of wide-experienced and high qualified personnel;
- ✓ good enough economic - financial results.

The organizational restructuring of the company activity includes the following corrective actions:

- ✓ reorganization of the informational system;
- ✓ reorganization of the commercial and technological activity;
- ✓ conformity of the quality system with ISO 9001 requirements;
- ✓ extension of the individual competencies and responsibilities;
- ✓ a better correlation between salaries and productivity of labour and between personal achievements and incomes;
- ✓ improvement of the financial management of the company.

In order to accomplish a good reorganization it is very important to work out and apply the reorganization program both to the whole company and to every organizational component.

Consequently, the company adopted the following organizational actions:

- a) creation of a co-ordinating board for the company restructuring including directors

and other managerial function staff which has to:

- ✓ choose the strategies and trends of restructuring;
  - ✓ assure the coherence between the reorganization objects and the assigned resources and the actions of reorganization;
  - ✓ approve the agreed reorganization programs;
  - ✓ allocate the necessary resources;
  - ✓ supervise the carrying out of the reorganization program;
- a. appointment of the person responsible for the reorganization program for every section, sector, department;
  - b. constitution of some complex teams which have to study the concrete problems, to find out the best solutions, to follow and report the carrying out of the reorganization actions. The selection of the members of every team was rigorously made because they had to meet the requirements of theoretical and practical knowledge necessary to solve the reorganization problems. In this way, people's mentality can be easily changed and a reciprocal training of the participants as well as a better thinking in finding the pragmatic and concrete ideas will contribute to rise the company performances.

The increase of the labour productivity supposed not only the improvement of manufacturing technologies but also the approval of some measures concerning: personnel redimensioning, growth of the professional qualification level, a better stimulation according to the work results, etc. In this respect, within the company, the personnel was reduced, staffing being only exceptionally, and the labour requalification was emphasized.

The management contract applied since 1994 allows and entails the decentralization of some decisions at the level of the operational responsibilities. The decentralization assures also a direct connection between some functions and activities of the company, and gives the necessary information to the persons interested by the putting into practice of the reorganization actions.

Concerning the financial reorganization of E1 company, the actions referes to:

- ✓ recapitalization of the company;
- ✓ cutting of manufacturing costs;
- ✓ decrease of need of working capital by reducing the credits and stocks of raw materials, other materials and finished goods as well as by reducing the manufacturing cycle;
- ✓ faster amortization of the fixed capital in accordance with the dynamics of the technological progress;
- ✓ growth of the share of the reinvested profit for the company development.

The use of long and medium term credits for recapitalization was difficult and even obstructed by the practise of some extremely high interests (over 100%, in 1993 and over 40% at present). This fact generated much losses by increasing the costs and consequently by reducing the rate of profit.

The degree of E1 indebtedness in the last period decreased, although it is still

involved in the burden of interenterprises credits and arrears.

The company tries to diversify its capacity of financial reorganization by sharing participations in the nominal capital of other companies in order to obtain dividends and at the same time to improve the economic and production links with up-stream and down-stream enterprises. The technological reorganization of E1 company is the main factor to increase its profitability without minimizing or neglecting other types which, practically, are a complementary support for this kind of reorganization. This case study points out that the technological reorganization involves and offers to the company a wider opening to the foreign market, both for buying of equipment and technologies and for products delivery of products to export and consequently in this way, the company is pressed to penetrate in an important environment of the competition market.

The economic-financial implications of the technological reorganization of the E1 company act favourably on the home market too, especially on some economic agents carrying on their activity in very important sectors of the national economy, such as mining and oil sectors - providing machines and equipment of high performance with favourable effect conducted in upstream and downstream. Unlike the type reorganization of other state-owned enterprises, in this case the financial resources are exclusively spent for investment purposes such as: one third from own sources of the company and two third from other sources. It can be seen the possibility to increase the importance of the own sources of reorganization. The external contingency concerning the technological reorganization by imports and exports of goods and services contributes advantageously also at the facility of integration of the company in the structures of the world and European economy. Between 1994-2000, the technological reorganization of E1 company forecasts two major directions:

- a. endowment by new equipment for those procedures imposed by the new and upgraded product group involved in the manufacturing program;
- b. upgrading of some equipment to bring back them at the initial technical parameters or, at least, close to these parameters in order to increase the product quality and the productivity of labour.

According to the estimates accomplished in the speciality studies, the cost of the technological reorganization would be of 35,5% of the company nominal capital. The technological restructuring program is carried on over a period of 5 years which couldn't be possible and compatible with a so-called "short term restructuring" because the restructuring process is related to medium and long time span. The needs of an external financial upholding was of about 3 thousand millions, only for 1994, as, for the next years, the company will have its own resources for supporting the whole program.

For the next years, the viability of the technological reorganization program is based on an estimated growth of profit of about 2.3 times (see table 2) and this fact will allow to increase the development capacity of the enterprise. The company foresees an increase of the incomes of 74.4% in 1998 as compared to 1994, while the expenses raise by 64.5%. This evolution involves a faster increase of the gross profit. But, the rate of profit is kept at the same level for 1995 to 1998.

**Table 2.**

*Forecasting evolution of the financial status between 1994-1998*  
*1994 = 100*

Factor	1995	1996	1997	1998
Incomes	116.6	133.3	151.1	174.4
Costs	110.0	128.8	144.2	164.5
Gross profit	156.0	159.6	191.8	233.3
Rate of profit	25.0	21.8	23.4	25.0

According to the program in 1994, the restructuring required funds of lei 2.8 thousand million, 32% from the own sources of the enterprise and 68% from the State Ownership Fund<sup>29</sup>. The financial implication of the enterprise funds for reorganization is important (about 1/3) and this offers guaranties for the recovery of the rest of 2/3 granted by the State Ownership Fund.

The financial supporting granted by the State Ownership Fund together with the own effort could be improved by bank loans and external loans from foreign partners or financial institutions.

For a better understanding of the characteristics of the technological reorganization above mentioned, two concrete examples concerning the opportunity of the reorganization of the cast-iron foundry and reducers manufacture are presented.

The reorganization of the cast-iron foundry is intended to manufacture products requested for export, such as semiproducts for housing and small castings included in screwed pumps, reducers, motorized speed reducers, electric and manual actuating mechanisms.

The restructuring program includes:

- ✓ endowment by import equipment, such as the air flow forming line, the induction melting systems, the automatic mixing installations.
- ✓ endowment by home equipment and self-endowment referring to the forming line.

Essentially, the economic effects result in the increase of the capacity at 1000t/year, creation of 78 new jobs, improvement of the technical parameters (dimensional precision, accurate composition, etc.), waste cutting, doubling of export value. The recovery time of the whole investment from savings and profits is 4 years and 6 months.

The restructuring of the reducer manufacture is intended to improve the technical and quality level of the reducers and especially of the mining ones which hold about 45% of the rate of turnover of the company over the period 1994-1998.

The restructuring program involves the buying of the curved bevel-gear tooth

<sup>29</sup> The State Ownership Fund, on the basis of some criteria and principles agreed with other institutions involved in restructuring, grants funds for the technological and/or financial reorganization of the trading companies with majority state-owned capital. In the main, these funds are recovered from the dividends of the company that received funds for reorganization.



grinding machine and the upgrading of some equipment by Romanian machine-tool companies including the import of display commands too. The economic effects result in the quality rise of the manufactured products, as well as in the increase of turnover, labour productivity and profit.

According to the evaluation of the management staff, the main factor involved in carrying out the restructuring program is the personnel's change of mentality at every organizational level.

In this respect, a series of actions were taken, such as:

- ✓ implication of personnel in preparing and carrying on the reorganization measures;
- ✓ improvement of general climate and challenge to an internal co-operation and communication;
- ✓ training of the employees and making them aware of their charges and responsibilities;
- ✓ matching the reorganization objectives to the allocated resources, the actions to be taken and the criteria of individual and team evaluation;
- ✓ improving of working conditions;

The personnel is periodically informed by the management staff about the appeared difficulties and the taken measures and also what it is demanded from him. The permanent communication between management staff and employees diminished the possible misunderstandings and developed a mutual trust. The increasing trust of the employees in the management staff was an essential factor, absolutely necessary for any reorganization step.

Consequently, two main kinds of communication were adopted:

- ✓ a vertical communication system - from top to bottom - the personnel is informed about the company objectives and the reorganization process steps, and - from bottom to top - by which the personnel shows his needs and aspirations.
- ✓ an horizontal communication system by a written settlement of the relations among compartments and by the application of a participation system of collaboration in order to make decisions.

Further, as far as the company profitability increases, the reorganization process, already started within its technological, financial and organizational components, will also include its "privatization" component that needs procedures and techniques specifically to the large enterprises, in accordance with the legislative body in force. For the moment, the strategy of the restructuring was adopted before the privatization of the company counting on the increase of interest for it of the Romanian and foreign potential strategic investors.

The lessons from this case-study for the process of restructuring are:  
in the firm:

- ✓ increasing motivation and possibility of rehabilitation and technological restructuring based on a combination of funding from E1 own resources and from State Ownership Fund;
- ✓ raw materials and energy inputs can be obtained especially in the conditions in which

- ✓ severe measures of material costs reduction have been undertaken;
- ✓ the reducing of overstaffed personnel has been induced by the underutilization of the production capacities and simultaneous effectiveness of supportive relationship;
- ✓ the management contract fostered the economic efficiency of the whole activity and gave a realistic basis for restructuring programs, sharing the responsibility with lower levels of organization patterns.
- ✓ in the industry of mining and oil equipment:
- ✓ deepening of specialization with a modest tendency of production diversification in order to meet the market demand;
- ✓ a good restructuring in E1 could be influential for investment relaunching process especially in oil industry;
- ✓ the increasing domestic and foreign competition is imposing growing needs and realistic measures for restructuring;
- ✓ in the Romanian economy:

E1 restructuring is inducing up-stream and down-stream favourable effects at least for the reduced needs in raw materials and energy inputs, and for better supplies with high quality mining and oil equipment having a strategic importance for Romanian economy;

E1 had to be first restructured, its privatization in the future is a problem which could be solved under the existence of a strategic buyer (domestic or foreign), the mass privatization procedure being inadequate for a healthy technological restructuring given the lack of needed capital in the case of small investors;

- ✓ for a period of time the restructuring of E1 has to be supported partly by the State, taking into account the considerable dimension of restructuring fund as well as the significance of the E1 products for the national economy;
- ✓ restructuring is hampered by the growing indebtedness and arrears of the other enterprises, by the high inflation as well as by lack of association between the goals or objectives of individuals and those of organizations.

## **5.2. Manufacturing - Buses, Trolleys and Special Vehicles**

### **5.2.1. General presentation**

E2 commercial company is one of the most important producers of buses, trolleys and special vehicles in Romania. The company has a majority state-owned capital and is of high importance for the national economy.

In 1994 E2 had a nominal capital of over lei 80 milliard lei and approx. 4200 employees, being among those companies requiring large investments especially in order to update products technical and economic performances.

#### **Scope of activity**

E2 is specializing in design, manufacturing, selling and service for the following product groups:

- ✓ city and inter-city buses;
- ✓ trolleys;
- ✓ special vehicles for cargo and passenger transport.

The company activity analyses showed the following aspects:

- ✓ the company products that several years ago were competitive as compared to similar international products, are lacking behind now, especially as far as motorization is concerned that does no longer correspond to ECE-UNO in point of environmental pollution regulations, noise level and passenger comfort.
- ✓ the significant decrease of production and export during the last years because of lower competitiveness of products; substantial import of buses and special vehicles; E2 main customers (such as Transport Administration, local administration) lack funds for investment; advanced wear of equipment, lowering the competitiveness of products, as a result of quality level decrease and cost increase.

nevertheless the company had an yearly profit.

The analyses of the company activity showed also that there are some favourable conditions for the future activity of the company, such as:

- ✓ skilled labour;
- ✓ a tradition of manufacturing the specific products (such as buses, trolleys, special vehicles) that should be maintained by upgrading of already existing products and customizing new ones;
- ✓ business relations with traditional customers and the possibility to establish further relations with home and foreign customers.

Products competitiveness on the market can be substantially increased by starting a reorganization program, mainly technological reorganization, as well as management and financial reorganization.

### **5.2.2. The market**

At present E2 products percentage of the national transport- means park is of 90% for buses, 100% for trolleys, 60% for smaller cargo transport (light trucks, delivery cars, isotherm trucks).

It is estimated an increase of the bus demand so that in 1999-2000 the demand will be significantly higher.

This conclusions are based on the following assumptions:

- ✓ the need to replace the already existing park because of 100% physical wear and failure to meet the requirements of ECE-UNO regulations;
- ✓ local budgets are established from local administration resources;
- ✓ the need to develop civil transport which is more efficient than the individual transport from several points of view.

Moreover, the introduction of environmentally friendly electric transport in several cities will lead to a significant increase in trolley sales beginning with 1995.

The market of special vehicles is being extended as a result especially of private sector development mainly small and medium enterprises, as well as due to significant extension of smaller cargo transport traffic. The increase of the special vehicles demand is due to the extension of the range of economic agents and of service demand in relatively short distance transport.

At present the company is the only home producer of buses and trolleys. In the future several competitors may appear in the country but, since large investments are required, this will not be possible unless it is supported by large foreign capital.

It can be concluded that the company has a monopoly at present and also for the next years irrespective of its ownership form. This can be either controlled or counterbalanced by:

- a) antitrust legal regulations;
- b) encouragement of new producers on the home market.

In smaller cargo transport, E2 in Romania has two most conspicuous competitors. Since have distinct features the products of these competitors, it is estimated that in the future also E2 will cover at least 50% of this market segment, occupying a further monopoly position.

Between 1990 and 1993 the competition on the bus and special vehicles market segment was generated by large imports of second-hand products. It is estimated that this type of competition is decreasing because of the following:

- ✓ increase of custom duties;
- ✓ low reliability of such products;
- ✓ high prices of spare parts;
- ✓ high prices of firsthand products;
- ✓ a more trusting attitude toward home products.

### **Foreign market**

At present the foreign market is dominated by famous companies in car transport facilities. A decrease of demand is registered on this market thus making the struggle very tough to keep various market segments and even tougher the penetration on new markets.

During the last years, the company has partially lost the market represented by the former CMEA countries. Only a small market segment could be maintained and the company succeeded to penetrate with buses and special vehicles on the South American market. Now the products offered by competing companies on the foreign market have a higher quality level but 1.5-6 times higher prices than similar home products.

The company can offer products with relatively similar quality level as those of foreign products at 1.5-2 times lower prices by financial support and cooperation with foreign companies. This could represent an important advantage especially for certain categories of foreign customers.

In the near future the most accessible foreign market for this type of Romanian products seems to be that of South-American countries. The company also tries to study and recover the traditional market of Eastern Europe countries.

### **5.2.3. Economic and financial characteristics of the company**

The analysis of the main economic and financial indicators of the company for 1993 as compared to the results for 1994 shows the following:

- ✓ 4.6 times nominal capital increase due to revaluation of fixed assets;
- ✓ 10.4% personnel reduction and significant labour productivity increase in real terms (more than 7%);
- ✓ 95.4% increase of total incomes and 105.1% increase of total expenses;
- ✓ 68% to 72% increase of material expenses and 31.9% to 27.1% reduction of expenses for personnel;
- ✓ 41.2% gross profit increase;
- ✓ 3.1% outstanding-debt reduction, 5.2% debt reduction and 8.7% reduction of backlog payment.

The financial autonomy index (calculated as the ratio of owned capital and debts) increased from 0.86 to 3.4 which means an encouraging start of debt reduction.

As a result of rapid increase of expenses as compared to incomes, the rate of profit (calculated as the ratio of the gross profit and the turnover) decreased from 9.8% in 1993 to 7.5% in 1994.

Significant changes took place also in the structure of financial resources for worked capital that are still insufficient for a normal development of production activities especially if the product manufacturing cycle were taken into account.

**Table 1.**

*Changes in the structure of working capital*

	1993	1994
Total working capital	100.0	100.0
of which:		
- company owned funds	23.5	32.5
- external sources	61.6	42.7
- bank credits	14.9	24.8

Source of information: the calculations were made on the bases of data included in the company accounting records

As it is shown in Table 1, in 1994 as compared to 1993 the following important changes took place in the structure of working capital:

9 percentage points increase of the amount of company own funds as a result of restarting the activity and profits investing;

18.9 percentage points reduction of external resources leading to a significant increase of payment capacity and financial solvency;

9.8 percentage points increase of financial resources coming from commercial bank credits that can be explained mainly as being the result on the one hand of the reduction of banks interest rates, that still remain very high and, on the other of capital being needed for continuing the activity.

Nevertheless, it can be seen that the external resources represent the largest share of the total needed working capital.

At present, illiquidities, because of financial tie up result in disfunctioning of technical and material supply.

The objectives of financial recovery and industrial rehabilitation of the company are as follows:

- ✓ the capitalization of the company;
- ✓ changing mentality at executive and operational levels;
- ✓ decentralization of management and creation of several profit nuclei (improving professional bureaucracy and training prospective managers);
- ✓ improvement of technical performances;
- ✓ higher level of product and service quality etc.

Financial relieve and better subassemblies supply will help to make a better use of production capacities, thus narrowing the gap between offer and demand.

The production and selling programme of the company for 1995-2000 forecasts a sales increase of 59% for buses, 108% for trolleys and 56% for special vehicles and it is conditioned by quality and reliability increase and aesthetic parameters improvement which can be achieved by an adequate retechnologization of the company. Given the critical situation of E2 so far, in our opinion the forecasts are overoptimistic even under the circumstances of a strategic investor involvement.

#### **5.2.4. Company reorganization**

The reorganization of the company is carried on in the framework of the restructuring process taking place in the manufacturing industry of cargo and passenger transport vehicles.

The company has export possibilities and a study of home and foreign market between 1994-1997 shows the economic efficiency of the modernization process carried out in several stages.

The company is one of large trading companies with majority state-owned capital whose reorganization program should be achieved by its own forces under the control of the Agency for Restructuring and of the State Ownership Fund with the support of several research and design institutes and consulting companies.

The progressive restructuring is vital for the company. It aims at reviving various production of the company and attaining the profit level required by the market economy.

The restructuring, the revival and efficiency increase process of the company have a complex and lasting character.

The restructuring program aims at making efficient the company activities, diminishing losses and backlog payments (arrears), efficient use of existing endowment, encouraging privatization.

The main reason of the company reorganization is the increase of product quality level by working towards a longer life span and better commercial look of products in order to raise their competitiveness on the home and foreign markets.

The restructuring program is based on the purchase of mainly technologic equipment and installations, as well as informatics equipment from domestic and foreign markets. The import of equipment seems to be preferred and at hand for the company because a part of the foreign currency has become available lately. Nevertheless, a tendency towards purchasing also home technologies and equipment was registered as a result of their parameters improvement and/or relatively lower prices.

This programme strategy aims at:

- ✓ rapid revival of technical and technological capacities of the company in order to cope with the requirements of the market economy and competition;
- ✓ production increase by narrowing the manufacturing range of products while adding new higher quality types and customizing new product types in order to extend its sales position on the home and foreign markets.

From the economic point of view, the company focuses first on obtaining a larger profit from existing resources and attracting external resources under the conditions of financial strengthening of the company, secondly, the significant reduction of material consumption and labour, and thirdly, building up the corresponding image for clients and maintaining credibility in all home and foreign relations.

Technological restructuring programme implies the following concrete aspects:

- ✓ the purchase of an informatics system for integrated management and control of production and equipment;
- ✓ to ensure CAD endowment;
- ✓ surface preparation equipment for chassis, bus and trolley bodies;
- ✓ to replace the painting system in order to improve painting quality and corrosion resistance by purchasing high quality materials and high performance equipment;
- ✓ to bring the equipment in the metal plating shop to nominal parameters;
- ✓ to ensure test stands and equipment;
- ✓ to endow with new equipment the primary sections (pressing and machining);
- ✓ to endow the shops with modern equipment for thick and thin metal sheet cutting;
- ✓ to replace highly worn welding equipment with new ones with high performances for improving the quality of welded assemblies of chassis and bodies;
- ✓ to purchase specific apparatus for checking up the compliance to the new regulations regarding the environmental pollution by buses and special vehicles;
- ✓ to improve sound proofing technologies of car bodies in order to reduce noise level in compliance with European norms.

The investments necessary between 1995 and 2000 represent 25% of the nominal capital of the company and are intended for essential improvement of manufacturing and result in cost efficiency increase and environmental pollution reduction. The investments will result in the increase of the company production demand and new jobs creation in cooperating enterprises.

In the first stage of restructuring (4th term of 1994 - 1st semester of 1995) the investments represent over lei 2.4 milliard of which 25.5% are from the company sources and the rest of 74.5% are received from the State Ownership Fund.

The restructuring funds are offered by the State Ownership Fund (SOF) according to the importance of the enterprise, its contribution to export, its capacity to generate technologic progress and profitability, its adaptability to market demands.

The funds received from SOF will be recovered from the supplementary dividends to be obtained by the company between 1995 and 2000 as a result of the restructuring measures.

**Table 2.**

*Economic and financial results estimated between 1994 and 2000*  
1994 = 100%

Factors	1995	1996	1997	1998	1999	2000
Total incomes	110.9	131.9	155.1	172.4	183.4	187.1
Gross profit	136.6	160.0	186.6	210.0	223.3	226.6
Dividends owed to the State						
Ownership Fund	139.0	160.9	190.2	212.2	226.8	231.7

The use restructuring funds received from SOF is controlled regularly. Their reimbursements is a condition in the management contract. The manager indirectly interested in obtaining good results in running E2 activity because a part of his dividends can be transformed into shares in the respective company. So the efficiency commitments for the next four years are becoming not only incentives but in a way compulsory for the E2 manager or managerial team interested in maintaining their functions.

The improved cash flow and profitability of E2 will lead to a greater attractiveness of the company in the framework of the privatization process.

Starting from the conclusions in the analyses of information on similar products made by competing companies and data on sales forecast for the next years, the company has established the strategy for product developing between 1995 - 2000.

For the time being, E2 could cope with the encountered difficulties related to undercapitalization, lack of external demand and low profitability.

**Buses**

Aiming at the revival of high performance buses manufacturing the 1995 production programme includes the production of the city buses with air suspension and carriage, thus meeting the customers demands of bus specific features required by road conditions. One other city bus is intended for the next stage with the engine placed in a rear console



improve and lowered floor. The front axis is rigid and has air suspension by removing the carriage.

Tourist and inter-city buses shall to be equipped with engines homologated according to EURO norms in order to meet the regulations of ECE-UNO norms regarding pollution and noise, and endowed with all the modern conveniences for passengers.

### **Trolleys**

This product group represents the key objective of the company development strategy-

There are several reasons in support of this product importance:

- ✓ the trolley is an ecological product now, when environmental protection problems are largely focused on;
- ✓ the company has a wide experience in design and manufacturing trolleys, and there are only a few foreign competing companies;
- ✓ Several trolley types will be produced during the next years, such as:
- ✓ jointed trolleys actuated by either classical step-by-step start resistance or logiccontrol block and transport capacity of about 150 passengers;
- ✓ single trolleys actuated either by logic-control block or thyristor direct tension variator. This type of actuation ensures 30% power consumption reduction (under crowded traffic conditions) by reduction to a minimum of losses to a minimum by sparking and power recovery at electrical breaking.

### **Special vehicles**

The following variants of a new type of special vehicle will be produced: with simple and double drive for 3 to 5 tones and 4 to 5 tones total mass. The tare coefficient (useful mass/own mass) will increase from 0.6 to 0.8-1.0; the specific is being 20 to 25 HP/tones; it has increased reliability of safety systems, brakes, steering, engine, transmission, installations, higher comfort for driver and passengers, meeting ECE-UNO regulations for noise and pollution gas emission.

Resistant and anticorrosion materials will be used for pipes, metal sheets, body and outercover profiles for the entire range of buses, trolleys and special vehicles.

The reorganization processes are subject to change having in view their improvement either by coming up with new suggestions or by changing the hierarchy of priorities. Their practical application implied the elaboration of coherent plans with terms and responsibilities by all departments. Periodical analyses shall be carried out regarding the stage of their application and taking concrete steps in order to stimulate their application when lacking behind is noticed.

When market relations are fully developed, the company will widen the range of skills and cooperation aiming at a higher quality and efficiency. The management of the company shall be ensured the State Ownership Fund and the Private Ownership Fund through the Shareholders Meeting until the company is privatized. The restructuring is

supported by investments from the State Ownership Fund, the capitalized profit and amortization and aims at privatizing the company as a result of the increase in the company attractiveness. The privatization procedure to be adopted is oriented toward a strategic investment potential from the country and from abroad.

E2 is facing a series of difficult problems with the energy supply, old equipment and new market penetration, some of them arising through occasional lapses in strategic management and restructuring.

In the short run E2 is concerned with opening new internal market and maintaining or improving the products quality as well as selling the underutilized equipment which is very costly. To sell such an equipment is not so easy because it is too specialized and there is no market for it. The further losses will force E2 to close down loss making products (such as certain types of buses) which swamped the profits from other successful goods lines of production such as trolleys .

In the long run the most prominent restructuring process for E2 is seen by creating a new joint-venture company with foreign participation, E2 providing infrastructure, bus and trolleys equipment and manufacturing know-how, while the strategic investor would provide managerial advice and capital.

### **5.3. Manufacturing — Shoes**

E3 company represents one of the greatest shoes producers in Romania with a high degree of production integration. The company has the capacity to ensure all the necessary semiproducts for its own use and for other shoes producers. Its tradition in this domain is well known in Romania and abroad for a long time.

#### **Scope of Activity**

The company is specializing in design, manufacturing and selling of the following products:

- leather and leather substitute shoes for man, women and children in a complete range including sandals, shoes (high shoes and boots), leather for shoes outside and lining; hard leather for soles, technical articles, shoes rubber soles and plates; synthetic soles for insoles, heel counter stiffener padding; plastics heels and shoe lasts; Morocco leather goods; adhesives; shoes metallic accessories; spare parts, stamps, holders, plants and machines for shoes; production of cremes, wax, paint, lakes.

The company produces the thermal energy necessary for its own production capacities and other companies on the industrial platform.

#### **Company management.**

The company top management is performed by the Shareholders Assembly through two representatives of the State Ownership Fund and one representative of the Private Ownership Fund at this level the decision-making belonging to SOF due to its majoritary participation to the total capital.

The Shareholders Assembly has the following main responsibilities:

to approve the organizational structure of the company and the jobs number;

- ✓ to appoint the general director, the members of the managing board and auditing committee; it establishes their wages;
- ✓ to analyse the reports of the managing board regarding the profit and dividends at present and in the future, the position on home and foreign markets, technical level, quality, labour, environmental protection, relationship with the clients;
- ✓ to establish the yearly activity programme as well as the income and expenses budget;
- ✓ to examine, approve and modify the balance sheet as well as the returns and losses statement after analysing the rapport of the managing board and auditing committee; it approves the distribution of the profit;
- ✓ to decide upon the increase and reduction of the nominal capital, change the shares number and their nominal value; it adopts and modifies the statute and legal form of the company etc.

The Managing Board has been replaced by a management contract in 1994 in compliance with the legal provision by which the appointed managers are engaged to observe a certain number of economic and financial performances, under the following conditions:

- ✓ to establish the responsibilities of the personnel in every department;
- ✓ to appoint and dismiss employees, to establish their rights and responsibilities;
- ✓ to approve the conclusion and termination of contracts;
- ✓ to establish the marketing strategy and policy;
- ✓ to approve buying and selling operations;
- ✓ to approve the cashing and payment operations etc.

The auditing committee having three members controls the financial administration of the company. Auditors are appointed by the Shareholders' Meeting. Its main functions are:

- ✓ during the accounting period it checks-up the management of the capital investment and working capital, the account book and informs the managing board on the possible disorders;
- ✓ at the end of the accounting period, it controls the inventory accuracy, the accuracy of records and information presented by the managers regarding the company accounts, the accuracy of the balance sheet and of the gains and losses account; then it forwards the written report to the Shareholders' Meeting;
- ✓ it presents to the Shareholders' General Assembly its point of view concerning to the suggestions of reducing the nominal capital, as well as the suggestions concerning modification of the statute and the company objectives.

The company had in 1994 a nominal capital of approximately lei 18 milliard, a turnover rate of over lei 41 milliard and over 9,000 employees. Its capital-intensivity is under the average level of the industry.

The organization of the company includes management offices, services, offices, factories, workshops, etc. For instance, the manufacturing activity is organized including the following sectors:

The leather factory including mineral and vegetal tanning shops ensures the working of raw leather to obtain soft and hard leather semiproducts.

The shoes factory produces a wide range of shoes with genuine and substitute leather vamps in several systems of medium series manufacturing (pairs/item).

The leather substitutes factory with artificial and rubber soles sections ensures rubber and plastics technologic components for shoes.

The mechanical and energetical section ensures the maintenance and repair activities, and the power and other utilities necessary to carry out the production.

The production cooperation between factories and workshops is facing a lot of difficulties and disfunctions mainly due to the confused status of property rights and obligations as well as to shortcomings in supply and distribution of inputs and outputs.

### **5.3.3. The market**

#### ***Home market***

The company sales on the home market both final products (shoes, Morocco leather items, technical items) and semiproducts for shoes manufacturing (soft and hard leather, rubber and plastics soles, accessories) and utilities (thermal energy).

The contracts concluded at home market level for the company products are a confirmation of demands existing for the its production volume and structure.

Essentially, the data show that the production for the home market registers two main tendencies: a decrease in the production of shoes with natural vamps and an increase of hard leather production. These tendencies can be explained by diminishing supply with natural leather and by a relative saturation of the domestic demand.

In 1998 as compared to 1991 the total shoes production of the company will increase by 15% out of which sales on the foreign market 114.3%. The production for home sales will decrease by more than one third.

#### ***Foreign market***

E3 is one of the most important export companies for shoes with genuine leather vamps of the Romanian economy.

When the CMEA market has been dissolved, the company had to reorient its export production by penetrating on other foreign markets. Until now E3 preferred to work by lohn, which has enabled its penetration on the foreign market while direct export of shoes will be preferred in the future. For the major part of specialists the "lohn solution" is not considered as a long lasting one, at least from the efficiency point of view.

**Table 1.***The production for the home market between 1991 and 1998 expressed in physical units*

Items	Units	Achievements				Forecasts			
		1991	1992	1993	1994	1995	1996	1997	1998
Total shoes	thousand								
production of	thousand								
which:	pears	2757	2364	2207	2232	2315	2020	2000	1635
- shoes with									
natural	thousand								
leather	pears	2521	2313	2190	2231	2190	1820	1700	1285
vamps									
- shoes with									
substitute	thousand								
vamps	pears	236	51	17	.	125	200	300	350
- Soft leather									
thousand sq.	thousand								
meters	pears	648	465	554	565	595	550	550	565
-Hard									
leather	tons	569	356	518	688	1070	1295	1295	1295
- Artificial									
soles	tons	737	553	528	600	665	665	665	665
- Rubber									
soles	tons	1043	502	570	704	805	805	805	805
- Adhesives	tons	468	362	364	440	480	500	500	500

**Table 2.***The production for the foreign market between 1991-1998 expressed in the physical units*

Items	Units	Achievements				Forecasts			
		1991	1992	1993	1994	1995	1996	1997	1998
Shoes	thousand								
	pairs	1570	1904	2129	2190	2370	2900	3000	3365
Mineral									
tanning soft									
leather	tons	.	.	.	.	.	85	85	85
Vegetal									
tanning soft									
leather	tons	.	.	55	95	145	175	175	175

As shown in the table above, there is a tendency to increase the production intended for sales on the foreign market. As a result there will be a change in the balance of shoes production.

**Table 3.**

*The distribution of the total production between 1991 and 1998 (in physical units)*

Items	Achievements				Forecasts			
	1991	1992	1993	1994	1995	1996	1997	1998
1. Total shoes production								
of which:	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
a) shoes production for sales on home market	63.7	55.4	50.9	50.5	49.4	41.0	40.0	32.7
b) shoes production for sales on foreign market	36.3	44.6	49.1	49.5	50.5	58.9	60.0	67.3

Essentially, the amount of production intended for home market sales will lower from 63.7% in 1991 to 32.7% in 1998 while the production intended for export will increase from 36.3% to 67.3% in the same period. This change is intended to be closely linked to the fulfilment of restructuring program.

Since 50% of the production is intended for export the company has a good position in respect of the following aspects:

- a) the need for continuously upgrading of the company in order to rise its competitiveness;
- b) higher chances to avoid financial tie-up as a result of timely payment made by foreign importers;
- c) the possibility to purchase equipment and plants necessary for upgrading and reorganization;
- d) higher adaptability to changes in the structure of home and foreign markets demands.

The total number of employees was over 9,000 persons (only 10% with higher education and qualification) out of which: 5,549 in the shoes factory; 840 in the leather factory; 1,000 in substitute factory and 1021 in the mechano-power sector.

The total share of salaries in production costs amounted to 22% in 1994. For 1995 it is estimated a reduction of employment especially in the shoes and mechano-power factories.

The skill level of labour force is good especially in shoes factory.

**Table 4**

*Between 1992 and 1998 the production expressed in physically units is the following:  
1991 = 100*

Item	Achievements			Forecasts			
	1992	1993	1994	1995	1996	1997	1998
1. Shoes	98.4	100.0	102.2	108.3	113.7	115.5	115.5
2. Soft leather	84.9	87.8	89.6	94.0	100.2	100.2	103.2
3. Hard leather	82.2	66.3	88.1	137.4	165.8	165.8	165.8
4. Artificial soles	102.2	116.1	132.1	145.7	145.7	145.7	145.7
5. Rubber soles	95.5	89.5	110.5	126.6	126.6	126.6	126.6
6. Sticking solutions	100.0	105.0	127.0	138.5	144.3	144.3	144.3

### 5.3.4. The evolution of main technical and economic indicators

Data show that between 1992 and 1998 important changes have taken and will take place in the company production structure as compared to the achievements of 1991, hard leather and artificial soles production being the most dynamic factor.

Important changes will take place in the economic and financial structure between 1993 and 1998.

The evolution of several economic indicators estimated for the company when the reorganization takes place with the support of the State Ownership Fund (Variant A) is presented in the Table below:

**Table 5.**

*The evolution of synthetic indicators between 1993 and 1998.*

Factors	1993	1994	1995	1996	1997	1998
1. Total income	100.0	177.1	194.4	207.4	209.9	210.4
2. Total costs	100.0	213.4	231.5	243.9	244.1	244.2
3. Gross profit	100.0	122.1	141.8	159.4	169.3	170.6
4. Net profit	100.0	278.5	391.6	357.4	430.0	493.0
5. Labour productivity	100.0	179.0	262.0	220.4	230.5	236.6
6. Profitability rate	3.6	2.1	2.2	2.4	2.5	2.5
7. Development resources	100.0	202.8	263.3	250.8	286.0	316.6

If the company is reorganized on the basis of its own resources (Variant B), between 1994 and 1997 the net profit will decrease by 60% and the available resources for development by 1/3.

Allotting of 1/2 of the net profit and amortization fund increase are envisaged in order to ensure the resources necessary for development.

As one can see the company E3 couldn't survive without a serious financial support. The SOF restructuring sums so far allotted have not been sufficient for the enterprise real production relaunching. They could contribute only to a temporary survival of E3 which being a very large enterprise is needing a considerable amount of capital investment for modernization.

The economic and financial results of the E3 at the mid '95 show an worsening financial situation concerning its degree of indebtedness and profitability. The high interest rates to the creditors is becoming a serious burden for E3 solvency and possibility to obtain new loans. In comparison with other foreign enterprises E3 is overstaffed taking into account the relative labour productivity level.

### **5.3.5. Reorganization of the company activity**

The carrying out of production and selling programmes is closely tied to the of reorganization of the company activity in general and the activity of retechnologization in particular.

#### ***Leather processing factory***

Under the conditions of the present technical endowment, the raw material (rough leather and chemicals) is subject to a technological process that cannot be accurately controlled, final leather quality parameters cannot be ensured and there is a large consumption of utilities and auxiliary materials.

The relatively high degree of wear of most equipment and plants has negative effects not only on the accuracy of processed leather, material and power consumption, but also on labour productivity and environmental protection.

Mechanical operations of leather processing are carried out using plants from various producers. That is why their maintenance and repair are very difficult to perform.

The development and systematizing of rough leather working takes place in several stages.

Between 1992 and 1994 modernizing took place in mineral tanning by purchasing several ecological drums for tanning and painting as well as other equipment.

In vegetal tanning operations are still performed on equipment put into operation in 1960. That is why, the reorganization programme for technology stipulates in the first stage both purchase of new equipment and automation of tanning technological process including the

automatic components dosage. A grid and several centrifuges are also intended to be purchased for modernizing the cleaning station.

This technological reorganization of the leather working sector aims at improving product quality parameters, reducing material and power consumption, increasing labour



productivity and environmental protection.

#### Shoes factory

The technological endowment of manufacturing lines for sewn shoes (welted shoes, machine sewn shoes) as well as the manufacturing lines for injected shoes is that of 1960 supplemented in 1980.

Between 1990 and 1993 according to the retechnologization programme of the factory, certain equipment was modernized and purchased starting from the assumptions made by the company specialists that the renewal cycle of equipment is of 15 to 20 years. The technological restructuring programme stipulates an endowment that cannot be covered entirely from the company's funds, requiring the support of the State Ownership Fund and/or other resources.

#### Substitute factory

The plants and equipment of the factory are generally at the level of 1970. In the meantime, modernizing and development of rubber and plastics working technologies took place in foreign similar industries. That is why the technological reorganization of this factory is urgently required. Therefore the reorganization programme stipulates the purchase of several machines for thermoplastic rubber soles injection and a group of rubber curing presses leading to the reduction of raw material and power consumption together with semiproduct quality improvement. The purchase and putting into operation of new plants and equipment will enable the production of rubber and plastics components at a level required on home and foreign markets. Rubber pressed soles will better imitate the natural and crape sole.

New adhesive classes that are now imported are under development now in the adhesive solutions section.

In order to carry out the production programme and to meet the demands on home and foreign markets, in 1994 a financial support of lei 2.5 milliard was received from the State Ownership Fund for technology improvement representing approximately 30% of the total fund necessary for reorganization. The rest could be ensured from its own resources and credits. But, given the critical situation of the E3 the borrowing from commercial banks on long term cannot be considered as a feasible solution because of the lack of creditors' confidence in the possibility of E3 rehabilitation.

The first stage of the retechnologization of the company will lead to:

- ✓ the doubling of the raw leather treatment capacities, thus meeting the export demands for wet blue;
- ✓ the elimination of the risk coefficient implied by chromium and acid solutions manual dosage, to be achieved in close rooms in the future;
- ✓ the reduction of material costs for tanning by 20% reduction of sodium dichromate daily consumption;
- ✓ 30% reduction of daily power and utilities consumption;
- ✓ 15% efficiency increase of finite leather used in shoes manufacturing;
- ✓ meeting ecological standards stipulated by the legislation in force for this particular sector.

Taking into account the difficult financial and economic situation of E3 company which has no sufficient funds for technological restructuring the managers and employees decided to buy 47.36% of E3 social capital (30% obtained by transforming certificates of property into shares from POF portfolio and 17.36% bought in cash from SOF). The majoritary owner with a participation of 55.64% of the total capital will still remain SOF which now is organizing an auction with preselected bidders in order to sell the remaining stock.

So far two strategic investors (a Romanian one and another one well known company from abroad) announced their intention to participate in the auction. It is expected that by using this combined scheme of privatization with the control package of shares belonging to a strategic investor one could obtain the necessary restructuring funds for E3 and a change in the existing inertial forces of a big state-owned enterprise.

The privatization will lead to a decrease of employment from 9,169 persons in 1993 to about 8,150 in 1998, what has a favourable influence on the labour productivity level.

This case-study of E3 company is typical for a state-owned enterprise which can in fact be restructured only after the privatization and not before because of lack of financial support from its own resources or from the state. For instance in 1993 and 1994 the E3 own resources spent for development needs amounted to lei 651 million and respectively lei 771 million while the "critical mass" of restructuring investment funds was estimated to around lei 2.5 billion only for the first urgent phase of technological restructuring.

In our opinion E3 could survive only in the situation in which the privatization procedure should be adequate for a strategic powerful investor. So far there are at least two such investors who are interested in buying and investing in this Romanian enterprise with long and good tradition. Despite its difficult situation at present, the privatization is considered as a mean of improving E3 economic and financial performances.

#### **5.4. Manufacturing — Porcelain and Vitreous Products, Household and Decorative Goods**

Initially, E4 company porcelain enterprise was founded in 1922 as a private enterprise and had as activity the manufacturing of porcelain and vitreous products, household and decorative goods. In 1948 this one enterprise became a Romanian stateowned property.

In accordance with the Privatization Law No. 58/1991 and the Government Order No. 10 of 8-th august 1992, 70% of E4 shares were forwarded to the State Ownership Fund and 30% of shares to the Private Ownership Fund - IV Muntenia. The distribution of this part to the public took place under the form of ownership certificates. The both bodies are shareholders of this company.

##### **5.4.1. Scope of activity**

The scope of activity of this company is the manufacturing and the selling of household, artistic and technical porcelain, as well as of heat-resistant products, and also

the carrying out of intern and international road transports of goods using its own transport means.

The manufacturing of porcelain household articles includes the following types: cups (tea, milk), cup-plate sets, plates (dinner plates, deep plates), various products (tureens, bowls, water decanters, etc.), dinner sets (of 6 or 12 persons), other sets (tea, coffee, fancy cake, sweets, compote, etc.), decorative articles (bowls of sweets, trays, vases, little baskets, etc.), trinkets.

The decoration is made using own models or purchaser's models; the hand-made decoration is also applied. The company has been carrying on an intense activity of creation such as: elaboration of new models, conception of hand-made single decorations and series of hand-made luxury decorations as well as artistic porcelain articles.

Besides consumer goods mentioned above, E4 produces technical porcelain articles and heat-resistant products for industrial consumption.

Further, the company has also as scope of activity the carrying out of colouring agents, drawings, cardboards, etc.

#### **5.4.2. Market of the company products**

Home market

In Romania, on the fine household ceramics market there are 6 most important companies in competition E4 occupying one of the first places. After 1989, many private capital companies came into being. These have also manufactured porcelain products but, for the moment, having small fabrication capacities, they aren't an important potential competitor. Nevertheless, the most significant private companies in the field are: "MeHterul Manole" Curtca de ArgeM, "Fine Porcelain Manufactures" Cluj-Napoca.

There are also some companies that manufacture the same range of goods, but of faience: "Cesiro" Sighifloara, "Faimar" Baia Mare, "Ceramarm" Baia Mare.

The companies with majority state-owned capital manufacturing porcelain and faience products are the important potential competitors for E4 company. Other new competitors on the home market can be the imports from China, Czech, etc. delivering household goods of faience, glass or plastics.

Presently, the Romanian market of the household porcelain is characterized by the fact that the actual supply doesn't satisfy the demand of the whole range of products. Only about 60-70% of home market demand is covered. In 1993, the customers of the company products were nearly 600. Referring to the rate of turnover, the home private customers held the highest participation of 47%, followed by the foreign customers of 26%, engross customers of 17% and en-detail customers of 5%. The private customers are also the most profitable category because they sell 70% of selling aggregate values of decorative articles.

The highly unsatisfied demand for porcelain goods in the first years after 1989 is explained by the totalitarian policy in Romania during the communist regime which ignored or minimized the importance of durable consumption for population, on the first place being situated the production of machines and equipment for heavy industry and

machine building. In the last period the demand of porcelain goods gradually is becoming more and more saturated, what imposes for E4 new requirements, as regards the production quality and prices.

E4 company covers almost a quarter from the home market of porcelain household products. The internal delivery of its products is made by the en-gros trading companies. A part of its products is directly sold by the two own shops.

The products of current use correspond to an average range position on the home market. But concerning the dinner sets, decorative articles of a high hand-made level and artistic porcelain products that are hand-decorated with more gold and cobalt decoration are placed, in many cases, on a higher position.

The percentage of the high quality products, according to the national standards, is, as average, of 50% the gross output.

The prices are set by the market mechanisms, but, lately, it can be seen the influence of the import prices.

Foreign market

In 1993, the company exported 26% of turnover to: Germany, England, Italy, France, Greece, Austria, Belgium, Egypt, Lebanon. The Japanese market is the latest market that the company has penetrated on.

At the present, the highest participation in accomplishing the rate of turnover at export belongs to Greece, Germany, Italy, England.

The world porcelain market is characterized by the fact that the outstanding exporters are the outstanding importers too.

E4 has a long tradition as exporter and its successful penetration on the foreign markets is explained by relatively low prices and fairly good quality. In the next years it is likely to survive among domestic and international competitors first and foremost due to the low labour costs and high qualification of labour force.

### **5.4.3. Company management**

The company management is represented by the two following bodies:

Shareholders' meeting - including three representatives of the State Ownership Fund and Private Ownership Fund.

Managing board including five members. The chairman of the board is the general manager of the company at present committed by a management contract with the SOF.

The company has an organizational structure with too many hierarchical levels what involves many difficulties in making some pertinent decisions. It must be also mentioned that the high levels of decision are charged by problems that can be solved by the lower ones.

There are four distinct sections, such as:

- ✓ household porcelain section, including production shops for household porcelain articles;
- ✓ artistic porcelain section, including production shops for decorative porcelain articles;

- ✓ vitreous section, including production shops for decorative household vitreous articles;
- ✓ chamotte section including production shops for heat-resistant products of silicon and carbon;

There are also:

- ✓ a mecano-energetic workshop;
- ✓ a computing office with a mean endowment.
- ✓ The organization and the management of the company is now characterized by:
- ✓ a function of research-development insufficiently advanced that doesn't dispose of enough information concerning the trends and the preferences of the market, being particularly guided to the creation imposed by customers' models and to the internal technological conception;
- ✓ a predominant function of production as compared to other functions of the enterprise, because of the importance given, in the past too, to the manufacturing activities and also of actual conjuncture;
- ✓ an incipient function of marketing with its actual tasks including: market analysis, prices policy, promotion policy of products, distribution policy;
- ✓ a function related to personnel, directed, particularly to manage the human resources and less to work out and apply the personnel strategy and personnel policy (recruiting, selection, training, promotion, award), function that is capable to increase the labour productivity;
- ✓ an informational function, in course of development and revaluation, for decisionmaking and an efficient pursuance to apply them into practice. There is an insufficient communication among organizational levels, both vertically and horizontally, what doesn't create a favoured climate of labour in order to get technical- economic performances;
- ✓ a new managing team faced to solve the current problems of the company and which doesn't succeed, in the present conjuncture, to solve the strategical problems (definition of objectives and actions on long and medium term) too.

The members of the managing team, recently appointed, have been working in the company for 12-20 years, what it's an substantial advantage in knowledge the company and its confronting problems.

#### **5.4.4. Labour force**

At the end of 1994, the percentage of workers was about 90.0% while of managing and administration staff was of 10.0%.

Referring to the training level on professional categories the situation is as follows: 62% of personnel has a middle professional training and 5.6% has a high training. Excepting some cases, there is a suitable correlation between the held function and the occupant's training.

Between 1991-1994, there weren't important changes concerning the number and the structure of the personnel, but there was a high turnover of 12.5-14%, particularly referring to the younger workers.

The existing personnel is of 32 years middle age and about 50% of personnel has worked for 5 years in the company because of the new-employed workers in the last three years. The oldest personnel was masters' category. The personnel of age under 30 years was of 48% of entire personnel, what it could represent a factor of the future development potential of the company. Taking into account the necessary training time of about 12 months for qualified workers in the ceramic field, the company is able to assure a reconstruction of its technical-professional experience for next years but on condition that a substantial stopping or reducing of personnel turnover take place.

In the accounted period, a high level of absence was noted, on an average such as: 14.3% for the entire personnel and 15.2% for workers.

The labour relations, and wages conditions inclusively, were regulated by the labour collective contract agreed between trades union and company managing board.

The most activities are carrying on within an eight hours shift program. The night shift is practiced in the workshops where there are ceramics roasting furnaces and they have to be maintained continually in operation.

The wages system is mainly based on the training-qualification criterion. Searching the wages diagram, it can be seen a tendency of uniformity of the salaries among different categories of personnel - technical, economic, specialized and managing - as well as a large variance of salary limits for different categories of this personnel (for instance: of 51% for diplomat engineers, of 35% for engineer and of 21% for masters).

According to the labour collective contract, the company's personnel receives a series of salary increases, such as: overtime salary increase by a company management's approval, night shift salary increase, service increments, rise in salary for leading a working team, salary increase for heavy working conditions, toxicity salary increase.

#### **5.4.5. General evaluations on production process**

Within the company, the sections and the workshops dispose mostly of necessary facilities for a normal activity. They can carry independently on their activities without influencing each other, excepting warehouses of raw materials, other materials and end products.

The existent buildings are in a good condition and they offer efficient possibilities of operation.

There are a lot of equipment in endowment but some of them present an advanced degree of obsolesce and physical wear, except the fast roasting furnace and the decoration burning furnace, the both put in operation in 1993.

The technological process is of middle level and it is necessary the acquisition of some modern means and techniques for controlling and supervising it.

The level of material and energetic wastes is relatively high. A rigorous long-term strategy has not been elaborated yet in order to decrease the losses, these ones influencing negatively the level of the consumption and the prices.

The installed capacities for facilities concerning pit gas and electrical power exceed the need level. Referring to water and canalization, these satisfy the production necessity

and the heat carrier offers possibilities of optimization.

The material supply for the production activity shows a deficit because of an inadequate choosing of suppliers, unrhythmical supply and a lower quality of the raw materials and other materials.

The production capacities are insufficiently used, mainly, not because of demands lack but on account of the organizational-managerial reasons and advanced wear of equipment.

The quality level of some manufactured products is under the international standards.

#### 5.4.6. Evolution of some economic-financial factors.

**Table 1**

*Dynamics of the carried out production determined in terms of physical units between 1991-1993 1989=100*

Article	1991	1992	1993
1. Household porcelain articles	89.6	95.3	91.4
2. Artistic porcelain articles	93.5	101.2	84.8
3. Vitreous articles	75 .0	78.8	77.2
4. Technical articles	65.9	10.6	13.9
5. Heat-resistant articles	54.1	179.4	129.4
6. Colouring agents	76.5	179.4	129.4

The information point out an important decrease of production at technical, heat-resistant and vitreous articles because of a reduced demand of the part of the customers facing serious problems of recession. The decreases of the production are comparatively lower for household porcelain and artistic porcelain articles company staples - but referring to the colouring agents an important increase took place.

The existence of unhomogenous cost structures, due to a diversified production structure, entailed some trends in changing the cost general structures, at the level of the enterprise, explained by the interference of a great number of factors, some of them being mentioned on.

The most important changes are:

decrease of the share concerning the expenses related to raw materials, other materials and consumption of plaster models, buying up of annuities, equipment and building repairs;

increase of the share concerning the expenses related to productive salaries and decrease of unproductive salaries;

increase of share concerning fuel and power.

**Table 2.***Changes of the share of some expenses in 1992 and 1993 (in %)*

	1992	1993
Total expenses of which:	100.0	100.0
a) variable expenses of which:	71.9	65.8
- raw materials and other materials	32.5	29.7
- productive salaries	17.2	19.4
- power, fuel	8.0	9.7
- equipment repairs	5.6	4.5
- wear and consumption of plaster models	8.6	2.5
b) fixed expenses of which:	28.1	34.2
- buying up of annuities	4.1	2.3
- unproductive salaries	14.1	9.7
- accessories, building repairs	1.3	1.0
- other expenses	8.6	21.2

According to the estimations, the highest profitability is carried out within the artistic porcelain section (49.1%), followed by the heat-resistant material section (35.8%) and household porcelain section (12.8%).

On the basis of the accomplished analyses, it can be seen that the greatest possibilities in reducing the manufacture costs are, in order, for: technical and heat-resistant articles, household porcelain, artistic household and vitreous.

In 1993, comparatively with 1992, the turnover of the company increased in current prices by 154.2%, the gross profit by 306.7%, the profit tax by 307.9%, the net profit by 305%; this situation was because of a strong inflationary rise (CPI index in 1993 year was of 295.5 percent). In the same time, the need of a cash reserve increased considerably from 14 millions lei to 1123 millions lei as a result of the remainders, but particularly, of the uncollected debts.

The bank credits increased from 270 millions lei to over 3000 millions lei. This explosive dynamics of the synthetic indicators is due to both the beginning of company production recovery and especially to a strong increase of the level of prices. The financial status of the company taking into account the profitability, solvency and liquidity is presented in Table No. 3. Referring to this table, these groups of factors shows that the economic-financial status of the company is satisfactory due especially to a favourable evolution in the last two years. Though the average term of payments of the suppliers improved substantially, however the average term of debts collection by the enterprise increased, what results unfavourably in providing the circulating funds for the renewal of the production and consequently there is the risk to amplify the capital tie up and not to diminish the insolvent debtors. So, as a result of the capital tie up even the gainful enterprises may become unprofitable.



Taking into account the rate of liability, the company makes now credit based investments which could be justified especially after the enterprise will succeed to carry out an increase of its own capital.

**Table 3.**

*Evolution of some indicators in 1992 and 1993*

Factor	1992	1993
Rate of gross profit 1)	9.6	15.4
Rate of net profit)	5.3	8.5
Rate of profit tax	44.8	44.9
Rate of debts cover	0.7	2.2
Rate of own capital	11.5%	35%
Average term of payments		
of the suppliers	32 days	7 days
Average term of debts		
collection	18 days	32 days
Average storage life of raw		
materials and other materials	21 days	24 days
Average storage life of end products	10 days	12 days

1) Estimated as ratio of profit and turnover

#### **5.4.7. Restructuring of the company**

Taking into account the present situation of the company, a reorganization is absolutely necessary on strictly defined stages at the level of all its functions (commercial, technical, financial, human resources, etc.) according to the market conditions and the needs of branch reorganization.

The accomplishment of all actions included in the reorganization program will allow the company to become more profitable and competitive.

The providing of quality products at competitive prices and at acceptable terms offers an important competition advantage, on the home market in order to stop the imports, to develop of downstream services and to create some opportunities for labour use (distribution networks) on the one hand, and on the foreign market by supplying of free currency, on the other hand.

The restructuring program of the company starts from two base conditions:

the company has to produce only what it can profitably sell;

all production sections become competitive.

Many people were involved in this action of working out and applying the reorganization program in order to find out and improve the applicable solutions and to carry on adequately the changing actions.

The reorganization program is intended to carry out before, during and immediately after the privatization of the company. Its success depends on the accomplishment of the following objectives:

- competing with quality products and competitive prices on the world market;
- maintaining and developing of diversified and reliable products, providing the same quality as for export and also acceptable prices on the home market;
- improving the profitability of the company;
- optimizing the use of the material resources as well as technical and human resources;
- answering for social and environmental problems.

To meet these objectives, the actions must be simultaneously conducted, in a coherent way, at commercial, financial, technical and industrial level; these actions have to be intimately linked and materialized within a detailed action plan.

Mainly, the finance of the reorganization program relies on own company resources, followed by loaned resources as well as on possible co-finances as a result of a foreign collaboration.

#### **5.4.8. Privatization of the company**

The company management is concerned now in preparing and carrying on the privatization process.

The privatization is considered as means of increasing the company performances in the interest of the shareholders, managers, employees and, implicitly, of the state.

In this respect, the company activity was deeply analysed and the employees and potential shareholders were made aware of aspects mentioned above.

The option of company privatization relies on the existing laws in force, its specific conditions as well as on the necessity of developing the market mechanisms.

Both the sellers of State Ownership Fund shares, of Private Ownership Fund Muntenia shares and the buyers of these shares - employees, managers and other potential purchasers - have in view, generally, the increasing of viability and profitability of the company. But, between these there are also diverging interests. Thus, the State Ownership Fund and the Private Ownership Fund as sellers want a faster viability and profitability of the company by selling the shares to Romanian or foreign natural and legal persons who dispose of enough financial means capable of company reorganization as quick as possible, namely a Romanian or foreign strategic investor who are able to realize the investments requested to keep on the reorganization program.

In exchange, the employees and the managers of the company want to change totally their property certificates, in shares, to buy a little number of shares from their own funds and to obtain advantageous credits in order to buy a great number of shares returnable in 5-6 years, especially, by the payments of dividends. In this respect, the employees and the managers decided to lay the foundations of an association - legal person - in order to be protected within the privatization process.

In 1995 E4 has been privatized by the Management Employee - led By Out (MEBO) method. The privatization positively influences the employees and managers motivation

as well as the propensity to save and invest. At the same time, given the profitability of E4, a wide range of outside owners have been or are involved, including foreign direct investments materialized in cash or in kind contribution.

The post privatization restructuring is facing several difficulties among which the lack of domestic capital should be mentioned on the first place.

Certainly, the privatization solution will be adopted by direct negotiations between sellers and buyers of shares.

Finally, it is necessary to mention:

- ✓ the company is a famous mark and its diversified product range covers many uses specifically for porcelain articles (current household, and occasional articles, small production articles, items of luxury, singles, etc.) providing a complex demand of products;
- ✓ the prices are competitive referring to the high quality exported products;
- ✓ the settled productive capacity is capable of covering the demand of products;
- ✓ the growth of sales is promoted by respecting the quality requested by customers and the terms of supply.
- ✓ the own design team offers a high value to the artistic porcelain products;
- ✓ the company can quickly accommodate its capacity to the customer's demand.

## **5.5. Manufacturing — Drugs 5.5.1. General presentation**

The enterprise E5 was founded in 1962 and manufactures a complex range of products covering over 600 types of drugs, including compressed tablets, sugar-coated pills, capsules, powder, injection solutions, plasma substitutes, surgery catgut, etc. that are used in medical therapeutics.

The diversifying of production had bad effects on the organization and programming of production, material base insurance, profitability, import, self-financing, as well as on the creation of specific work conditions for every workplace in drug industry.

The main concern of the company management was to manufacture new products and modernize the existing ones.

The largest part of customized products represents the result of the company research carried on by contract agreement with the national chemistry, pharmaceuticals and health national research institutes. This is how several original products were made, such as: Gerovital, Aslavital, Covalitin, Distonocalm, Ulcosilvanil, Apilarnil, etc.

Some products are manufactured on the basis of imported licenses and by international cooperation with famous producers from Switzerland, Germany, France, USA., etc.

As a result of its products quality, the company is estimated to be the main Romanian drugs producer on the home and foreign markets. In 1989 the company ensured 50% of the total Romanian drugs production (2/3 human drugs and 1/2 veterinary drugs) and the export volume was 10% of the total production.

At present, the company has the following fields of activity:

intermediary products synthesis for drugs, odorants, tanning materials; conditioning of human and veterinary drugs; surgery catgut; specific package production (bags and pouches for blood collection and solutions perfusion); substances used for diagnosis, exploration and for laboratory tests; home and foreign transport; production of cooling agent and ensuring other utilities such as steam, water, compressed air, nitrogen and electric energy; maintenance, repair activities and specific equipment production, etc.

The registered social capital in 1995 was about lei 59.8 milliard, realizing a total turnover of lei 85.7 milliard. The technologies used by E5 are: domestic (ICCF) and foreign (licences from Austria, Sweden, Switzerland). The number of employees at the beginning of 1995 was around 3,069 persons.

*Production capacities and utilization rates at E5 company:*

Item Product	UM	Installed capacity	Used capacity	Utilization rate (%)
1 Tablets and similar ones	mil. pes.	4300	3201	75
2 Capsules	mil. pes.	300	163	55
3 Injectable solutions	mil. pes.	320	192	60
4 Perfusable solutions	mil. pes.	10000	7456	75
5 Seaming material-catgut	thou. pes.	2000	554	28
6 Dextrane	thou. pes.	1000	480	48
7 Drugs and active principle synthesis	t	1520	1009	70

The company E5 is supplied with raw materials and materials from domestic sources in a proportion of 75% and from import sources for the remaining 25%.

### **5.5.2. The organization and functioning of the company.**

E5 commercial company was founded on the basis of legal norms<sup>1)</sup> issued in 1990. The patrimony of the company remains in the State ownership, the company having economic and financial autonomy.

According to legal norms, the management of the company is represented by the Shareholders' Meeting Assembly including State Ownership Fund and Private Ownership Fund representatives, the Managing Board, the general director and the other managers of the company. They establish also the organizational structure of the company.

To stimulate and rise the responsibility of managers, in 1994 a management contract was concluded between the representatives of shareholders' and the general director, for four years based on a test. This is an important new and stimulating aspect of the organizational and functional structure of the company. The contract stipulates the performance objectives and criteria, expressed in quantitative, physical, and value factors for the manager (turnover, profit, import-export balance, investments, labour productivity, bonuses for meeting the respective objectives and criteria).

The basic production is organized into 6 sections of medium, fine synthesis and small tonnage synthesis, as well as for wet and dry conditioning, while the auxiliary production is organized into mechanical, power and automation sections.

The company activity is coordinated on four directions: production, trading, research and development, finances and accounting, having several general departments and departments specific to drugs industry.

In 1994, 98% of the total production value represented the basic production and approximately 2% represented the auxiliary production.

The quality control starting from the raw materials and up to the final product, is ensured by the control department of the company, through interphase laboratories and the central laboratory, as well as by the state control institute for drugs and the chemical and pharmaceutics research institute.

### **5.5.3. The market**

Before 1990, according to the concept of centrally planned economy organization (ministry - central departments - enterprises), enterprises received demands (orders) from the Public Health Ministry through the Chemistry Ministry, namely the Central Department of Drugs Industry, Bucharest, because the production units had no marketing activity themselves. Under the market economy transition conditions, the following combined procedures were adopted for information on home drugs market demands:

specialized organizations of Health Ministry and a large number of private drugstores were consulted on the evolution of drugs consumption and demand;

the study elaborated by the Health Computer and Statistics Center referring to the drugs demand carried out according to therapeutical groups until 2000;

information and the data from the studies carried out by PROMARKET Trading Company, Bucharest were used referring to some aspects of the foreign drug market.

Starting from the above mentioned information and the company experience in manufacturing and selling of drugs, the company management succeeded in laying better foundations of the promotion strategies in manufacturing and export, as well as the suggestions regarding the technological, organizational and financial reorganization. Moreover, several alternative behaviour patterns were adopted by the company in order to be integrated in a developing competitional framework.

#### **5.5.3.1. Home market**

The main partners of the company are health and agriculture business organizations. The company ensures 50% of the total production for the home market.

It has approximately 200 customers on the home market of which the most important are:

- ✓ Pharmaceutical Offices and private drugstores (75%);
- ✓ FARMAVET veterinary products pharmaceuticals offices (10%);
- ✓ enterprises of the chemical and petrochemical industries (9%);
- ✓ enterprises of the textiles and leather industries (6%).

Between 1994 and 1995 economic contracts were concluded with all the pharmaceutical offices of Health and Agriculture Ministries from over the country as well as with several customers.

A characteristic feature of the company is the fact that drug prices are supervised by the Finance Ministry and the prices for other products are negotiated with the customers taking into account the importance of these products for population health.

The company products are distributed through state-owned local warehouses and through the private drugstores network.

Taking into account that in 1993 deliveries to private drugstores represented 30% of total sales of the company (10% increase as compared to 1992) in the future, deliveries to private drugstores will increase even more because private sector will register a higher development rate.

### **5.5.3.2 Foreign market**

During the last years, although speaking in absolute terms, the production registered a decrease, the company sold products on the foreign market representing 10-20% of its production. The most important partners are: CIS, Hungary, Bulgaria, Germany, USA, etc. The main exported products are conditioned forms and active principles of drugs, such as Vitamin C - substance, Phosphobion - vials, Gerovital - pills, Propranolol, Calcium Gluconicum etc.)

The largest percentage of export is allotted to geriatric drugs (Gerovital H.3 and Aslavital) that are sold in significant amounts on the market of Germany, Austria, Mexico, Andorra, Hong-Kong, being a real competitor to other foreign market products.

Lately the company has had to take into account the increasing demand of geriatric drugs on the foreign market as they contain vitamins, aminoacids, mineral salts essential to elderly people and reorganize its production accordingly.

### **5.5.4. Evolution of the economical and financial status of the company**

During the transition to the market economy the enterprise was confronted with several problems, such as:

- ✓ the sudden and chaotic destruction of old organizational structures and economic mechanisms without first or simultaneously replacing them by other that should undertake their disfunctions;
- ✓ ambiguous legislation as to who is the real owner of the state capital of commercial companies patrimony;
- ✓ the impossibility to take over in relatively short time and to carry out at an adequate qualitative level the functions and jobs of the former industrial central offices and ministries;
- ✓ the lack of circulating means necessary to normally carry out the economical activity and the development funds required by production upgrading;
- ✓ inflation, financial tie-up, unfair competition;
- ✓ high devaluation of the national currency (leu) as compared to the American

currency (dollar).

These problems and other similar ones resulted in the general destruction of production, cooperation and sales relations, production reduction, unemployment etc. Therefore, production volume estimated in constant prices decreased by 7.5% in 1991 as compared to 1989, and 32.8% in 1992 as compared to the previous year. From 1993, the decline of the production has stopped, representing 80.8% and 84.8% of the production registered in 1989 and 1994, respectively.

**Table 1.**

*Changes in personnel number and structure of labour in %*

Years	1989	1990	1991	1992	1993	1994 (9 m)	1994/ 1989
1. Total average number of employees of which: - skilled workers	100.0 77.0	100.0 76.2	100.0 75.9	100.0 75.4	100.0 78.2	100.0 80.5	
Years	<b>1989</b>	<b>1990</b>	<b>1991</b>	<b>1992</b>	<b>1993</b>	<b>1994 (9 m)</b>	<b>1994/ 1989</b>
unskilled workers	9.9	6.9	6.4		5.6 6.1	3.0 6.2	
high school specialized staff	1.6	9.1	6.2			7.3	
higher education specialized staff		6.3				3.0	95.7
managerial staff		1.5					167.9
2. Labour productivity <sup>1)</sup> (calculated as the ratio of the turnover and the total number of employees)	100.0	75.9	245.7	261.8	315.2	194.3	994.4
3. Average monthly nominal salary <sup>1)</sup>	100.0	100.0	333.3	250.0	376.0	213.8	700.0
4. The relative share of the participation fund of the employees in the profit as compared to the salary fund	9.5	9.5	7.1	5.8	9.9	15.0	
5. Salary tax share in the salary fund	—		20.0	22.1	23.2	27.5	—

1) Changes as compared to the previous year (current prices).

Data show that in the analyzed period a series of structural and volume changes took place, such as:

a) reduction of total number of employees by 10% as a result of dismissing personnel

- b) with discipline problems and pensioning of employees according to legislation in force;
- c) improvement of labour structure by increasing the percentage of skilled workers and higher education personnel;
- d) increase of the managerial staff percentage who contributed in organization improvement, consulting and supervision of carrying out the established programmes;
- e) the concern of management regarding the increase of personnel salaries according to of production programmes fulfilment, productivity and living cost increase; therefore the average salary increased 66 times in 1994 as compared to 1989, while consumer goods and services price index increased approximately 100 times;
- f) after a period of decrease, attaining a maximum in 1992, the relative share of the participation fund of the employees in the profit as compared to the salary fund increased (from 9.5% in 1989 to 15% in 1994);
- g) starting with 1991, individual salary tax was reintroduced, its share in the total salary fund increasing from 20% in 1991 to 27.5% in 1994;

Although personnel salaries increased, they are still lower than consumer goods and service prices significantly affecting employees living standard. Significant changes also took place also in the structure of production costs (table 2) which essentially show two major tendencies:

- ✓ significant reduction of raw material and other materials expenses rate, as well as that of maintenance and repair;
- ✓ almost 3 times increase of fuel, power and water expenses rate, a doubling of salary and amortization expenses.

**Table 2.**

*Manufacturing costs structure between 1989 and 1994 in %*

	1989	1990	1991	1992	1993	1994 (9 m)
Total manufacturing costs of which:	100.0	100.0	100.0	100.0	100.0	100.0
- raw materials and other materials	77.4	71.2	67.3	65.8	64.1	63.2
- personnel salaries	8.3	10.5	10.6	12.7	15.0	15.9
- fuel, power and water	3.3	5.8	10.3	10.4	15.0	15.2
- maintenance and repair	5.1	3.9	6.7	5.0	0.8	1.1
- amortization of fixed means	2.3	2.2	2.3	4.7	4.6	4.5

The factors underlying these changes are rather numerous and diverse in their effect, such as:

- ✓ distortions in the price system of this period, such as power, raw material and other materials prices;
- ✓ partial neutralization of production capacities generating factory overheads increase;
- ✓ between 1991 and 1992 a disagreement appeared between production volume and labour productivity level on the one hand, and salary fund and average salary on the



other hand;

- ✓ revaluation of capital investments in 1992 and 1993.

These factors, as well as the system of profit and salary taxes had certain effects also on the results of the company.

**Table 3.**

*Evolution of company economic indicators between 1989 -1994 in %*

Years	1989	1990	1991	1992	1993	1994 <sup>x)</sup>
1. Turnover (current prices <sup>1)</sup> )	100.0	86.2	230.8	250.7	281.1	191.8
2. Production <sup>1)</sup>						
- expressed in current prices	100.0	111.6	260.6	226.4	296.0	224.0
- expressed in constant prices						
(1989)	100.0	100.2	92.3	72.6	120.2	105.0
3. Gross profit <sup>1)</sup>	100.0	342.8	158.9	186.0	568.1	308.1
4. Profit tax <sup>1)</sup>	100.0	1305.5	150.0	152.8	581.8	218.8
5. Net profit <sup>1)</sup>	100.0	169.8	171.2	226.2	556.9	322.0
6. Rate of profitability <sup>2)</sup>	3.9	15.5	10.7	7.9	15.9	38.9
7. Profit rate <sup>1)</sup>	5.8	20.0	10.5	9.2	20.7	31.5
8. Rate of profit tax <sup>4)</sup>	15.2	58.0	54.7	44.9	46.1	43.6
9. Rate of nominal capital profitability <sup>5)</sup>	8.9	14.7	20.9	4.4	24.8	18.6

x) Achieved in 9 months and estimated for the 4th quarter of 1994

1. As compared to the previous year
2. Calculated as the ratio of gross profit and turnover
3. Calculated as the ratio of gross profit and production costs
4. Calculated as the ratio of tax and gross profit
5. Calculated as the ratio of net profit and nominal capital

The following aspects can be mentioned on the basis of the above mentioned information in Table 3:

the increase of turnover is lower than that of production volume expressed in current prices (except 1992) as a result of drugs selling to hospitals and local drugstore offices that further distribute them to the network drugstores thus increasing their payback time and amplifying the financial tie-up;

the rhythm of production increase was surpassed by that of the profit because of the latter low level in 1989 and significant stocks of raw materials and other materials existing at lower prices than those at the time of their use in manufacturing; a high degree of production integration.

For the last two years, the company witnessed an improvement of the economic and financial status and bank credits were no longer needed. Thus, at the end of the 3rd term of 1994, the company had to receive over 16 milliard lei and its debts to suppliers and

customers were of 12.3 milliard lei. The company also had a development fund of 7.6 milliard lei and an amortization fund of fixed means of approximately 6 milliard lei, which grant the possibility to start and extend the reorganization and retechnologization process of the productive activity.

Essentially, the following actions were taken to counterbalance the difficulties encountered in contact by the company:

short term actions

- ✓ organization and development of marketing, foreign research trade, and development, sell in retail and in bulk of the manufactured products;
- ✓ taking up steps in order to know the solvency of customers and accelerate the cashing of delivered drugs value;
- ✓ direct delivery of drugs at the established daily amount to private drugstores that pay in cash immediately;
- ✓ giving up bank credits starting with 1992;
- ✓ the supply of raw materials and other materials necessary for the production on a period longer than the cycle of the respective products manufacturing.

medium and long term actions

technology and management restructuring;

company privatization using specific programmes and procedures.

### **5.5.5. Company restructuring**

Represents an urgent process that is based on both internal and external factors directly connected to the requirement of improving production structure and efficiency as well as ensuring long term aggressive strategies.

#### **5.5.5.1 Technological restructuring**

Although the company activity is profitable there are still a series of difficulties, such as:

- ✓ decrease of demand on the home market for certain products;
- ✓ inadequate use of certain capacities;
- ✓ certain products of the company are on the wane and need replacement; other products are obsolete and must be withdrawn from production.

These deficiencies do not necessarily imply that the company should change its profile because the drugs sector is and will always be socially necessary and has a good perspective of sales and consumption in Romania as compared to other countries.

Low current drug consumption in Romania now represent another disadvantage for the company. Studies on marketing, feasibility and drugs production reorganization in Romania carried out by specialists with the support of P. A. Consulting Group of England forecast that there will be an increase of expenses for the health sector resulting in a favourable growth of the Romanian drugs production due to the increase of future sales and production according to existing international tendencies.

Taking into account all the above mentioned aspects, the basic activity was estimated to be the production of human drugs, while restructuring the manufacturing range in order to cope with drugs market and economic efficiency requirements.

The following steps shall be taken for the reorganization of the manufacturing range:

renewal of production description on economical and therapeutic criteria for the efficient use of the production capacities by customizing competitive products required both on the home and the foreign markets for which the company has its own technologies and collaboration possibilities with foreign companies as well as license import.

giving up the manufacturing of therapeutically outdated products, rather non profitable and have a low share in the general profit while increasing production of the profitable drugs.

Taking into account the evolution of the foreign market and Health Ministry forecasts regarding to main diseases registered in Romania in several period of time it was established that the product necessary in the future fall in the following therapeutic categories: cardiovascular, anti-infectious, breathing, gastrointestinal, central nervous system, etc.

Reorganization strategy aims at the following main objectives:

to meet the international standard in point of product quality and ensuring manufacturing safety conditions according to GMP norms (Good Manufacturing Practice Norms), that have become comparsery in the European Economic Community since 1992;

meet the demands of pharmaceutical products on the home market at foreign therapeutically level;

creating manufacturing conditions that should lead to quality and economic efficiency increase and enable to obtaining of competitive products on the home and foreign market.

Production restructuring also implies modernizing and retechnologization of the main manufacturing section in both synthesis and conditioning sectors.

The analysis of technological flows emphasized different technological conditions of equipment as a result of an endowment with equipment having uneven performances because of the limited foreign exchange resources of the company under the conditions in which the replacement of machines was done because of physical wear rather than the obsolete character and the entire retechnologization of manufacturing lines.

The company was sometimes compelled to customize to parts or whole high cost equipment in order to keep installations running because of the restrictive system for import in Romania.

In some manufacturing sections, there are certain deficiencies regarding air conditioning, ventilation, unfinished white zones (clean room condition) that prevent the company from meeting the GMP international norms requirements.

As a producer of organic synthesis pharmaceutical substances and conditioned products, the company is below the medium pollution level according to norms and standards in force regarding the environmentally friendly manufacturing.

### **5.5.5.2 Management restructuring aims primarily at:**

- a) Revision of the organization structure in order to better define and distribute authority and responsibilities, to create the conditions for the introduction of efficient management methods;
  - ✓ decentralization of decisions and the enhancement of responsibilities at various operational decisions (plant, sections, workshops);
  - ✓ the improvement of the organization and functioning regulations, of the jobs description (establishing and describing the authority of all decision centers; the definition and establishing of responsibilities appointing performance indicators; establishing the need for professional knowledge improvement and conditions regarding job appointment and promotion etc.);
- b) Upgrading of informational and accountancy system, improvement of informational level:
  - ✓ the carrying out of a study on the informational system;
  - ✓ the design of a general concept of the informational system for the next five years;
  - ✓ establishing objectives and resources regarding: endowment with computer techniques, the implementation of informatics applications and expert systems; better training of personnel in informatics; the connection to data basis systems;
- c) The planning and implement an informational system that should ensure the distribution and control of performance factors, computer-aided decision-making at top organizational levels;
- d) Introduction of management by objectives and budget, etc.;
- e) Professional improvement training of the management staff and specialists (by external assistance and company's own resources);
- f) Development of new activities and/or department such as marketing, research and development, distribution on network, transport system for supply and delivery, etc.;
- g) Reconsidering and improvement of all types of norms: labour, material consumption, power and utilities, costs, designing measuring system, updating and perfecting these norms;
- h) Drawing up a specific system of quality ensurance;
- i) Drawing up and implementing a system of job assignment for the main skills and specializations.

As compared to other companies, E5 company carries out the reorganization on its own resources.

### **5.5.6. Company privatization**

Company is one of the approximately 3000 companies intended to the subjected to the mass privatization program between 1994-1995, for a maximum 60% shares package. In this sense, the company management has analyzed several privatization forms. Concrete decisions have not yet been taken because of reasons that are both independent and specific to the company, such as:

- ✓ the company is one of greatest drugs producers in Romania, having a large range of products covering a wide therapeutically scope.
- ✓ the specific of this companies drugs production is the high degree of functional integration as required by the manufacturing process.

Taking into account that the program of reorganization and investments does not stipulate reliable financing sources, the following diagram is suggested for privatization:

51% of the nominal capital shall be based upon ownership certificate and minimal coupons of privatization;

49% of the nominal capital shall be covered by selling of actions to potential investors from the country and abroad who will available to participate in the reorganization and development of the company.

The company is looking for a foreign strategic investor in order to improve the managerial activity of the enterprise as well as to upgrade the competitiveness and technological level.

The total estimated financial requirements amount to a total of US\$ 3.6 million out of which US\$ 2.9 million from external resources.

As far as the employment is concerned it should be reduced simultaneously with the improvement in the technological level and productivity growth.

## **5.6. Manufacturing — Wool Textile**

The commercial company E6, within the wool textile industry, takes hold one of the first places together with other two textiles companies in Romania, which are its main competitors.

### **5.6.1. Short description of the company evolution**

Founded in 1850, as a cloth manufacture, E6 which has been considered as the nucleus of a strong textile industry in Transilvania; this manufactory became later the enterprise E6.

At the beginning, this factory manufactured coarse cloths and included a carding spinning mill section with 1200 spindles, a weaving mill with 22 weaving looms and a dressing section.

In 1918, the factory was rebuilt and took in the following sections: wool washing, dye works, spinning works (1700 spindles), wearing mill, dressing and a power installation of 150 HP.

Between 1920-1922, a power installation of 350 HP was put into operation, the number of weaving looms increased at 73 and the wool washing, dye works, and dressing sections extended.

In 1948, this factory became state-owned enterprise.

Concerning the activity of the company, two development stages are distinguished:

- ✓ within the first stage, between 1948-1965, the following actions were performed: a laying out of the equipment according to a rational and efficient technological flow, the upgrading of the old equipment and the increase of the production capacity.
- ✓ within the second stage, between 1966 - 1969, some important funds of investments were allocated in order to change entirely the technical endowment of the enterprise, this one becoming a strong unit of the Romanian textile industry which had produced the combed wool tissues of 100% wool and of wool mixed with staple fibres for making men suits and overcoats.

### **5.6.2. Scope and management of the company**

The scope of activity of the company is the manufacturing and selling of combed wool yarns and tissues as well as of unweaved textiles, services for third parties and import-export activities.

A diversifying of the production took place within the last four years. Thus, besides the tissues for man suits and overcoats which held 80% of production until 1990, the share of the tissues for women ready-made clothes increased reaching now approximately equal proportions in men and women cloth makings.

The company is managed by the shareholders' meeting - two representatives of the State Ownership Fund and one representative of the Private Ownership Fund - and the managing board incorporating the general manager of the company, two banking managers and two managers of some trading companies in the textile field.

In its present structure as institutional representation the shareholders' meeting is a transitional decisional body until the privatization of the company.

In September 1994, a management agreement was signed by a manager team of five persons, of which one is a general manager, and the representatives of the State Ownership Fund and Private Ownership Fund. The organizational structure of the company is conceived on three levels: management offices, functional compartments, production workshops. The company activity is co-ordinated by three management directions: technical or of production, commercial and financial - accounting.

There are 17 functional compartments which contribute to practice the functions of the enterprise and company management.

According to the technical endowment, the production activity is organized in ten workshops, such as : dyeing works, spinning mill, weaving mill preparation, weaving mill, tissue control to find out and rectify some weaving mistakes, finishing, wadding linen, design and mechanic-energetic shops. All these workshops assure the carrying on of the whole technological flow.

The company disposes also of a creche-kindergarten for employees' children, an eating hall, three employees accommodation and a sports base for lawn tennis.

### **5.6.3. Market of the company products**

The products manufactured by the company are sold both on the home market and foreign one; the prices are set by negotiations between suppliers and beneficiaries.

As the physical production decreased between 1991-1992 and then, in 1993, it amounted to the production level of 1989, a considerable change was accomplished in the structure of the sales on the home and the foreign market.

Between 1989 - 1994, an important increase of the production for export is evident, specially in 1993 and 1994, what is explained both by a decrease of the internal demands (as a result of cutting down the people's buying power) and by a relative sure solvency of the foreign partners.

**Table. 1**

*Structure evolution of the production by destinations between 1989-1994 in %*

	1989	1990	1991	1992	1993	1994 (9 m)					
Production destination	100.0	100.0	100.0	100.0	100.0	100.0	92.2	89.8	85.4	76.5	52.8
home market	52.5	7.8	10.2	14.6	23.5	47.2	47.5				
foreign market											

Source: Evidence information of the enterprise.

For the next years, it is supposed to increase the sales of the company products on the home market, as far as the people's incomes will rise.

Referring to the export, a further increase of the exported production is however conditioned by the retechnologization and the upgrading of the enterprise in order to get high and competitive quality products destined for the foreign market.

The increase of export share is proving the high flexibility of E6 to meet the rapidly changing needs of external market.

#### **5.6.4. Evolution of the economic-financial activity**

Between 1989-1994, the analysed company faced many difficulties, such as:

- ✓ restriction of the home market;
- ✓ insufficiency of working capital;
- ✓ a considerable increase of the interests due to the bank credits;
- ✓ hyperinflation;
- ✓ increasing financial arrears and interenterprises credits;
- ✓ imbalances between the prices of the fuel and power, on the one hand and the prices of the raw materials and other materials, on the other hand;
- ✓ decorrelations between the increase of the labour productivity and salaries; - insufficient funds for upgrading and retechnologization.

The short term feed-back of the company referring to these difficulties resulted in the following actions: diversification of the performed production, increasing of efforts for a better knowledge of the foreign market, working out and permanent pursuance of the promotion program relative to the products for the foreign market, improvement of the organizational structure and the management methods as well as the improvement of the labour management and human potential use, preventive verification of the solvency of

the potential customers, sending of offers to the potential customers, a direct implication of the company in carrying on its own account trade, etc.

However, the measures adopted by the company couldn't counteract the negative influences provoked by the economic-financial difficulties.

The continuous increase of the prices for the performed products had and has a special impact on the value factors. In this respect, to point out the fact mentioned above there were calculated the factors concerning the turnover and the carried out production both in current prices and constant prices, (Table 2)

The information presented in this table show a decreasing trend of the turnover and carried out production simultaneously with a great increase of the prices. While in real terms the turnover decreased by 0.4%, the prices increased over 11 times and the carried out production diminished by 25%.

The main factor of the rise in turnover (in current prices) or of its quasi recovering in 1994 as against 1989 is the export orientation of E6 products (under the conditions of a relatively high efficiency), the enterprise having a good reputation on the external market. This was a kind of turnaround strategy for E6 which included:

- ✓ cost reduction (personnel reduction by attrition or layoff reduction in less crucial maintenance costs, leasing equipment instead of purchasing);
- ✓ reduction of assets (selling of obsolete assets, buildings and equipment not longer needed or those needed to implement an unrealistic growth strategy initially conceived by the hypercentralized, imperative planning;
- ✓ increasing revenues by a better investment of cash and current assets, better collection of receivables, tighter inventory controls, more effective advertising, sales promotion, etc.

The turnaround strategy focusing on improving the firm's efficiency has been combined with the divestment (partial selling off of assets).

**Table 2.**

*Evolution of some factors concerning results obtained between 1989-1990*  
*1989=100*

	1990	1991	1992	1993
1. Turnover				
- current prices	100.5	216.9	525.2	1171.0
- constant prices	86.7	78.4	81.6	99.6
2. Carried out production				
- current prices	96.2	220.8	500.0	883.6
- constant prices	82.6	79.7	77.5	75.0



The continuous decrease of the production performed by the company, that can be identified as a "forced" reorganization, caused by the unfavourable conjuncture in the respective period, made changes in the number of employees as well as in labour force structure (Table 3). It can be noticed a staff reduction of over 12% in 1994 as compare to 1989, especially relative to the unskilled personnel.

**Table 3**

*Evolution of personnel and structure of some labour indicators between 1989-1994 in %*

	1989	1990	1991	1992	1993 (9 m)	1994	1994/ 1989
1. Total average number of employees, of which:	100.0	100.0	100.0	100.0	100.0	100.0	
- skilled workers	81.3	83.3	80.0	80.2	80.2	79.8	86.3
- unskilled workers	3.6	3.8	3.6	3.6	3.3	3.1	75.8
- high-school specialized staff	4.7	4.8	5.8	5.7	6.1	5.8	109.3
- higher-education specialized staff	2.6	2.9	2.8	2.8	3.0	2.9	98.4
- managerial staff	0.9	1.0	1.1	1.1	1.2	1.2	113.0
- other categories	6.9	4.2	6.7	6.6	6.2	72	91.3
2. Average salary <sup>1)</sup>	100.0	341.7	265.7	309.9	153 74		
3. Labour productivity <sup>1)2)</sup>	100.0	106.5	212 3	231 2	136 3		
4. Relative share of the participation fund of the employees in the profit as compared to the wages fund	6.5	9.0	20.5	0 3	-	-	
5. Share of the tax on wages as compared to the wages fund	-	-	19.7	21.8	22 0	21.9	-

Modifications as compared to the past year.

Calculated as a ratio of turnover and total number of employees.

Source: Evidence information of the enterprise.

Now, the company has a specialized staff of high qualification degree concerning its profession. Shortly, the information make evident the following:

- ✓ change of the labour structure in order to improve it;
- ✓ lower increase of labour productivity as compared to wages (in current prices);
- ✓ upward trend (except 1993) of the ratio participation fund of the employees at the profit and wages fund;
- ✓ an important share of the tax in the wages fund.

Important changes took place in the production costs structure, too.

**Table 4.***Structure of the production costs between 1989-1994*

	1989	1990	1991	1992	1993	1994 (9 m)
Total production costs of which.	100.0	100.0	100.0	100.0	100.0	100.0
- raw materials and other materials	73.6	67.8	58.3	52.1	35.4	39.7
- personnel wages	21.0	25.5	31.3	36.8	52.4	44.8
- fuel, power, water	2.4	3.4	5.4	8.2	9.2	9.2
- maintenance and repairs	0.2	0.1	0.3	0.4	0.4	0.3
- amortization of capital investment	1.4	1.5	2.0	1.2	1.3	0.7

For the analysed period it can be easily noticed:

- the share of the costs was considerably reduced at raw materials and other materials within the total manufacturing costs what is mainly explained by the cutting down of the production volume and a relatively slower increase of the costs for raw materials and other materials as compare to fuel and power costs as well as to wages;
- the share of the costs concerning fuel, power and water increased substantially as well as personnel wages; these factors of inflation push act less intensely now;
- the stability of extremely reduced share of the costs concerning the amortization of the capital investments doesn't offer the possibility to produce funds for a faster replacement of the old equipment by other new and performant ones;
- a very low level of the costs for maintenance and repairs of capital investments which has a negative influence on their performances.

The insufficiency of own working capital required by the carrying on of the manufacturing process forced the company to resort to bank credits. This aspect is significantly illustrated by the information in Table 5.

Referring to the structures of the financial-banking liability, two aspects must be mentioned:

- ✓ a substantial increase of the share of the bank credits in the circulating assets, in the last three years;
- ✓ a high level of bank interests in the last two years, what involved a considerable reduction of the performed gross profit got by the company;

In this regard, the recapitalization of the company and the renunciation at the expensive bank credits are a very pressing solution. Also, the redistribution of the company debts as well as the freeze of the penalties in order to delay the payments and to return the credits are considered as possible ways to improve the economic-financial status of the company.

**Table 5.**

*Evolution of short time banking costs in the total circulating assets between 1989-1993 in %*

	1989	1990	1991	1992	1993
1. Share of the short time bank credits in the total of the circulating means	5.3	3.3	27.2	12.8	20.5
2. Share of the interests in the total of the short term bank credits	2.2	1.2	4.2	39.9	50.6
3. Share of bank interests due to the short term credits in the gross profit	3.9	1.3	6.9	28.6	76.8

At the same time, the restructuring funds allocated by the State Ownership Fund and recoverable from the realized dividends as well as the selling of assets represent other sources of improving the company status. Although potentially there are many strategic investors, however the privatization of the company is still an up-to-date problem.

The information presented in Table 6 print out:

the company is profitable;

- ✓ the increase of the gross and net profit is lower in regard to the turnover and the realized production within the concerned period of time;
- ✓ the profit tax remained at a very high level in 1989 and 1993, what to a great extent, doesn't stimulate the company to reinvest the profit;
- ✓ the rate of profit had a downward trend in the last three years and this fact reduces the possibilities of recapitalization of the company.
- ✓ For the next period of time, the restructuring and the privatization will be the main concern of the company. In the long run, the restructuring strategy of E6 comprises several growth strategies such as:
  - ✓ internal growth strategies assuming measures aiming at increasing sales and profits of its present products lines, especially in the domestic market;
  - ✓ diversification strategies (concentric and conglomerate diversification) in compliance with the changes in the demand based on departments and divisions to promote new opportunities and take moderate risk;
  - ✓ external growth strategies by horizontal, especially concentric and conglomerate mergers.

Given the relatively high level of its profitability as well as of attractivity for strategic buyers one can estimate that the strategical objectives and programs established by E6 are feasible and realistic. This is also sustained by an improved economic and financial situation in the last months of 1995.

**Table 6.***Evolution of main financial factors between 1989-1993*

	1989	1990	1991	1992	1993
1. Gross profit	100.0	175.8	224.7	388.3	659.8
2. Profit tax	100.0	117.9	111.4	211.8	652.5
3. Net profit	100.0	506.3	870.9	1395.1	701.5
4. Rate of gross profit <sup>1)</sup>	13.5	23.6	14.0	10.0	7.6
5. Rate of net profit <sup>2)</sup>	2.0	10.2	8.1	5.3	1.2
6. Rate of profitability <sup>3)</sup>	14.7	29.9	16.5	12.0	10.1
7. Rate of profitability of the nominal capital <sup>4)</sup>	–	–	23.6	11.5	5.8
8. Rate of profit tax <sup>5)</sup>	85.1	57	42.2	46.4	48.1

1. Calculated as ratio of gross profit and turnover
2. Calculated as ratio of net profit and turnover
3. Calculated as ratio of gross profit and production costs
4. Calculated as ratio of net profit and nominal capital
5. Calculated as ratio of profit tax and gross profit

### 5.6.5. Restructuring of the company

The company management worked out the restructuring strategy starting from and specifically extrapolating its present efficient situation and pursues to the put it into practice in order to assure a more profitability of the company.

The gradual reorganization of the company is intended to assure production and profitability levels requested by the market economy.

The reorganization program of the company intended to be carried out before, during and after the privatization has the following objectives:

- ✓ to increase the competition capacity on the international market by quality products at competitive prices;
- ✓ to maintain and develop diversified products of high quality and accessible prices on the home market;
- ✓ to improve the combination of the financial, economic, material and human resources, included the backlog of the liabilities and stocks;
- ✓ to solve the social and environmental problems.
- ✓ From the analysis of the restructuring program, it can be seen a series of ascertained facts, such as:
  - ✓ need to satisfy the demands on the home market by a commercial, coherent and offensive policy;
  - ✓ commercial efforts concentrated on the export to the countries with a high potential but, in the same time maintaining the present customers too;
  - ✓ reduction of the production costs by cutting down and removing some losses and
  - ✓ even some facts of negligent management of the resources.

The reorganization program involves also some risks. If it is not put immediately into practice or it is only partly applied, the long-time survival chances diminish facing the national and international competition. The most significant risk is the inactivity, that can entail in time the insolvency of the company.

The managerial restructuring focuses on:

- ✓ a complete involvement of the whole managerial team in the reorganization actions in a co-ordinated and coherent manner, avoiding existing present disfunctions;
- ✓ development of the marketing activity by an extensive investigation of the home and foreign markets in order to provide firm orders and contracts; with this aim a marketing division has been created;
- ✓ setting-up of an informational system which can permanently supply the necessary information to conceive and apply the strategy and the export policies;
- ✓ elaboration and application of an offensive strategy concerning the export;
- ✓ application of the Total Quality Management (TQM) as an indispensable solution to improve the products performances and to satisfy more the customers' demands;
- ✓ a substantial improvement of the maintenance and repairs activity referring to machines and equipment;
- ✓ a complete use of the existing human potential by stimulation in terms of a tighter connection among the base pay, the salary increases and the rewards according to the professional competence, importance and complexity of the charges, actually obtained results, working conditions, scientific labour rating and a strict correlation between wages fund and labour productivity.

The carrying out of the restructuring program imposes the increase of the responsibilities of all members of the managerial team, the participation and stimulation of the whole personnel in order to reach the company objectives, taking into account the principle that the solutions taken under cooperative conditions are not only ingenious but also attractive for all employees.

The financial restructuring intends to get a technological modernization fund from the State Ownership Fund in order to reduce or give up at bank the credits. Concomitantly, there is an activity to increase the own sources necessary to complete the working capital considering the rise of the profitability and the reduction of the needful circulating means. Anyway, in the near future the own sources aren't sufficient to accomplish a vast restructuring and that is why E6 is looking for obtaining credits from foreign banks or investors.

The technological reorganization has as scope the removal of the equipment presenting high physical wear and obsolescence, on the one hand, and the acquisition of new equipment necessary to improve the quality and to diversify the manufactured assortments, on the other hand.

At the end of 1993, the company had a development fund of 83 millions lei and a amortization fund of 477 millions lei; these funds allow only to begin the carrying on of the restructuring program but not to continue it. A good part of absolute machines and

equipment (more than 15% of the total fixed value assets) is intended to be sold or liquidated.

### **5.6.6. Privatization of the company.**

The company is entered in the Government's privatization program for period 1994-1995.

The privatization of the company imposes a selling amount, as far as possible, that allow a future better run of the company, without debts and liquidities which could affect the level of future performances.

This privatization action is considered by the managers and the employees as a means to increase the performances and the profit, and also a means to develop the individual and team initiative as well as the entrepreneurship.

It is intended that the employees and the managers buy the majority stake of shares of 51% approved selling value, namely 30% by changing their ownership certificates into shares and 21% by selling the shares to the employees and the managers under the form of the subscribed and paid cash.

The nominal capital of 49% would temporarily remain as a state ownership, this parcel of shares being to be sold on the basis of open auction or auction with selected participants, preferably foreign natural or legal persons disposing of important possibilities of investments.

In order to start the privatization program of the company, the action of getting the property in the lands utilized by the company was begun. The charges manual is in process of accomplishment for the consultancy firms as participants at the auction of offers in order to estimate the patrimony of the company.

At the same time, the Association of the Employees and Company Management was founded under the legal existent frame, in order to afford some possibilities to the employees and the managers in the privatization process.

To buy a majority parcel of shares, the employees and the managers want:

to change their total ownership certificates in shares, within the parcel of 30% due to the Private Ownership Fund;

to buy a parcel of shares of the State Ownership Fund, in cash;

to get profit from advantageous credits in order to buy 21% of shares; these credits will be returned particularly from the payments of the dividends.

Certainly the sellers of shares of the State Ownership Fund and Private Ownership Fund will accomplish a deep analysis of the alternatives of privatization, according to the buying power of the future stock-holders as well as to the development capacity of the company under conditions of transition to the market economy.

According to the Law 55/1995 of mass privatization an other new privatization scheme could be taken into account:

- ✓ a package of share of 60% from the total social capital should be given to the interested buyers (employees or non-employees of E6) by transforming the free of charge certificates of property and nominative coupons of privatization into shares;

- ✓ the remaining 40% of the social capital belonging to the State Ownership Fund is simultaneously sold by a specially organized auction in the framework of which the preference should be given to a powerful investor; 20% of auction proceedings have to be retained free of charge by the privatized company.

The disadvantages of the mass privatization schemes are:

- ✓ a dissipated mass of shareholders which makes difficult and slow the decision making process;
- ✓ the weak attractiveness for a strategic investor in the situation in which the control package of shares doesn't belong to him;
- ✓ the lack of capital for new investments in the case of the large mass of new shareholders;
- ✓ the absence of a social and enterprise's profile protection in the sense that no reasonable constraints are established for the size of labour force firing and the time-horizon change of the enterprise profile.

## **5.7. Manufacturing — Light Sources**

### **Scope of Activity**

E7 is one of the three Romanian producers of light sources and is specializing in manufacturing special electric lamps, halogen lamps, gas-discharge lamps, glass and metal semiproducts necessary for lamp manufacturing. In other words E7 is a fairly large state-owned enterprise having more than 4,200 employees with a total turnover of lei 27.2 billion in 1994 and total production costs of lei 22.45 billion in the same year. E6 has two major competitors in the country. At present E7 is covering more than 25% of the domestic market demand.

In 1994 one of E7 competitors has been privatized and because of its after-privatization situation is worsening from economic and financial viewpoints, the competitive power of E7 improved. E7 is a capital intensive enterprise what makes difficult its relatively rapid privatization and restructuring.

Given the real difficulties for the immediate privatization of the company, a set of restructuring measures (managerial, operational, technological) have been taken in accordance with the transition requirements.

The product range covers 2400 types and variants including the most diverse fields of application, such as: lamps for vehicles in car, ship, space and railway transport, industrial signal lamps, general lighting, halogen lamps for general lighting and cars, gas-discharge tubes illuminated advertising etc. E7 has a lot of customers and this creates to him difficulties in payments.

### **Management of the Company**

According to the new jobs, skills and functions, resulting from the new legislation, a series of changes in the company organization structure and the management took place.

The reorganization of the company management aims at changing management

conception, leaving aside old principles and methods, management resources and procedures, abandoning the old organization structures and statute and creating a flexible structure with a higher degree of adaptability.

These changes took place under the following conditions:

- ✓ the lack of a developing strategy of the company;
- ✓ insufficient information on home and foreign market evolution;
- ✓ insufficient management training in the field of market economy mechanisms;
- ✓ increasing difficulties, such as: insufficient financial resources, raw materials, materials, electric power;
- ✓ inertia of management staff and employees in solving the new problems.

The management system adjustment to the new requirements of the transition to the market economy was at the top of company agenda.

The new managerial conception resulting in a better adaptability of the company to the requirements of a continuously changing social and economical environment has had as concrete achievement the creation and development of marketing, financial and accounting as well as research and development departments, the change of management style, informational system improvement, development of partnership relations and negotiation forms between management and employee's representatives, promotion of competition in work relations by appointing employees to jobs on the basis of tests and the promotion to higher functions according to professional criteria.

### **5.7.3. The market**

The products manufactured here are sold on the home as well as foreign markets.

#### *Home market*

The home market of light sources includes two segments:

- a) population and b) industries
- b) In comparison with the period between 1989 and 1990, the delivery of electric lamps to the population was reduced in 1992 by 47% as compared to 1990.

The company faced difficulties in fulfilling the production program in 1993 as it lacked the financial resources necessary to ensure raw materials and other materials.

In 1993 there was an increase of 1 million pieces production, and, at the end of 1994, the production reached around 20 million pieces, representing an increase of 150% as compared to 1993. This increase is very high and unusual for the transition period. The explanation resides in the increase of the demand and the possibilities of production upgrading. Domestic demands well keep on at a high level, as a result of the following conditions:

- ✓ the demands for household and public lighting lamps increased;
- ✓ the car parks increased significantly;
- ✓ there were customized new types of efficient general lighting light sources;
- ✓ the prices of similar import products are still prohibitive for the population;
- ✓ the light sources consumption level in Western Europe is 2-3 times higher than that in Romania.



Consumption reduction in 1992-1993 was due to of payment difficulties registered by state-owned trading companies. And they are still confronted with this problem now. Nevertheless, private trading agents appeared having greater capital and larger mobility. They undertake over 80% of the sales to population, now. In the first half of 1995 the shipments of E7 have considerably increased.

b) After 1989 a series of industries restricted their activity (such as civil and industrial constructions, metallurgy, chemistry etc.) and, accordingly, the special lamps consumption. Other sectors (such as car industry, road and railroad transport, street lighting) are developing their activity and therefore manifest also increasing lamp demands.

Product sales to the industries was and still is hampered by the financial tie up that runs the risk to go even higher. As compared to 1989, the production decreased continuously, so that in 1993 a level of 55,6% was reached (see Table 1). A light improvement of the sales was registered in 1993 as compared to the previous year based on export increase. The import of special lamps in the profile of the company for the population and industry is rather low.

**Table 1.**

*Diagram of sales on home and foreign market between 1989 and 1993 (in %)*

	1989	1990	1991	1992	1993	1994
Total production index	100.0	83.2	77.5	59.1	55.6	74.8
Total sales index	100.0	85.9	71.1	56.0	63.5	75.0
of which:						
a) on the home market	100.0	100.0	101.6	57.6	55.5	61.4
b) on the foreign market	100.0	72.2	56.4	54.3	71.4	77.1
The share of sales:						
a) on the home market	49.4	57.5	59.8	50.8	43.1	54.7
b) on the foreign market	50.6	42.5	40.2	49.2	56.9	55.3

Compact lamps, protection lamps and halogen car lamps cover a larger percentage of imports. Nevertheless, E7 started to produce itself these types of lamps at 2-3 times lower prices, rising its competitiveness on the foreign market.

#### *Foreign market*

E7 is a traditional exporter, with 20-year sales on special electric and incandescent lamps market.

Since home market demands covered only half of the production, the company shifted towards the foreign market. The quality level of its products is in keeping with the European standards; the ratio of price and quality is corresponding to a large market segment. It is estimated that the market segment could be extended on the condition of quality increase, maintaining accessible prices and product range extension.

The product value for 1994 is 34% higher than that of 1993, representing 74.8% of 1989 annual production, that means a production relaunching.

The main partners were RING LAMP and STI (United Kingdom), TOP LAMP and SAAR COMMERZ (Germany), MANAD (Spain), ETECHNO and SICRAM (Italy). Approximately 75% of the export is performed through the foreign trading companies: ROMSTAR, LOHUIS S.R.L. and SELUM EUROPA S.R.L., where E7 has 33% and 50% respectively of the nominal capital.

E7 has an average profitability rate amounting to about 4%, export efficiency being still larger.

#### **5.7.4. Economic and financial conditions of the company**

The company has registered losses in 1990 and 1992 and higher profits in 1991 and 1993. At the end of 1993, the company succeeded to recover the losses of 1992 and to obtain a gross profit of 1.4 million lei, and at the end of 1994 a profit of more lei 2 million.

By 30 June 1994, the debts to suppliers (2260.0 million lei) and to the state budget (1158.0 million lei) surpass the immediately required debts (customers - 2628.3 million lei), so there are stocks (mainly finite products - 5033.8 million lei) that can and will be turned to account in the next period.

The company has a high capital shortage since only about 8.3% of the existing working capital are financed from its own resources.

The most difficult problem facing the company in this period was insuring financial resources necessary to restart production cycle. Here are some of the factors generating this situation: superinflation, the high rate of interest, a long bank cycle of debt collection, etc.

In order to improve the financial conditions of the company, the management adopted in 1994 a series of procedures intended to reduce working capital request, such as:

- ✓ reduction of material and power consumption, as well as labour;
- ✓ decrease of unfinished production and finite product stock;
- ✓ improving the time of manufacturing cycle;
- ✓ reduction of customers and suppliers credits as well as current debts towards other creditors as a result of the company capital increase;
- ✓ introduction of a more accurate administration management control.

Mention should be made that, during this year, inefficient bank credits for some suspended investment objectives of 430 million lei and bank credits for the production of suspended investments of 90 million lei were undertaken from the company on account of the domestic public debt, on the basis of Government Decision no. 441/22 July 1994.

The value of investments set into work at 30 June 1994 was 792 million lei of which 738 million lei represented the amount registered by two investment objectives for which restructuring funds are required reorganization from the State Propriety Fond: technologic fluids factory and the section for clouding, colouring and aluminizing, while 54 million lei represented expenses for other investments: gas separation, careful management of drinkable water etc.

### **5.7.5. Company restructuring**

The reorganization of the company is necessary for:

- ✓ hydrogen production for internal consumption; turning to account of the technological fluids factory excess of capacities;
- ✓ meeting present and future demands of coloured, clouded and aluminized lamps (approx. 10 times higher than the present manufacturing possibilities);
- ✓ increasing the economic activity efficiency;
- ✓ creating the conditions for privatization.

A series of steps were taken for the good understanding by all employees of the need to restructure and create favourable conditions to achieve reorganization, such as:

- ✓ the clear description of the conditions faced by the organization (difficulties and existing possibilities);
- ✓ establishing main guiding lines of the company reorganization;
- ✓ the implication into the restructuring activity of whole organizational levels;
- ✓ the formation of work groups for the elaboration and application of development strategy;
- ✓ the starting and application of a training program for all personnel categories;
- ✓ the periodic organization of dialogue between company management and employees from the main structural components.
- ✓ The reorganization study aims at the following objectives:
- ✓ finishing of works in the technologic fluids factory;
- ✓ technology upgrading and production capacity increase for coloured, clouded and aluminized bulbs;
- ✓ informational system upgrading;
- ✓ increase of profitability and competitiveness of the company.

The objectives suggested in "The study Company Restructuring" are in accordance with the general framework and directions of industrial reorganization strategy provisions for the electrotechnical sector 1993 mainly aiming at production restarting, export increase, production efficiency increase and reduction of transport expenses.

The putting into operation of new plants will result in a production increase in 1995 of 6.5 milliard lei as compared to that for 1994 and a supplementary gross profit of 1.3 milliard lei. The investment necessary to accomplish this program is about 1.7 milliard lei for buying plants and equipment specific for the two objectives and for due construction and assembly operations. As a result of lacking its own financing resources, the company resorted to support from the State Ownership Fund under the form of funds repayable in a period of three years from the dividends obtained by the company during that period.

As estimated, the dividend increase will be high enough for the company to pay back the funds received from the State Ownership Fund and to increase its own development fund. The funds necessary for the technologic reorganization of the enterprise are allocated on the condition of regularly controlling their use through State Ownership Fund organizations of the bank system. The main reorganization strategies focus on the

purchase of new technologic equipment from abroad for the increase of production capacities and upgrading manufacturing technologies.

### **Putting into operation the technologic fluid factory**

#### a) Hydrogen production

The final stage of technologic fluid factory upgrading is the putting into operation of the hydrogen production capacity by electrolysis. At present, the technologic hall has already been built, some of specific equipment has been purchased. Hydrogen is now supplied in cylinders at the price of which the most expensive is the transport.

The putting into operation of this industrial capacity will ensure the following:

- ✓ all the hydrogen necessary for the company consumption, filling of cylinders and selling of the overplus production estimated at approx. 58% (for which there is a demand);
- ✓ the use of the oxygen resulting from electrolysis for the company consumption will selling the overplus to various customers.

These objectives can be attained on the condition of building a cylinder filling station and ensuring the specific equipment.

### **Technology upgrading and development of production capacities for coloured, clouded and aluminized bulbs**

In 1993 only 4 million pieces of coloured, clouded and aluminized lamps were manufactured and sold while the export demands were of over 39 million pieces. Upgrading and modernizing of colouring, clouding and aluminizing department mainly result in a supplementary export of 1 million US dollars, due to price difference as compared to foreign market prices. The export price of this type of lamps is 1.2-3 times higher than that of the traditional lamp with transparent bulb. Since constructive differences refer only to glass bulb, production costs are only 50-60% higher.

The main objectives of upgrading are the following:

- ✓ The implementation of inner surface colouring technologies using colouring agents and having as a support the fritted glass. This technology aims at improving the technical quality of products as compared to the traditional technologies using the cellulose as support material which is not high-temperature and humidity resistant.
- ✓ Three times increase of clouding capacity. Having this in view, the clouding hall shall be finished and specific equipment should be purchased.

Now, the export of ornamental lamps (spherical, tapered, and mirroring lamps) wholly consists of clouded bulbs. The export efficiency is achieved by reaching a favourable exchange rate as compared to official one (more than 25 percentage points).

The doubling of the aluminizing capacity by purchasing new installations and upgrading the already existing ones will induce a higher economic efficiency. The export price of a 63 mm mirroring bulb is over 3 times higher than that of a classic bulb.

Calculated costs point to a 17 - 121% profitability of products as a result of technologic reorganization.

The incomes, expenses and profit analyses for 1994-1997 show that the company has a profitable activity during the whole period and will be able to return the funds received from the State Ownership Funds for its technologic restructuring and modernizing.

The investment completion requires funds from the State Ownership Fund of 1 - 3 milliard lei. These funds will be returned by the company in 3- year time from the reception with a surplus of over 50% dividends per year. These funds for reorganization and retechnologization will contribute to the diversifying of the manufacturing range of products, competitiveness and export raising.

33% of total investment for reorganization are from the company's own resources, 43% are from the State Ownership Fund and the rest from other sources. 85% of funds required from the State Ownership Fund are for construction and assembly.

As a result of production relaunching in 1994 and at the beginning of 1995, the viability of E7 has considerably increased. This revigoration was partly due to the substantial changes in the management and labour force utilisation as well as to the better use of the own resources and financial support from State Ownership Fund.

**Table 2.**

*Evolution of technical and economic estimated indicators according to expected restructuring effects 1993, achievements = 100*

ForecastsFactors	1994	1995	1996	1997
1. Electrical lamps	120.4	126.0	134.5	140.2
2. Turnover	320.7	411.9	453.1	541.4
3. Total production costs	270.7	337.6	375.0	442.5
4. Gross profit	240.0	350.0	370.0	465.0
5. Net profit	240.0	350.0	370.0	465.0
6. Number of employees	92.0	87.8	83.6	83.7
7. Labour productivity (pieces/employee)	130.8	143.5	160.8	167.5

As presented in the table in 1994-1997 the economic and financial results of reorganization will be higher than those of 1993. The following conclusions may be drawn:

- ✓ there is an yearly increase of the production and its value;
- ✓ there is a substantial profit increase;
- ✓ labour productivity will also increase as a result of both product increase and personnel reduction.

Consulting companies, such as BRAXTON, DECOITTE and TOUCHE of England carried out an analysis of the company activity at the request of the Romanian Agency for Development showing that the company can survive without even undergoing a through reorganization process.

In conclusion one can point out that E7 is a viable enterprise which needs some further financial support from the state in order to improve its efficiency performances

without changing its regime of property.

The privatization of E7 encountered some difficulties related to:

- a) the large sum needed to be paid by the private buyers;
- b) the desire of managers and employees to buy the control package of shares and the lack of necessary money to acquire it;
- c) the inexistence so far of an interested investor in buying E7 shares, explained mainly by relatively low company's profitability on the one hand and the large investment needs on the other;
- d) some factors outside the firm (environment) economic, governmental and legal; market and competitive supplies and technological do not stimulate in a sufficient measure an effective and rapid privatization.

A major problem of E7 not yet solved in a satisfactory manner which has a negative influence on the restructuring process refers to the supply with raw materials, energy and some semifinished products which in general are delivered by economic agents having a monopoly position on the market or a bad situation of production;

After a drastic decline of production till 1993 and relaunching in 1994 and the first half of 1995, E7 proved its capacity of rehabilitation being the enterprise which first is needing an in-depth restructuring with the aid of the State.

The privatization should be possible in the medium term, although the selling of some share package of the social capital to managers and employees is not excluded, taking into account the expressed intention in this sense.

**The Law regarding reorganization of state-owned enterprises into autonomous management units and trading companies, no.15/1990 and the Law regarding trading companies no. 31/1990**

# **Part III**

## **Restructuring State Enterprises in Albania**

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# Restructuring State Enterprises in Albania

## 1. Features of The Economic Structure in Albania Till The End of 80s

With the first pluralistic elections of 1991, Albania put an end to the socialist system. This historic change opened up the way to the democratic transformations and created the premises for a transition from a centralized economy to a market one, be it a **free market economy, a social market economy, or a mixed market economy.**

There is no general theory on transition or a formula helpful to all countries. A transition, however, may be characterized by two essential processes: the overthrow of the old system — the centralized economy; and, the creation of a new system — the market economy. Both processes, whose duration depends on a number of internal and external factors, run alongside and have a social and economical cost.

In Albania, too, experience shows that after the establishment of the political pluralism with its respective institutions, the economic reforms and their results define the success of the transitional period.

No new system arises from naught. Thus, the heritage from the previous system serves as the starting point, as the precondition of understanding the range and the dimensions of the necessary processes to be encouraged. It also serves to show the ways to be followed, the rhythm to be maintained for the demolition of the old system and for the construction of the new one.

### 1.1. Structure of Ownership

The economic and social system that ruled in Albania till the end of the '80s was a socialist model of the Stalinist type. It had, however, a chain of overlays which the only political power in Albania, the Party of Labor of Albania (PLA), appraised as "original and creative developments of Marxism". The whole economic and social life of the country ran on two well-known postulates:

- ✓ **the absolute rule of the social ownership everywhere and in everything; and,**
- ✓ **the centralized and planned managing of the economy by the state.**

The social ownership existed both in state property and cooperative property. This



led to the rapid demolition of every kind of private property regardless of its size, in towns and villages in the middle of the '60s. The paradoxical inclination of nationalization turned even the craftsmanship and commercial businesses in towns into state enterprises.

The monopoly of the **state property** included land, mines, forests, pastures, rivers and lakes, natural resources of energy, plants, factories, agricultural enterprises, machinery and tractor sectors, dwelling houses, roads and railway, air and sea transportation means, all kinds of banks, post-offices and their telegraphic and telephone services, radio television stations, cinematography, etc. (Constitution of the People's Socialist Republic of Albania, 1976). The industry made up the main element of the state property. After 1945, it was constructed based on centralized and planned economy principles and on the import of the technology chiefly from the former socialist countries. Its distinctive feature was the high level of the concentration of the labor power and production means in big enterprises. It often had huge expenses and little input efficiency. In 1980, 1/3 of the total number of the labor power were concentrated in enterprises with more than 2,000 workers.

The **cooperative** (or group) **property** was mainly established in villages as agriculture cooperatives. In the first phase, these cooperatives were small. Most of them had about 100-150 ha of land. Later, these cooperatives united and formed big cooperatives with an initial land property of 500-700 ha and then 2,000-3,000 ha. Some of these grown cooperatives turned into the so-called 'cooperatives of the high type' in whose businesses the state participated directly, thus becoming a joint-owner.

The state sector of agriculture represented a considerable part in the Albanian agriculture. It consisted of a number of specific enterprises that dealt with the purchase of agricultural and livestock products and with the supply of all inputs necessary for the continuation of production. The **personal property**, too, was a part of the structure of the social economic ownership in Albania. It covered the means of the personal use of the family and members of the society. It never included the production means that could enable independent social and economical activity, of whatever kind and size. It allowed for use only some simple work tools that were used by members of agriculture cooperatives in their personal land plot.

The **land plot of the agriculture cooperative member** was considered as a particular kind of personal property. Its size varied according to the extent of the regions of the country. It had 0.10-0.15 ha of arable land given for use to a family, that was a member of the cooperative, but it, however, remained a property of the agriculture cooperative. In this small parcel of land the family could keep a cow or 10 sheep as well as poultry and bees. At the beginning of the 80s, the land plot reduced and turned into common property. This change was conducted based on the collectivization of the agriculture cooperative member's personal cattle and livestock.

The following data of 1989 give a general synthetic view of the importance the ownership structure in the respective sectors. It also shows the role it played in the social and economic life of the whole country. (Table 1)

**Table 1.***National Income, Total Gross Industrial and Agricultural Production, Labor Force*

	<b>Total</b>	State sector	Cooperant .sector	Land plot	Private sector
National income (in %)	100	74	26	—	—
Total Labor Force (in 000)	1.400	840	560	-	-
Total gross industrial production (in %)	100	96	4	-	-
Total gross agricultural production (in %)	100	29.8	60.1	10.1	-
Area of agricultural land (000/ha)	706	168	519	19	-

*Source-* Statistical Year Book 1991

## 1.2 Organizational Dependence and Structure of Enterprises

The centralized and planned managing of the Albanian economy was conducted by means of administrative and bureaucratic ways and methods that were supported by a mechanism of a vertical hierarchic structure. This mechanism started at the top, the Political Bureau of the Central Committee of the PLA. It continued down to the Government, to the Commission of the State Plan, to the ministries of various branches and ended at the bottom — the enterprises.

The enterprises were estimated as technical-production and economic-administrative units created by the state with the quality of the juridical person. They established relations with one another for the development of their activity based on the unique state plan.

Several criteria defined the administrative-bureaucratic dependence of the enterprises. Two of them were the most important: the type of ownership; and, the competence of the state organs that approved the plan indexes and gave account for their fulfillment.

The state enterprises were subordinates of their respective ministries or of the Executive Committees of People's Councils in the districts. The ministries and other central institutions led only the enterprises that produced goods of national importance. Other enterprises were subordinates of local power organs. In 1981, these enterprises made up 80%.

The dependence of an enterprise on an administrative organ was of great importance for its activity. As a rule, the enterprises dependent on the central organs enjoyed facilities in obtaining everything necessary for the fulfillment of the plan decided by the latter.

The foreign trade sphere represented a certain characteristic. Specific enterprises for the export of the Albanian products or for the import of the foreign goods were created in

this sector. This sector was under the direct control of the Ministry of Foreign Trade that sent its representatives of commerce to other countries. The connections of the industry and of other branches of economy with the foreign trade enterprises were established through the respective ministries and central organs. The foreign trade was the most centralized sector in the central organs of the state. This enabled the state monopoly on the import-export of the goods as well as on the foreign currency.

The organization structure of the state enterprises, however, was not the same for all. It was conditioned by a range of factors like main and assistant organs for the profile of the enterprise production; the level of the concentration of production factors; the proficiency level in production; branch relation and appertaining, etc.

Usually, the organizational structure of an enterprise was defined in the decision of the Government to establish an enterprise. For an industrial enterprise, the typical structure was this: a director, chief engineer, vice-director, plan branch, financeaccounting branch, technical branch, supply and distribution branch, chief of the factory, etc. Almost the same applied also for the agricultural enterprise and other sectors of economy. Respective specifics were, however, imparted to them.

Specific duties for each component of the organizational structure and the competencies for each function to manage within an enterprise were defined by the internal rule of the enterprise.

The agriculture cooperative was formally dependent on and led by its elected organs. The highest organ was the general assembly of its members. This assembly approved the internal rule, the plan of the economic and financial activity, the organizational structure, fund raising and distribution, etc. It also elected its leading board: chairperson, vice-chairman, chief agronomist, and other members that were to be approved by the administrative organs according to the defined nomenclature. In fact, even agricultural cooperatives were fully under the control of the central and local power organs and were by the latter as agriculture state enterprises.

### **1.3. Economic and Financial Independence of Enterprises**

A state enterprise had to formally run its economic and financial activity on the principle of self-payment. This principle was embodied in the hozrashot method. This method implied that the expenses and the output of the enterprise should be calculated in financial assets (money), so that the enterprise income could cover the expenses and ensure surplus (accumulation).

An enterprise was endowed some essential funds and other means of production to fulfill the plan. In this way, the relative economic and financial independence was recognized to an enterprise in the framework of the duties defined by the plan. The enterprise had the right and the obligation as well to better organize the technological process of production; to use its essential funds more rationally; to sign contracts with other enterprises for the sale and purchase of goods and machinery according to the competencies the law allowed; to secure the labor power and engineer-technical staff; to have its state bank account, and to get credits in this bank; to keep a countable evidence;

to have its independent balance, etc.

A state enterprise had no right to use its basic funds for purposes other than those defined by the plan, or sell them. They were given by the state only for use. It similarly had no right to give or get commercial credits and was obliged to fully respect the financial discipline pre-defined by the state through its laws.

Securing profits was a fundamental part of the financial and economic independence of the enterprise. The enterprise had the right to use 10% of its profits only for these main purposes:

- a) for capital investments in its basic funds or for the multiplication of its means of trade;
- b) to satisfy social and cultural needs of its employees, as well as to reward its hardworking employees;
- c) to pay off the bank credits taken to introduce new technology; and,
- d) to be redistributed by the respective ministry to other enterprises of the same economic branch.

The rest of the profit was delivered to the state budget as profit surplus. If the enterprise obtained profits more than what the plan defined, it could use half of the profit for its own use till the annual balance was approved. The other half was used by the ministry to cover the losses of the enterprises subordinate to it, or to cover the lack of trade means that these enterprises might have.

The enterprise had to pay to the state budget the activity tax, despite its financial situation. This tax was a part of the price of wholesale goods the enterprise produced. When the enterprise could not secure profits and its work resulted to a loss, the state budget covered its losses and did not allow its bankruptcy. The excessive centralized management and the strict control of the state over the enterprises led to the disrespect of central administrative-bureaucratic organs for the financial and economic independence of the enterprises they governed.

#### **1.4. Management Principles**

In the framework of the centralized plan, the central organs recognized a formal financial and economic independence to the enterprises. The enterprise, however, could not find possibilities to use its management means and methods that might be truly efficient and independent and that might guarantee its productivity. This was a consequence of the operation of many factors: the centralization of the financial and economic indexes that regulated the whole activity of an enterprise; the external difficulties the Albanian economic development had faced time and again (the credit cut by Soviet Union and other Eastern European countries in 1961 and by China in 1978); the attempts to avoid the reforms implemented in the other countries of Eastern Europe; underestimation of the economic management methods by interpreting them as "the reestablishment of capitalism"; the equalization of the enterprise financial relations with the state budget with other relations existing in this field in other budget institutions.

Consequently, at the end of the 80s many enterprises at a national scale were

undergoing grave and critical situation that was expressed in: the ill and unprofitable use of resources (labor, basic funds and means of activity, etc.); the considerable lack of consumption commodities and those necessary for investments; in the creation of unusable stocks of goods; the poor quality of many products; lack of interest and possibility to introduce new technology. Shortly, a state of disorder was created.

At the end of the 80s the Party of Labor of Albania (PLA) tried to cope with this disorder and to eliminate its causes through the application of a restricted, lame and belated reform called "New Economic Mechanism" (NEM). In principle, this mechanism predicted to broaden the competencies and the financial and economic independence of the enterprises, the concern and the material responsibility of its employees for production growth and effectiveness increase. It also aimed to promote democracy and what were called "the line of masses" in production.

PLA envisioned to meet these objectives by making changes in the production plan of the enterprise, in export-import, in labor and wage, in finance, credit and relations with the state budget, and through declining the indexes defined by the central organs. It also aimed at growing the profit role in the life of the enterprise, to reduce and remove budget subventions for an enterprise or products resulting to loss, to ameliorate administrative price criteria and level applied by enterprises. The latter would be achieved through expanding their competencies.

New Economic Mechanism showed that even in the Albanian economy attempts started to be made to pave the way for principles of a more efficient management of enterprises. This would take effect by using even market economy instruments, despite the socialist economic structure — social ownership and the centralized management remained unchanged.

NEM was initiated at the beginning of 1990 and its full application at the second half of the same year. The changes applied to the enterprises, belated and limited freedom-giving as they were, worsened more the financial and economic state of the enterprises and of the Albanian economy as a whole.

## **2. Macro-Economic Changes and The Creation of a Market Environment for The Functioning of Enterprises After 1990**

### **2.1. Financial Stabilization**

The first transformation processes of transition in Albania initiated in a socioeconomic situation exasperated by destruction, chaos and crisis. The 45-year old selfisolation period accompanied by an economic policy of centralization principles and tendency led to the creation of an unbalanced, backward and conservative economic structure with huge and inefficient expenses of the resources. Gradually, this caused the vicious circle of anarchy with production growth almost to nil during the second half of the 80s. This threatened a full collapse to economy.

This threat became real during 1991 when the old structures of centralized management were almost completely broke and economy was commandless. There

ceased to exist, whereas the market had not been created yet. There simply was a chaotic situation that was gravely worsened by numerous strikes, by the absurd physical destruction—plunder, burning, etc.—of a part of the social property.

The overall economic situation of the country during its first steps of transition is shown by these classic macro-economic indicators:

- ✓ **Brute fall of the industrial output level** — over 40% in 1991, 51% in 1992, whereas other branches of industry did not operate at all. The agricultural output experienced a decrease of 17% in 1991. This was due to the spontaneous dissipation of the agricultural cooperatives and the dilapidation of the state system of the input supply for the agriculture and of the gathering of its output. Consequently, GDP reduced 28% in 1991 and 7.2% in 1992.
- ✓ **Country-wide unemployment.** At the end of 1992, unemployment reached 394,000 people or 26% of the active population.
- ✓ **Unprecedented budget deficit** was over 40% of GDP during 1991 and reached 50% during the first half of 1992. This was a result of the big increase of expenses, meanwhile no income was ensured and the strict control on budget expenses was lacking.
- ✓ **Huge debt to foreign countries** created from the deficit in the foreign currency payment balance - USD 254 million in 1990, USD 350 million in 1991 and USD 625 million in 1992. This situation made foreign credit impossible right in 1991.
- ✓ **Hyper-inflation** was 236% at the end of 1992.
- ✓ **Quick devaluation of Lek** whose currency exchange rate in 1991 was 1 USD = 7 Leks. In July 1992, 1 USD was equal to 106 leks.
- ✓ **Accented deficit in the foreign trade balance.** In 1991 it reached USD 308 million and in 1992 USD 470 million.

The grave economic condition of Albania was due also to the lack of political stability. This was reflected in the paralyzing of the administration and legal institution operations. Four governments were changed (First Nano, Second Nano, Stability and Technical governments) from March 1991 to March 1992. Their frequent change hindered the drafting and application of a stable long term strategy for the economy. This situation was reflected also in the living standard of the people and especially in the lack of food for their majority.

The emergent aid of the European Community and money transfers by emigration were of great help to the life of Albania. However, the start of the structural, institutional and legislative reforms was more than necessary to overcome the numerous difficulties of the situation. These reforms were required to accomplish the transition to market economy as the only and most realistic alternative for the country's future.

Macro-economic stabilization and economy liberalization were the first imperative undertaking in the function of this alternative. The former are preliminary and necessary conditions to be fulfilled in order to have a successful transition.

The macro-economic stabilization program started in March 1992, when the

Democratic Party led by Sali Berisha won in the second pluralist elections. This program gained the support of the International Monetary Fund and World Bank. It was based on these elements: liberalization of prices, trade and foreign currency exchange; restrictive monetary policy; reduction of budget deficiency; and income policy.

Viewed from all economic aspects, the transition from controlled prices to real prices through their liberalization was the most complicated and delicate block for the achievement of this objective. Despite its social consequences, this reform would prepare the Albanian economy and the state enterprises to cope with all other measures emerged from the macro-economic stabilization.

In August 1992, the Albanian Government liberalized the wholesale and retail goods' prices through 'on Prices and Tariffs' bill and its later modification. In the first phase the government exercised administrative control over about 25 articles, like wheat, bread, oil, sugar, drinkable water, electric power, rent, medicines, telecommunication and transport services, school texts, etc. Consequently, liberalized prices increased 1012 times, while those under the administrative control increased less than the former, yet without managing to cover the costs. This remained an objective to be achieved in the future. The liberalized prices and their increase that was under control, were attended by the decrease of the subventions and ended the obstacles for the promotion of the domestic output and import growth. In 1993, the subventions for the prices of the goods of consumption fell from 3,3% GDP in 1992 to 2%. With all undesirable consequences such situation brings, the downhill rolling of economy on the verge of hyper-inflation made control and the decrease of inflation one of its key objectives in the complex program for the achievement of the financial macroeconomic stabilization. In this case, the heaviest burden would fall on the reduction of budget deficit that was the main source to feed inflation. This would be achieved through the compilation and approval of a new legislation that regulates the fiscal policy, disciplines budget expenses and credits, paves the way for real norms of interest, etc.

As a result of measures taken to reduce state expenses, at the end of 1992 the budget deficit fell to 20% of GDP. Then, in 1993 it fell to 16% and 14% in 1994. This reduction was succeeded mainly through the abolition of price and other subventions. It was also due to the reduction of the number of people working in the state organs and in the state enterprise administration as well as in the civil and military service personnel. In 1992 the state administration had employed 260,000 persons. In 1994 this figure dropped to 160,000 persons. The budget deficiency reduced due to the removal of almost all state subventions to the prices of consumption goods and to the non-productive state enterprises. In 1991 these subventions were 17,8% of GDP, in 1994 they dropped almost to zero. State budget deficit reduced also because of the income increase from the customs system and taxes.

While speaking about financial macro-economic stabilization, ceiling credit given from the banks played an important role. This was accompanied by the high rate interest policy, which is currently defined in an administrative way. Thus, from July 1992 the annual interest rate was 39%. In July 1993 it reduced to 30% and in 1994 it fell to 26%,

whereas in 1995 it reached 20%. With the creation of the new bank system on two levels based on the Law No. 7560, date 28.04.1992, the National Bank of Albania oriented the second level commercial banks to give short-termed credits. The short-termed credits comprised 85% of total credits given during 1993.

A big number of labor power is employed in the state enterprises. Thus, the Government settled a ceiling nominal wage in the various branches of economy, according to the objectives of keeping under control the inflation flow and rate. As a result, the monthly average wage increased less than the consumption commodity price. This led to the decrease of the real wage of the state sector employees. In 1994 the real average wage in the public sector was 16.3% smaller than in 1990.

The application of this ambitious program with its paces would be impossible without the numerous financial assistance of the international organization and the foreign currency transfers of the Albanian emigration. From 1991 till the end of 1993, Albanian received an overall foreign aid of about 900 million ECU from the European Community. The average income was 270 ECU per person, whereas the national income was about 600 USD per person a year. The foreign currency transfers of the Albanian emigration have influenced a great in the financial stabilization. The exact figures on these transfers by the state organs that deal with these are lacking. However, these transfers are supposed to reach the annual average of USD 200 million during 1991-1993 and USD 350 million during 1994. The mass media say these figures are higher. Keeping the main financial aggregates in an economic scale under strict control enabled the fall of inflation rate from 236% at the end of 1992 to 31% at the end of 1993. In 1994 the inflation rate was not more than 16% and in 1995 it was 10%. The financial stabilization was reflected with the stabilization of the Albanian Lck. Full change ability of Lck for the internal accounting flows was achieved. Despite its inconsiderable ups and downs, the relative stability of the changing the Albanian Lck with foreign currencies was achieved as well. One American dollar was changed with 106 Albanian leks in July 1992. At the end of 1995 one American dollar was 94 leks.

Three years after the application of this policy, the inflation rate fell to 10% in 1995, budget deficit to 12%. The foreign currency change has been almost stable during the last two years. The foreign debt of 500 million USD inherited from the previous regimes has been settled (20% of the foreign debt are paid off, the rest is rescinded). These are undoubtedly a relative success of the macro-economic stabilization program. If other criterion of estimation, wider than those mentioned above, one would see that the industrial output is still decreasing, although at a lower rate. The deficit of the trade balance is constant in spite of the growth of export. The massive unemployment has reduced due to the illegal immigration to the neighboring countries. According to the optimistic predictions of a study performed by an international organization, Albanians hope "to see a light at the end of the tunnel perhaps by 2005" (Albania 1995, UNDP, Tirana 1995).

All these were accompanied by the huge changes in the structure of the social production. The former main sector of economy, the industry, gives now only 11% of



the overall social production, whereas agriculture from 37% in 1990 to 56% in 1995, Economy passed from one disequilibrium to another. (Table 2)

**Table 2***Selected Macro-Economic Indicators, 1990-1995*

	1990	1991	1992	1993	1994	1995
Nominal GDP (mil. Leks)	16,813	16,473	49,517	113,041	171,215	
Nominal GDP (mil. USD)	2,102	1,144	660	1,107	1,781	
Real Growth (%)	M0	-28	-7.2	9.6	9.4	
Industry	-14.2	-42	-51.2	-40	-2	
Agriculture	-5.4	-17.4	18.5	10.4	10.3	
Average Inflation Rate	0	35.5	226	85	22.5	
Infl. Rate (end of period)	0	104.1	236.6	30.9	15.8	
Exchange Rate (Lek/USD)	7	14.4	74.5	102.4	94.7	93.1
Trade Balance (mil. USD)	150	-308	-470	-489	-459	-482
Unemployment (000 pers.)	150	140	394	301	262	191
Gover. Deficit (% of GDP)	43.7	21.8	13.9	12.1		

Source: Ministry of Finance and IMF estimations.

## 2.2. Opening of Economy

Transition to an open market economy cannot be realized unless an end to the selfisolation of the Albanian economy is put. Also, the integration to the world economy, and the economic and financial cooperation with the other countries and international organizations specialized in this field is essential to Albanian economy.

This unavoidable process made the termination of the state monopoly on the foreign trade and currency inevitable. It also required the creation of a new liberalized order for the payments, for the foreign currency, for the economic relations with other countries, and for the emigration in the labor foreign market. Alongside this, the Albanian Lek had to be stabilized. Its real exchange rate was to be achieved. These requirements were sanctioned with the approval of the respective laws during 1991-1992.

The realization of this process started with Albania's membership in principal international economic and financial organizations, like International Monetary Fund (IMF) in 1991, World Bank (WB) in 1992, the European Bank for Development and Reconstruction in 1992, and with the establishment of institutionalized relations with the European Common Market (ECM) in 1991.

In December 1992, the agreement on trade and cooperation with the European Union entered on force. This "first generation" agreement is the premise to the achievement of an another association agreement with the European Common Market in the future.

The Albanian actual system of the foreign trade, of the payment, and of foreign

currency is legally not restricted. The export licenses are limited only for a few products. There are no import licenses or quotas, while the norms of tariff code have been reduced to a considerable number. 80% of the foreign trade activity are actually accomplished by the private sector.

The stability level of the opening of the Albanian economy to the outside world is dependent on the foreign investments in the Albanian economy. In this field, there are still unsolved problems. However, there are encouraging signs of the interest the foreign capital (mainly Greek and Italian) is showing in Albania to invest in the economy. From the estimations of the state organs, 400 joint-ventures have been created until 1994, out of which 110 in the production sector. The foreign investment capital is as much as USD 120 million.

The approval of the law "On the Foreign Investments" in November 1993 completed with other governmental decisions as well the legal definition on ownership, will promote foreign investments.

Another meaningful indicator of the opening of the Albanian economy is the emigration in the international labor market. This is a new phenomenon for Albania since the World War II, and started in the second half of 1990.

With the break of the prolonged self-isolation and due to the very grave economic and social situation, emigration as massive exoduses occurred in great measures. Some statistics say that at the end of 1992 the number of the Albanian emigrants living and working in Greece and Italy was about 300.000. This means that nearly 10% of the total population and 16% of the labor power had emigrated during this period. Nowadays the massive exoduses have not been proved. The illegal emigration, however, has not interrupted. The total number of the Albanian emigrant (many of them illegal) is supposed to be 350 - 400 thousand, who are working temporarily or seasonally (Misja 1995). It is important that this emigration be no spontaneous, but organized to increase its economic and social efficiency so that Albania overcomes the difficulties it is coping with at present.

In the framework of the problems whose solution would facilitate the opening of the Albanian economy, appropriate solution of 500 million USD debt of the state to foreign countries unpaid up to now is fundamental. The debt was solved in 1995 through paying off 20% and the other part was rescinded. So, the way to new credits from foreign private banks was opened to Albania.

### **2.3. Private Sector Development**

After the stabilization and liberalization of economy, the creation of the private sector is the most important and essential element to pass to market economy. The programs of all the political parties running their activities in the Albanian pluralist scene converge in this point. Their divergences, however, include the ways, the methods and the paces of the private sector creation as well as the model of the market economy in Albania at the end of the transition period.

The creation of the economic private sector is realized by interweaving two ways: 1.

Social property privatization, and, 2. Stimulation of the new private activities in all the branches of economy.

The first phase of privatization started in the middle of 1991 and ended in 1993, The privatization covered retail sale enterprises, craftsmanship and service enterprises (hotels, restaurants, bar-buffets, etc.). Transport, construction, dwelling houses and apartments, the former agriculture cooperative land as well as giving the land of the former agricultural enterprises for use to its employees, were privatized. During this phase several enterprises of the light and food industry and of other branches were privatized. We might mention workshops, factories, and small or middle size enterprises. Besides this, Albanian and foreign investors have created new private enterprises in the production and service economic sphere during this period.

At the end of 1995, **the private sector of economy, where small enterprises are predominant** (Table 3), **gave 65% of GDP, whereas 70% of the national property has been privatized.**

**Table 3.**

*Number of Active Economic Private Enterprises According to The Number of Employees and Economic Activity:*

Empl	Agriculture	Industry	Construction	Trade	Transport	Service	TOTAL
1	1.004	2.683	241	20.173	5.999	5.823	5.923
2	125	524	146	3.324	989	1.048	6.156
3-4	73	383	103	909	105	470	2.043
5-9	40	211	137	256	18	167	829
10- 19	31	107	114	66	12	60	390
20-49	9	89	67	44	9	52	270
50 -99	11	20	14	6	6	11	68
Over	1004	41	14	3	4	6	72
TOTAL	1.297	4.058	836	24.781	7.142	7.637	5.751

*Source:* Statistics 8, 1995

The private sector created in agriculture represents one of the most important component of the Albanian economic private sector. The following facts indicate its importance in the economy:

- Agriculture produces about 56% of the overall value of the domestic production, and 2/3 of the population continues to live in the countryside.

With the completion of the land privatization, 440,000 private farms have been created in the countryside. The average plot of land a farm owns is 1.4 hectare<sup>1</sup>. In 1993 these farms gave almost all the agricultural production of the country.

<sup>1</sup> Osmani M. Tranzicioni, problemi bujqesor dhe shteti, Rilindja Demokratike, 2 9.1995

The creation of the private sector and the privatization of the social property were backed by drafting and approving several laws concerning these processes during 1991-1993. Few important ones might be worth mentioning.

- ✓ 'On State Enterprises' (July 13,1992)
- ✓ 'On Land'(July 19,1991)
- ✓ 'On Foreign Investments' (August 8,1992)
- ✓ 'On State Enterprise Bankruptcy"
- ✓ 'On Sanctioning and Protection of the Private Property, Free Initiative, Independent Private Activities, and Privatization.'
- ✓ 'On Returning and Compensating the Property to the Former Proprietors'

Some of these laws did not fully respond to the actual problems the privatization and free private sector development rose. Some other laws are being drafted to give a solution to these problems.

The **National Privatization Agency** was main institution appointed to privatize the state property. It was set up and functioned at the Council of Ministers. This agency was given the task to manage, organize and coordinate the work for the process of privatization.

To accelerate the privatization process, two new elements were assigned to the National Privatization Agency in May of 1993: 1. The Board of the National Privatization Agency at the capital city; and, 2. the boards of the branches of this agency in other district of the country. It is the right and duty of these boards to define the method they will use to privatize every object and to select potential subjects to participate in the privatization of an object through auction.

### **3. National Policy and Institutional Framework for the State Enterprise Restructuring**

#### **3.1. The Legislative Framework for Restructuring**

Macro-economic stabilization and state enterprise privatization do not simply imply aims. Either can these complex social-economic processes be conditioned by momentary political interests or fancies. They should first consider the possibilities, the real needs and the perspectives for the restructuring of the whole economy to establish market economy on one hand and to create a powerful private sector on the other hand by reducing the public sector.

Pursuing this strategy would solve two of the most urgent problems of the transition:

- ✓ Dynamic re-activation of a part of industry that stopped operating due to the cut of subventions by the State;
- ✓ Employment of as much as possible of the jobless labor power by promoting the structural transformation of industry and the development of the new production and service activities.

The achievement of these objectives through state enterprise restructuring is the most important and difficult field of the economic reform during the transition in Albania. Viewed from many angles, the state enterprises are in urgent need of restructuring. Ownership is one of the major problems. **Their capital stock has undergone excessive moral and physical dilapidation<sup>1</sup>.** In 1989 this stock had an average level of physical consumption of as much as 70%. This continued to worsen during the first years of transition.

Among branches of economy, the capital stock of geology, mineral and oil extraction industry, textile industry, and construction had the highest level of consumption. For example, 30% of construction heavy machinery and 44% of its transportation means had passed the accepted limits of their physical amortization. The average age of the mechanical machinery in the mechanics industry was 25 years old. Other branches of industry were in similar conditions.

**The low level of production and labor mechanics** was another exasperate phenomenon to this situation. In 1989 the mechanics level in the material production branches, excluding agriculture, was about 53%. In food and mineral industries this level was even lower. The process of plastering, for example, that occupied 25% of the work volume, was almost done physically, due to the lack of modern equipments that would facilitate the work by rendering it almost completely mechanically.

This situation was a result of **remarkable surplus of labor power** that reached 2530% of the overall labor power employed in the state enterprises<sup>2</sup>.

Even **structure and quality of the commodities** the state enterprises produced or are currently producing lagged behind (and still do) of those of the international markets. Some of the enterprises belong to the futureless branches of heavy industry that during the totalitarian regime were running completely on state subventions on the expense of productive enterprises. They are now coping with the international competition.

In these conditions, the preparation and transformation of the state enterprises to the new market economy system should inevitably be attended by an overall restructuring covering ownership, organization, management, marketing, technology renewal, product structure and quality, financial system, managers' mentality change, etc. The whole restructuring should aim at making the enterprise products successfully handle the competition in the domestic and international markets and maximize profits.

The compilation of legislative regulations and laws would be the first necessary step to precede the state enterprise restructuring. They should be adequate for the market economy system. To meet this objective, a number of portentous laws have been approved, out of which a law on state enterprises occupies an important place. This bill was passed in July 1992 and regulated the economic, financial and managing activity of

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<sup>1</sup> Mara H. Problems and perspectives of the Albanian economy viewed from the aim of establishing a market economy, Quaderni Mediterranei 1. Bari 1991

the state enterprises. It defined the juridical regime of the state enterprises in accordance with the objective envisioned in the act of its creation. The state enterprise has the right to exercise productive, commercial and/or service activity aiming to increase its profits and its assets value. This bill solves even the key problem of ownership. The state is and remains the sole owner of the enterprise capital. The competencies of the state enterprise have been adapted to the free market demands in the conditions of free competition. A state enterprise has no right or privilege to devastate these conditions.

As far as production is concerned, the state enterprise has the full right to decide the quantity and structure of the commodities it will produce based on the demand and offer of the market. It will also decide the techniques and technology it will use, on the supply sources, on prices, on quantity and structure of all inputs it will use, on the number of employees and their wage, etc. Likewise, it enjoys full right to define its financial program of expenses, income and profits. In accordance with this, an enterprise has the right to set the price for its products and find a domestic and/or foreign market for their sale, thus coping with the competition. The bill also defines the way of using the profits, of financing the investments, the right to get credits and loans, of keeping an analytic accounting, etc. Finally, this bill defines the leading organs of the enterprise, the nomination or dismissal of the leading council and director, and other competencies these organs have.

The legislative framework for the enterprises restructuring included the law **„On State Enterprise Bankruptcy“** too. This law describes in details the cases when a state enterprise submits to the process of bankruptcy. It also describes bankruptcy objects and procedures as well as the ways of an enterprise liquidation. Another law and other governmental laws related to it sanction and define the procedures of exercising, protecting private enterprise activity, its rights and obligations, and **the institutional aspects of state enterprise privatization**. The law **„On Trade Companies“** specifies the definition on trade associations, their types, statute, advertising, economic and financial relations, management, legal responsibilities up to their bankruptcy. Finally, a law **„On Foreign Investments“** came to help foreign investors in Albania. According to this law, "A foreign investor enjoys the same rights as the Albanian investor." Likewise, a foreign investor enjoys full protection from nationalization, etc. The law does not include bureaucratic obstacles for foreign investors, such as authorizations and other papers like that. The law recognizes the right of foreign investors to settle disagreements in international courts, to transfer their profits and capital, etc. Another guarantee for foreign investors is the approval of the decree on real estates and pawn.

### **3.2. State Policy on Industry and The Problems of Restructure Privatization Proportion**

The crisis the Albanian economy is undergoing is a consequence of the crisis ruling in industry. The sharp symptoms of the economic crisis like the drastic fall of output level, massive unemployment, the huge deficit in the payment balance, inflation, etc., emerged in this sector. Many state enterprises are not operating yet, or are working at a lower level than their real capacity allows. Most enterprises feature a high consumption

of raw material and electricity per unit of extracted product. Their majority should better be imported. Finally, it should be mentioned that during the first transitional years all enterprises lacked the management resources suitable to market economy.

To overcome the crises that have clenched the Albanian industry, it is important to intervene immediately and at a large scale. The intervention to the productive system of industry will, of course, four-square complicate operation that will be followed by a high social and economic cost. To meet this objective, the Albanian Government compiled a medium-termed program (1994-1996) in which the government has defined the policy it will apply to industry. Its main directions are:

**Strengthening and expansion of the energetic sector** through the development of the oil extraction and processing industry, gas industry and electric power industry;

**Oil production** was in 1994 about 550.000 tons and natural gas was 52 million cubic meters. The technology and technical means and tools are old and there is a considerable lack of in the most necessary material base. Outmoded methods of work and organization are still being applied. These factors render the actual production level unsecured and its growth difficult. The personnel are skilled and capable of grasping and applying the modern technology. Investments in this sector have proven efficient. Thus, many foreign companies, like OMV, AGIP, OXY, CHEVRON, HAMILTON, etc., have started their work in searching oil in sea and terra.

**The oil processing industry** is composed of 4 plants, out of which only one is operating. Two of them have closed because their technology is quite backward and the technical and work means and tools are extremely amortized.

**The electric power industry** has a considerable energetic potentiality. Its annual output during 1994 was 3,9 billion kilowatts per hour. The rich and unexploded hydroenergetic resources enable the 4-5 fold increase of this output. During the period of the medium-termed program, the government will seek financial possibilities for the construction of a 60 MG new hydro-power station. At present, the main attempts will be concentrated in the development of the transmission system in order to increase the exploitation level of the existing generation capacities. In this way, the electric power output will reach 4 billion kilowatts per hour in 1995. An urgent in this sector is the decrease of the losses and abuses in the electric network. They make up 40% of the total electric power amount produced.

In the framework of energy, there will be no development in the **coal industry**. What is more, there will less output in comparison with its capacity. The production of 2,2 million tons in 1989 decreased to 170.000 tons in 1994. The decline of output is due to drop of the economy's demand for coal, of its high costs and poor quality. Consequently, many mines have closed.

**The chrome industry** will take priority in the **mineral extraction industry**, in which Albania is relatively rich. In 1989 about 10 million tons of chrome were extracted. Nowadays and in a medium term perspective, this branch of industry will more than any other branches contribute to obtain foreign currency and to secure the country's payment balance. The development of the chrome industry will rely mainly on the increase of the

local processing capacities of the chrome and of its concentrate in ironchrome. To achieve this, investments to improve the technology of processing furnaces of iron-chrome by turning them into open furnaces will be made. Alongside these, new mines will open and the ones that are not productive will close.

**Copper industry** output has undergone a remarkable drop, though this industry works in a closed cycle. There are many mines of this branch that are not efficacious and its revival requires an overall reconstruction.

**The black metallurgy** has really been "black hole" to all the Albanian economy. It grabbed the limited sources of foreign currency. Its future is problematic. The nickelcobalt plant is close, whereas for other metal minerals some small workshops and electric furnaces are working.

In other branches of industry, like **chemical, rubber, plastic, and glass**, there are many enterprises that with a re-organization and restructuring have the chances to survive. So, it is expected that they develop, increase their production and improve the quality of their products.

**The industry of phosphate fertilizer** will have the state support. In this way, it can become competitive in the market economy. **Sodium, and chlorine products industry** has closed down not only due to the low output but also due to the great pollution in Vlora region. This seaside region is one of the most important tourist resorts of Albania.

The **construction material industry** is showing a remarkable revival. Cement, bricks and other construction materials production are thriving due to the demand increase for public and production construction. The development in this industry indicates that it will succeed its production, though it is in need of radical technological and organizational restructuring.

The **light and agri-food industry** comprised 42% of the overall industrial output in the centralized economic system and provided 85% of the overall consumption commodity circulating in the domestic market. It now has to cope with difficulties like the competition of the foreign market commodities of low prices good quality, and lack of foreign currency to import raw material with which some enterprises will process. The survival of these enterprises requires the introduction of modern technology that bring radical improvements in the product quality, in accordance with the demands and taste of the consumer. This policy of the state must be considered as an integral part of the total concept on national production restructuring. It should be reflected in the market economy construction strategy with open and competing capabilities to world market to provide an equilibrated payment balance.

The government has planned to take these measures:

- ✓ closing down all non-productive enterprises and those that have no chances to become productive and profitable in short and medium terms;
- ✓ temporary closing down non-productive enterprises that have chances to become productive and profitable in short and medium terms when financial capabilities are accessible;
- ✓ transformation of state enterprises in stock holder companies.



The **total and rapid privatization** is a necessary premise to Government **of the** complex and long-termed solution of the industry restructure and development. **The** acceleration of privatization process in the actual conditions of Albania requires **the** inclusion of large state enterprises in this process, because they produce the main **pari** of the country's output. Large state enterprises are those that have more than 300 **workers** and a capital stock of 500,000 USD. There are 300 similar enterprises that **include** mines, harbors, banks, telecommunication, hydro power stations, etc. Medium enterprise are those enterprises whose capital stock is less than 500,000 USD and that have employed less than 300 workers. Small enterprises include those enterprises with less than 100,000 USD as capital stock and with no more than 50 employees.

Speeding up the privatization process set two main problems for an adequate solution: a) restructure-privatization proportion; and, b) utilization of a method for a rapid privatization of large state enterprises. The solution of the second problem would enable investments in these enterprises, which would be acceptable by the population.

The strategy of the Albanian Government is quite firm in solving the restructure-privatization proportion. Large state enterprise restructure will not hinder rapid privatization, and it will continue. The new private owners will proceed with the restructure of these enterprises. On the other hand, the privatization of those large enterprises, that since August 1995 have started to become stock holder companies, is being conducted by combining and applying two way at the same time: privatization vouchers, that will be given to people over 18 and living in towns and cities. The vouchers are interchangeable with shares of enterprises to be privatized. The second way is the sale of enterprises to foreign or native investors in cash.

### **3.3. Restructure State Institutions**

Due to the conditions created by market and price liberalization as well as to the new policy of interest norms, state enterprise restructure could not be realized out of the free forces of the market. A self-conscious action of the government would be more than necessary to restructure state enterprises.

To meet this objective, in September 1992 the Council of Ministers decided to create an **administrative unit for the Short-Termed Support for State Enterprises (SSE)**. This unit would function at the Ministry of Finance. The unit would help state enterprises by importing raw material and providing technical assistance for a two year period. It estimated and distributed all aid due to the lack of expertise in commercial banks. International organizations donated aid to the Albanian state or delivered it in concessionaire credits. Such aid were two credits of ECU 10 million and 20 million delivered by the European Community through PFIARE project and were predestined for industrial inputs. Any ministry that administered state enterprises had units similar with the SSE unit of the Ministry of Finance.

SSE unit was also to help Government in preparing a short-termed plan on those enterprises that could not be immediately privatized and for which credits were needed. Based on this plan, and on a questionnaire prepared with the assistance of Cooper and

Lybrand Company experts, SSE created **a new information system, identified the state enterprises that could survive** in the new conditions of the price and market liberalization, and the **non-competitive enterprises that would have to close down**. Finally, SSE had to help state enterprises in developing managing skills. It also had to provide state institutions that administered production state enterprises financial and marketing expertise.

State enterprises that would receive SSE assistance were divided in two categories:

The first category included all enterprises that could pay the counter-party value of the imported goods in cash. The payment might be through their financial means or through credits in leks state enterprises obtained from banks on commercial conditions. Enterprises might be state or private-owned. The latter would profit provided their aim to use the assistance or the credits did not contradicted the aims of the foreign assistance.

The second category covered enterprises that cannot pay credits off immediately, but that SSE, based on its criteria, judged that they should be primarily supported with credits through imported goods. Criteria utilized for an enterprise were: perspectives to become profitable; potential exports; efficiency of medium and long term production operation; links with the other economic sectors; perspective to be privatized; employment of people; quality of management; readiness and punctuation to pay previous debts, etc.

Based on these criteria and in collaboration with the units at each ministry, SSE selected the enterprises that would obtain the credits delivered by the European Community. Then, from the lists of demands of enterprises, made the list and defined the needs for raw material, distributed the funds, etc. SSE would send the list with the request for raw material to the Italian procuring Company ITALTREND. This company was chosen by the European Community, and organized the auctions for input purchase.

SSE credits were given at a interest rate 25% higher than the interest rate for similar credits delivered then by the National Commercial Bank of Albania. The schedule to pay off started 6 months later from the date the credit was obtained. It did not end later than 18 months starting from this date.

During a year and a half period, SSE activity stretched on 140 state enterprises. Its main objective was to ensure the continuation of production activity of these state enterprises through obtaining raw material for them from European Community member countries and through getting foreign technical assistance. Raw material was often purchased at higher prices than the international market prices.

In the framework of small, medium and large state enterprises restructure, SSE compiled registers with the technical, economic and financial data in accordance with market economy demands. Registers included information and data on 2,000 state enterprises. It was on this basis that the new information system on state enterprises was processed. This system showed that **few medium and large state enterprises could be privatized without first undergoing restructure**.

In order to help state enterprises restructure with a more qualified assistance, the Albanian Government set up the **State Enterprise Restructure Agency (ERA),** **thai**

enjoyed juridical rights. This agency was appointed to directly administrate 32 large state enterprises that were selected from various branches of industry. They represent the majority of industrial problems of the Albanian economy. These problems lie in the concentration and the monopoly characteristic of their production; high costs and poor quality of the goods as a result of outdated technology; a production structure that does not respond to the demands; the labor power employed in these enterprises; and, the non-productivity of most of them. With the start of radical reforms, their deficit became even bigger due to the removal of state subventions; due to imported goods and commodity competition; a destruction of production links, and because experts and specialists working in these enterprises left as private enterprises offered much better payment to them<sup>3</sup>. At the end of 1993, 23,520 workers or 22% of labor power were employed in these state enterprises. ERA is organized and functions in accordance with its statute. ERA and its director are the ministry and the minister respectively for the enterprises that are their subordinate, as far as their competencies and obligations defined in "On State Enterprises" bill are concerned.

The main objective of ERA is to give assistance to the 32 state enterprises it administers, so that these enterprises become efficient and later be privatized to local or foreign investors. The realization of this objective asks for a radical restructure based on the market economy logic. Through this restructure, the best alternative for their perspective will be set within a reasonable period of time. Another result would be their transformation into efficient enterprises by making them ready in all directions for privatization, or liquidate them and sell their actives. It is predicted that 17 million USD be used for the state enterprise restructure. This fund is taken from budget sources or from the credits of the World Bank given as technical assistance. Based on the studies of local and foreign specialists, funds for ERA are given as credits for enterprises with the same interest rate as the local banks.

State enterprise restructure includes some elements that can be realized in several phases. These elements are:

**Organization restructure.** This meant the division of large enterprises, the unification of some units, the creation of suitable structures for administration, the creation of suitable structure for financial information, the preparation of new and real business plans, etc.

**Financial restructure** implied the creation of efficient financial structures and the cleaning of the accounting from reciprocal debts with other state enterprises.

**Labor power and administration restructure** stressed the creation of an administration oriented to market, the reduction of labor power at a necessary level for function, etc.

**Production restructure** required the replacement of old machinery, updating buildings and equipments, the application of advanced technology, and the creation of logistic structure.

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3 Celso G., Enterprise restructuring process in Albania, Tirana 1995.

The first three elements required small investments. They could be relatively quickly realized and be applied before privatization. The fourth element needed great investments of medium and long term.

In July 1994 the Albanian Government declared the general strategy of privatization for 1994-1996, that during that time was missing. This strategy defined the main methods, criteria, and forms for privatization. These criteria, clearly defined in "Privatization Strategy" (Kopliku 1994) were:

**Rapid privatization**, with the objective of privatizing as many sectors as possible, running on slogans like "within 1996 we must have privatized the majority of the Albanian economy", or "in 1997 more than 70% of GDP must come from the private sector", etc.

**Total privatization of economy**, or, as stated in "Privatization Strategy", "all state property that can be privatized". The strategy writes "A property is considered possible to be privatized if somewhere in the world this kind of property is private."

**Privatization, then restructure**. This implies investments to improve technology, to increase production, etc. This restructure, related to material and time expenses, will be realized after the privatization of the enterprise.

The capitals by people were very few, and the acceleration of privatization was the first criterion. Thus, realization of this strategy would condition the selection of the main privatization method, the one with vouchers, especially for large state enterprises. Besides this, "Privatization Strategy" advised that state enterprises be divided in smaller parts, so that their privatization speeded up.

In these conditions, ERA and other structures set up for the privatization of state enterprises were paralyzed. For the moment, the State Enterprise Restructure Agency and its subordinate units were charged with the duty to forward the methods of enterprise restructure to the person(s) that wanted to privatize and buy the enterprise. They were also to help the future owner(s) of an enterprise with the respective non-commercial financial credits, or with raw material accorded by the European Community.

The state enterprises, that were under restructure process and for which the Government had obtained financial support from international organizations, continued to make investments for their restructure. The private owner(s) that would buy these enterprises would have to meet a condition that prior to buying the enterprise, the owner(s) would engage in continuing the restructure and pay the respective financial support to the state, so that the state did not suffer financial losses. The state continued to withhold the payments to foreign financiers, despite that this financing continued to be realized in a private enterprise.

## **4. Structure Changes in State Enterprise System**

### **4.1. Ownership Structure**

The radical reform for the transformation of the Albanian economy that started to apply during the second half of 1992 aimed at achieving two main objectives: a. macroeconomic stabilization; b. creation of market structure with its mechanisms.

This complex process would be accompanied by an ambitious program of privatization through re-delivering the right of ownership and reducing the load of state enterprises on the economy of the country. This program would also aim to restructure the Albanian economy by eliminating the non-efficient agents and structures of the latter. Two years after the application of this reform, it is noticed that its main objectives have not been achieved at the desirable level. Despite its relative successes, the Albanian economy is still facing sharp problems and huge disequilibrium, whereas state enterprise privatization and restructure have not gone with the predicted rhythm.

Most state properties privatized up to now are small and medium enterprises that had previously been administered by the trade, service, transport and agriculture sectors.

The foreign capital has taken part and played its role in the ownership structure of the Albanian economy. This applies mostly to joint ventures with private and state enterprises. The main part of the foreign capital is invested in industry, mineral and energy resources, agriculture and food, and tourism.

The new ownership structure in the Albanian economy, that is still developing, witnessed that from now on the absolute rule of the state property in the economy of the country has come to an end. The state property was then the basis of the centralized economy. The formal solution of the ownership form and its structure did not automatically solve either the issue on state enterprise organization and management or make state enterprises competitive and efficient. In general, the practice is indicating that the solution of the problems the micro-economic reform emerged, is delaying and requires more time than macro-economic stabilization. This will be achieved through the establishment of financial and monetary equilibriums.

#### **4.2. Organizational and Managing Structure**

The process of the creation of market structures, accompanied with the adequate legislation for the function of these structures with their respective mechanisms, opened up the way to transform state enterprise organization and management. This transformation covered state enterprise administration and management structures, its financial system organization, the function and duties of its director, etc.

Prior to the economic reforms, an enterprise did not enjoy the real freedom to take economic and financial decisions without the approval of the ministry it was dependent on. The decentralization of the administrative control of the state enterprise was the first measure taken for the extension of its freedom. For this reason the state enterprises were divided in two groups: enterprises dependent on the ministry of their branch; and, enterprises dependent on the local power organs (municipality hall) of their districts. The first group included enterprises that were of national importance due to their production and/or service structure and volume as well as labor power. The second group covered enterprises whose importance was local. These enterprises had employed local labor power and served mostly to the district it was situated in.

A two year experience, however, showed a big contradiction between state enterprise dependent on the local power (municipality hall) and the latter. Instead of

helping state enterprises in their independent operations in the new conditions of the market economy, the local power organs played more or less the same role as the ministries did. They dictated the main issues of the economic and financial activity of the enterprises. A new measure was taken to increase the financial and management independence of the enterprises that did not depend on ministries. Based on the new economic legislation on companies, a range of corporations were created. They included all enterprises of an economic sector. The corporations had their monopoly on the activities of the enterprises they involved. Some of these corporations were:

**Energy-electric corporation** that covered the production, delivery and distribution of the electric power throughout the country for the consumption needs of production and population.

**Oil and gas corporation.** This corporation involved in its monopoly the search and extraction of oil and gas, and their processing.

**Chrome corporation** covered mines for the extraction of chrome, iron-chrome processing plant, and the export of this mineral.

**Copper corporation.** This corporation covered the copper mines, its processing plants and factories, and the sale of copper (goods) in the domestic and/or foreign markets.

**Albanian Telecom** was another corporation. It controlled all activities of postal, telegraphic and telephone services throughout the country.

Corporations enjoy full financial, economic, organizational and managing independence. The ministries of their branches have the right to only exercise administrative control on corporations in relation to the application of the laws on force. The independence of the corporations enabled the restructure of enterprises from the viewpoint of their reduction and their division into small but more efficient units. This independence helped also to create a competition within the corporation, despite how small this competition was.

The approval of "On State Enterprises" law, made in the economic reform framework, was undoubtedly the most important measure to the transformation of the state enterprise organization and management structure. According to this law, the **Leading Council** was the highest leading organ to direct the independence of all the activity of an enterprise. The council is made up of only 5-7 members. The members and their director are nominated every 4 years by the minister or by the local power organ the enterprise is dependent on.

This council takes decisions on most important issues of the financial and economic activity of the enterprise. These issues might be:

The creation or division of an enterprise, the unification or division of its filiates;

The participation of a state enterprise in the capital of other native or foreign enterprises and companies;

Setting of wages for its employees, their increase and supplementary rewards to its employees;

Selling and/or renting of main means of the enterprise;

Signing contracts with the creditors and debtors in the domestic and international markets, etc.

The employees of the enterprise are represented in the Leading Council by their delegate who is elected by the syndicate with the highest number of members in the enterprise. The delegate has the right to participate in the solution of various problems by the council. He, however, has no right to vote.

A state enterprise can be changed into a shareholder company or in other forms of companies. This is always conducted in accordance with the laws on force. In case of bankruptcy, the liquidation of an enterprise is performed based on the legislation.

In order to facilitate and make the daily operational management of an enterprise activity more efficient, functional departments are set up at the council or at the director. Such departments are: **Finance Department, Marketing Department, Technology Department** that operate based on the regulation of their enterprises.

In the old and centralized economic system, the enterprise financial policy was quite passive. With the economic reform and due to its independence, issues on finance, profit, cost, price, credit, investment, etc., came to be primary and vital to the survival and the future of an enterprise. In these conditions, neither enterprise independence could work, nor its efficiency could be achieved, without a functional and operative service in the field of finance and accounting. All problems related to this field must be efficiently solved by the finance department specialist of the enterprise.

After the liberalization of prices of inputs, materials, and commodities in the domestic and international markets, a range of new problems emerged to the enterprises. These problems could not be adequately solved without a specialized and functional service. In the market economy conditions, the horizontal and direct relations between the sellers and buyers replaced the old inefficient system where the central organs decided the objectives planned to be achieved, the material resources to be used as well as the distribution of the commodities to the consumers. Thus, the marketing department was set up in order to solve the new problems emerging from the opening of market to supply the enterprises and for the sale of its products. This department is very important to the survival of the enterprise and to increase the financial means.

Despite the attempts the state enterprises made to improve techniques and technology in order to fit to the demands of the market competition, most of them are old viewed from the physical and moral point. Most of enterprises need renovation and modernization of their technology in order to become more competitive in the international markets, to become more attractive for local or foreign investor to privatize. To meet with these objectives, most enterprises have set up a technology department. This department has selected most specialized technical engineers that worked in the enterprise before the economic reformation, or that were in the technology bureau during its old centralized system. This department has the obligation to work to accelerate the technical progress and modernization of the enterprise, so that its products fit to the esthetically and industrial norms and quality ruling in international markets, especially in the markets of the industrialized countries.

### **4.3. Financial Situation of Enterprises**

In principal, the freedom and the independence the state enterprises enjoy in management has enabled them to have full independence in their finance and accounting activities. The direct intervention of banks and other credit organizations in this field is completely eliminated. The further promotion of this independence is coping with a serious obstacle. This is about the debts the enterprises owe to one another. These debts are threatening in many directions: macro-economic stabilization, enterprise restructure, privatization process, competitive and productive enterprise survival, etc.

During the old centralized system, enterprises possessed a lot of raw material purchased with a very low price. With the liberalization and considerable increase of prices, the activity of those enterprises that were losing came out to be of profit. This did not, however, last long, because it changed very quickly in the new economic conditions of the liberalized market for inputs. Consequently, due to the old links the enterprises had with one another, the former and new debts caused a paralyzing chain to the activity of most state enterprises. In the end of 1992 the debts of enterprises to one another reached 16 billion leks (about 218 million USD) or 33% of GDP.

This dangerous situation should be immediately overcome in order to have a normal function of the new market economy. In January 1993, the Albanian Government froze the bank accounts of the enterprises and reduced their debts to 4,9 billion leks (67 million USD). After this, the government engaged in two directions:

The government decreed continuous instructions and regulations for enterprises and banks. The latter have to apply strictly to the interest rate of the commercial credits by including penalties for delayed pay-off of credits. The bank must refuse to pay any enterprise check or money order for the debtor enterprises if these enterprises do not possess the respective financial funds and support.

The government has set aside a fund of 1,7 billion leks (approximately 23 million USD) to partly and selectively compensate net creditor enterprises, whose production activity is damaged or threatened to halt due to the non-payment of their debts. Actually, this is a kind of subvention for the enterprises in financial difficulties for which these enterprises can not be blamed.

The sharp refusal of the state to financially support non-productive enterprises will enable the real establishment and application of the financial discipline. The law "On State Enterprises Bankruptcy" will undoubtedly help to finally solve the problems of debts the enterprises owe to one another. This law will also help to promote the financial discipline of the state enterprise. A solution of the debt problem should be found before an enterprise is privatized.

## **5. Case Studies of Albania**

### **5.1. The Bread Production Enterprise**

The food industry in Albania in 1990, made up 26% of the industrial production and compared with 1960 it has increased four times. The bread industry, as a separate



subsector of the food industry, was almost totally concentrated in the urban areas of the country. In 1990 the Bread Enterprise of Tirana, produced 18% of the overall production of the State bread sector.

The State bread industry is also one of the branches of industry, that suffered a marked recession during the period of transition. This happened because of private sector competition that has established small bread production units and because of the reduction of the productive capacity of the Bread Production Enterprise in Tirana.

### **5.1.1. General information about the Bread Enterprise and its history.**

The Bread Enterprise of Tirana was set up in 1966 implementing a special decision made by the Government. It was set up to respond to the demands for better quality and increased quantity of bread consumers in Tirana. In addition to the central factory, the enterprise consisted of 13 smaller units, spread throughout the Capital city that produced different types of bread and which represented about 15% of the total bread output in Tirana.

Since its establishment, the Bread Enterprise has been a State property. The Bread Enterprise is administered by the Municipal Government of Tirana. It is the Municipal Government that nominates the directors, approves the members of the Managing Board, oversees the economic reports, and monitors the functions of the Bread Enterprise. The enterprise also, make reports on some aspects of its operation to the Ministry of Food and Agriculture.

The implementation of reforms for macroeconomics stabilization and for the transformation of the Bread Enterprise itself, was accompanied by reduction in output, reduction of the number of employees and a reduction in the distribution network of the State enterprise. For the period 1989 - 1995, the dynamics of sales, of the number of employees and of profit is shown as follows:

**Table 1.**

*Sales, number of employees and profit for the period 1989 - 1995.*

Year	Sales in ton	Number of employees	Profit in 000/USD
1989	65.021	952	1,7
1990	65.213	967	1,0
1991	65.017	1.020	7,8
1992	62.450	1.054	28,0
1993	40.835	958	400
1994	9.450	490	40
1995/6 months	4.300	487	?

For 30 years or so, the Bread Enterprise has supplied the population of Tirana with bread, and had a monopoly in this sector. Since the very beginning of its activity, primitive bakeries were part of it, and these were located in different parts of the city.

These primitive bakeries, were gradually transformed into relatively modern factories. This situation continued to 1991, when the process of privatization of small and medium enterprises began.

On the eve of the reform, the enterprise consisted of 14 production units, while at the present time it consists of only three, which are now considered as large enterprises. It was predicted that these large enterprises would be privatized after the second half 1995.

Of the 11 privatized units, three were bought by their ex - employees, while 8 were bought by the ex-owners of the factory land. The process of privatization was organized by the Tirana Branch of the National Agency of Privatization. Among the privatized factories, only one of them operated for about a year at 20% of its capacity. The others have changed their function, becoming either warehouses or trading stores, where a higher profit is earned.

The following Table shows the output and the number of employees, at the time when the units were still functioning, and were still part of the Bread Enterprise.

**Table 2.**

*Output, labor and other data from the 11 units privatized.*

Unit	1992 Output (in ton)	1992 Number of employees	Who has privatized	Is it still operating as a bread unit
1	500	13	Landowner	No
2	940	20	Landowner	No
3	2.160	38	Employees	No
4	4.152	48	Employees	No
5	9.000	120	Landowner	No
6	290	8	Landowner	No
7	1.100	27	Employees	No
8	936	25	Landowner	No
9	1.356	9	Landowner	No
to	670	12	In the process of privatization	No
11	670	8	In the process of privatization	No

The reduction of production, which was marked in 1993 - 1994, resulted from the interaction of the privatization of the 11 units and of the reduction of demand because of the competition by the private sector. In 1994, the private sector met more than 80% of the needs of the population of Tirana, of about 500.000 people.

In the past, bread was sold by the state trading enterprises which comprised a vast network of stores. With privatization, some temporary difficulties were experienced with the bread distribution network of the enterprise.

### 5.1.2. The management of the Enterprise.

In the framework of carrying out the reform, some organizational changes have been made to improve the quality of management of the economic - financial functions of the enterprise. One of these changes is the establishment of a Managing Board. The Board is made up of 5 persons: the Managing Director, the Finance Manager, the Marketing Manager, the Production Manager and the Production Quality Controller.

**The Director**, is graduated in Finance, from the Faculty of Economics in Tirana. He has 23 years experience as an economist in industrial enterprises and acts as the principal Finance Manager. He was nominated by the Municipal Government of Tirana in 1991. He is 47 years old.

**The Finance Manager**, is graduated in Finance, from the Faculty of Economics in Tirana. He has 15 years experience in the enterprise. He was appointed manager by the enterprise. He is 38 years old.

**The Marketing Manager**, is graduated from the Faculty of Economics, Branch of Industry. He has 6 years experience in the enterprise. He has been appointed manager by the enterprise. He is 30 years old.

**Production Manager**, is graduated in Chemistry, from the Faculty of Natural Sciences. He has 18 years experience in the enterprise. He has been appointed manager by the enterprise in 1991. He is 43 years old.

**The Production Quality Controller**, is graduated in Chemistry from the Faculty of Natural Sciences. He has 15 years experience in the enterprise. He was appointed Controller in 1993. He is 43 years old.

The composition of the Board was totally revised during 1992-1993. All the members of the Managing Board have university education. Their average practical experience is 16 years, and their average age is 40 years old.

Although all the members of the Managing Board have adequate professional training, it has become clear that a better understanding of a market economy is needed by the management staff. This is more evident in the field of marketing where their knowledge and past experience have been very limited.

The salaries of the members of the Board and of the other technical - administrativestaff, have been set in accordance with Government Regulation, within the limits of Food Industry. In 1993, the salaries were increased by 50% and in April 1994 there was another increase of 30%. The average monthly level (April 1993 - December 1994) of the salaries of the members of the Managing Board was 6.100 leks (about 61 US dollars), that of the technical - administrative staff 4.500 leks (about 45 USD). While the average monthly wage of employees was 3.600 leks (about 36 USD). The level of salaries of the enterprise managers is about 60% of the private salaries, while the wages of the employees in the Bread Enterprise are 50% of the wages of the employees in the private sector.

### **5.1.3. The influence of recent reforms on the Bread Enterprise and its behavior.**

The implementation of the economic reform together with the measures taken by the Government caused considerable shocks to the enterprise, among the most important problems we mention the following:

The reduction of demand because of competition by the private firms.

Reduction of the production capacity due to the changes in ownership, brought about by partial privatization of the enterprise's productive units.

The liberalization and the sudden market price increase of some of the inputs.

Frequent price changes in electricity and steam.

The breakdown of the bread distribution and marketing system.

The high interest rate (about 35%) severely restricting possibilities for borrowing money.

The pressure exercised by trade unions to interfere in all problems of the enterprise.

All these factors affected the production decrease at different rates and different intensity. Among the factors, the two that mostly affected the production decrease were: a) the privatization of the 11 units, which previously were part of the enterprise, and b) the competition of the new private firms, responding to most of the demand in Tirana. Furthermore, it should be pointed out that the reduction of the competitive ability of the Bread Enterprise, compared to the small private units, is linked with the following factors:

First, the breakdown of the old system of bread distribution and marketing. Due to the privatization of the marketing and transport network, limitations and difficulties have emerged in the field of bread marketing. The number as well as the quality of the state trading stores is not satisfactory.

Second, considering fiscal policy, the private firms, for a period of three years have been enjoying various privileges, as for e.g. the private firms do not pay profit taxes for a period of three years, while the State enterprises pay a 30% profit tax.

Third, in many cases the enterprise is restricted its independence by Government Administration and this hinders successful competition. In certain cases, the Central Government Administration dictated which supplier would provide the goods at a fixed price or dictated that the enterprise sell bread to specified institutions which had not paid previous debts.

This difficult economic - financial situation of the enterprise, was further complicated by the continuous price increase of electricity and steam, and by the technical backwardness inherited from the past. Analyzing the cost and the cost structure of the Bread Enterprise for 1991 - 1994, it turns out that the total cost is increased 8,1 times and according to the cost elements, the cost of raw materials was increased 8,8 times, the cost of electricity and steam 63,6 times, the cost of components and supplies 5,8 times, the cost of wages 2,8 times. In the cost structure of 1991, fuel constituted 2% of the total cost, while in 1994 about 16% (See Exhibit 1).

Under these circumstances, the Bread Enterprise reduced production and later the number of employees. In 1994, the level of production compared to 1991 was 14,5% and the number of employees was 48%. So, it turns out that output fell in greater proportions compared to the number of employees. To maintain the employment level, the enterprise had to partially reduce the profit, which is increased as a result of increasing the prices.

The number of employees reduced either through voluntarily resignations (emigration or finding another job with a higher wage) or by firing some of the employees. During this period, the trade unions were split and in the process of reorganization, so their reaction to this situation was very weak.

The Government directed the Bread Enterprise to continue to supply its products to some institutional customers who had not met their prior obligations for previous supplies, so the Bread Enterprise found itself in a difficult financial situation and by the end of 1993, its debts amounted to 5 million leks and the other institutions owed 23 million leks to the Bread Enterprise.

To the question whether the reform has created new opportunities for the enterprise operation, the answer was "Very few".

#### **5.1.4. The objectives, the strategies applied by the Bread Enterprise and the restricting factors.**

The main problem of the Bread Enterprise, at the beginning of the reform, was to survive. This objective of the enterprise was conditioned by the traumatic effects that accompanied the reform. Actually, a series of measures have been taken, and serious attention is being paid to the problems linked with the on - going of economic productive operations of the factory. In the future, the bread enterprise aims toward growth, restructuring and marketing. The objectives of the enterprise are schematically presented below:

Category	Since reform began	For the next year	For the next 3 year
Survival	1	3	3
Continuity	2	1	2
Growth and Restructuring Marketization	3	2	1

Note: 1 is the primary objective.

During the first phase of the reform, in order to realize the objective of survival, the enterprise included in its strategy the solution of the following problems: to prevent bankruptcy, to maintain the level of employment, to improve the supply and distribution

system, to provide sufficient cash flow, etc. Special attention was paid to the problem of an adequate sales network, through opening its own stores and minimarkets. By the end of 1994, about 200 employees worked in the supply and trading system and 380 persons constituted the administration staff and the people engaged directly in production.

The short - term and medium - term strategy of the bread enterprise was to achieve the objectives of continuity and restructuring, and it focused on the solution of the following problems: investments in new technology, profit maximization, access to the market (improvement of marketing, becoming more competitive, the study of the market demand, improvement of the information system), etc.

The relative importance of the previous factors in the enterprise's strategy in achieving the objectives, varies according to the stages of the implementation of the reform. These factors for the Bread Enterprise are as follows:

Factors	Since reforms began	In the near future
Shortage of funds	5	4
Unclear responsibility of management for firm's long term future	1	3
Information systems inadequate	3	2
Barriers to shed/restructure labor	8	6
Barriers to restructure capital, production	6	1
Unclear property rights	2	5
Other: Trade Unions	7	8
Do not know what to do	4	7

As we have seen, since the reform started, these factors have come out: the unclear managing responsibility of the enterprise in the long run, the unclear rights on ownership, the inadequate system of information, not knowing what to do, lack of funds (mainly in sales network as well as in the distribution one), etc.

For the second stage, the main factors are: obstacles to restructuring of capital and production, the improvement of the inadequate information system, unclear responsibility for the future, lack of funds, unclear rights ownership, etc. A characteristic for the second stage is the intermingling of the capital restructuring factors and the improvement of the information system with the lack of funds and uncertainties of ownership.

*Exhibit 1. Level and cost structure of the Bread Production Enterprise in Tirana.*

Cost structure	1991		1992		1993		1994		94/91 in times
	Mil. of leks	In %	Mil. of leks	In %	Mil. of leks	In %	Mil. of leks	In %	
Raw Material	2,0	66,9	7,13	76,2	14,83	79, 4	17,60	72,7	8,8
Components and Supplies	0,1	3,3	0,18	1,9	0,47	2,5	0,58	2,4	5,8
Electricity and Fuel	0,06	2,0	1,08	11,5	1,75	9,3	3,81	15,7	63,6
Wage	0,43	14,3	0,45	4,8	0,91	4,9	1,20	5,0	2,8
General expenses	0,40	13,5	0,51	5,6	0,72	3,9	1,01	4,2	2,5
TOTAL	2,99	100	9,35	100	18,68	100	24,20	100	8,1

## 5.2. The Military Clothing Manufacturing Enterprise

The clothing and textile industry is one of the branches that in the previous economic system, occupied an important place in the industrial production of the country. In the total overall industrial production, this sector constituted 5% in 1950, and it went up to 16% in 1990.

However the clothing and textile industry is at the same time the one which suffered most during the period of transition. This situation was due to the reduction of the domestic demand mainly as a result of the irresistible competition of imported goods.

### 5.2.1. General information on the enterprise and its history.

The Military Clothing Manufacturing Enterprise (MCME) in Tirana was set up in 1946, implementing a special decision of the Government. Since the very beginning, it was set up as a State enterprise, depending directly on the Ministry of Defense.

Over time, the enterprise extended to other cities of the country, setting up branches with limited independence. At the time of the survey it had 10 branches, set up in Shkoder, Durres, Kukes, Peshkopi, Elbasan, Korze, Fier, Gjirokaster, Bcrat and Vlora, covering thus the whole territory of the country.

The enterprise produces these groups of goods: outfits for the needs of the Army (clothes of all sorts, shoes, tents, accessories, etc.), various outfits for the civil population and export as well.

The process of the reform for the macro - economic stabilization and for the transformation of the enterprise was accompanied by reduction in production as well as in the number of employees. Compared to other industrial enterprises of this branch of economy, this effect has not been as great. For the period 1991 - 1994, the dynamics of the level of production and of the number of employees is shown as follows:

**Table 1.**

*The level of output and labor for the period 1991 - 1994.*

Year	Sales in million of leks at current price	Number of Employees
1991	47	764
1992	101	742
1993	106	729
1994	128	541

The moderate reduction of output at the MCME compared to other enterprises is due to new conditions, which are as follows:

The MCME together with the other four enterprises of this sector, have supplied the Army with outfits and other commodities for 47 years in succession, having a monopoly in this field. At the beginning of the reform, the other four enterprises of that sector closed down and MCME remained the only one to meet the reduced demand of the Army.

To compensate to a certain degree the reduced demand of the Army, the MCME began to produce and export ready - made products, made with the material of foreign customers and according to their requirements. This production constitutes about 16% of the total.

At the same time, the MCME started to produce uniforms for the private police and work clothes for the miners. These goods constitute 3 to 4% of the general sales.

In 1992, in order to modernize the technology on new basis and to maintain the level of production and of employment, the MCME established relations with an Italian firm which invested about 400 million Lireta. This investment represented a negligible part of the capital of the enterprise.

### **5.2.2. The management of the Enterprise.**

One of the most important changes that took place in the internal organization and management of the enterprise during the period of transition was undoubtedly the setting up of the Managing Board, composed of five persons: The Managing director, the Finance Manager, the Marketing Manager, the Production Manager and the Head of Department.

The Director, graduated in Industrial Economics from the Faculty of Economics. He has 25 years experience as a senior economist. He has worked in the Ministry of Economy, in the State Committee of Labor and Wage as well as in the administration of the Council of Ministers. He is also a part - time lecturer at the Faculty of Economics. He is co - author of a series of studies, mainly in the field of labor, wages and economic management. He was nominated director of MCME by the Ministry of Defense and was approved by the enterprise in 1991. He is 45 years old.

**The Finance Manager**, graduated in Finance from the Faculty of Economics. He has 21 years experience as an economist. He was nominated finance manager, in 1992,



by the enterprise. He is 45 years old.

**The Marketing Manager**, graduated in Industrial Economics, from the Faculty of Economics. He has 25 years experience in the military enterprises of various cities of the country. He was nominated by the Ministry of Defense and approved by the enterprise in 1990. He is 51 years old.

**The Production Manager**, graduated from the vocational school, in ready-made garments. He has 30 years experience. He was nominated by the enterprise. He is 53 years old.

**Head of Department**, graduated from a vocational school. He has 24 years experience. He was nominated by the enterprise. 45 years old.

The Managing Board was set on the basis of the New Law on the State Enterprises, issued in July 1991. The initial composition of the Board has almost completely turned over in the years that followed. The previous finance and marketing managers had received only secondary education and for that reason they were replaced during 1992 - 1993. The main reason for these changes was to improve the qualification level of the Board.

In general, the current members of the Board, with the exception of the production manager, have received university education. They also have an average professional training of 25 years. However, it is also necessary to improve the technical - professional level of the members of the Managing Board, and above all that of the marketing sector. The average age of the Board members is 48 years old.

The salaries for the director, for the Board managers and for the other staff of the enterprise are set in accordance with the limits defined by the Government Regulation for the textile industry branch. The increase in the wage of 50% in 1993 and of 30% in 1994, is made in accordance with the Government decisions.

The level of the salaries of the managers of the enterprise is twice the average wage of the employees. In December 1993, the average wage of the managing staff of the enterprise was 6.500 leks (about 65 USD), that of the administration staff 5.100 leks (about 51 USD), while that of the employees was 3.300 leks (about 33 USD).

The salaries of the enterprise managers are half of those of the private enterprises. This wage and salary disproportion in the State sector compared to the private one, has negatively affected not only the motivation of the existing managers but also the improvement of their training.

### **5.2.3. The main impacts of the reform on the MCME and the enterprise behavior.**

The measures taken by the Government to carry out the economic reform, have caused difficulties of different sizes and characteristics to the MCME. Among them we can mention:

- ✓ the reduction of domestic demand as well as the competition of imported goods.
- ✓ the destruction of the previous system of supply and distribution.
- ✓ the liberalization and the frequent increase of the prices of raw materials, electricity and fuel.

- ✓ the measures to limit credits and the high interest rates.
- ✓ the trade union's pressure to interfere in all the problems of the enterprise.

Since the very beginning, the implementation of the reform was accompanied with the reduction of output caused by the decreased demand of the Army. This situation became more complicated by the reduction of the ability of the Military Administration to pay its previous obligations. Being a superior State organism, it forced the enterprise to produce and supply it without paying for the value of the goods provided to it. This brought about mounting debts between the enterprises. In 1993, compared to 1991, the debts increased 6,8 times and credits 29,6 times, while the specific weight of creditors to the debtors decreased from 149% to 63%. Over 95% of the debts in 1993 are attributed to the Ministry of Defense, on which the enterprise depends.

Under the above mentioned conditions, the enterprise had to reduce the level of production and the number of employees. During this period production was reduced 12% while the number of employees was reduced less than 5%. Together with this, the enterprise began to produce and to extend the market not only for the private firms but also for the foreign market with the customer's material.

As it is shown by the data below, the profit of the enterprise has increased. This was due to two factors, not linked with the enterprise management:

- ✓ the first factor was the increase of the sale price of the ready - made product, as a consequence of price liberalization and from its favorable monopoly position.
- ✓ the second factor is the use during 1993 - 1994 of the available inputs, inherited from the previous period at low and unchangeable prices.

Year	Enterprise Profit (million of leks at current price)
1991	0,683
1992	15,129
1993	16,612
1994	12,192

The MCME has used a part of the profit to keep constant the level of employment, not to reduce it at the rate as the reduction of production did.

The carrying out of the reform, opened to the enterprise new opportunities to develop its activity. Among the opportunities due to the reform, the enterprise appreciates:

- ✓ the increasing independence to set prices, as a source of increasing profit and effectiveness.
- ✓ the discovery of new markets and changing the variety and destination of goods
- ✓ making use of new inputs and finding of foreign partners to manufacture products with the customers' material.
- ✓ introduction and use of new technologies and equipment.

The growing independence of the enterprise to set prices of ready - made products, has affected the increase of the level of the effectiveness, as an important factor in improving the economic - financial situation of the enterprise and in maintaining a stable

level of employment. While in 1991, the enterprise effectiveness was 12,4%, in 1992-1993, it increased to 18,2% and 29,3% respectively. The enterprise has started to make first steps in applying new technology in cooperation with foreign partners.

To the question whether the reform has created new opportunities for the enterprise operation, the answer was "Few".

#### **5.2.4. The objectives, the strategies applied by MCME and the restricting factors.**

During the initial phase of the economic reform (1992 - 1993), all the attempts made by the enterprise were focused on its survival. This objective was imposed on it by difficulties such as: reduction of demand by customers, the competition of imported goods, the liberalization and input price increase, the breakdown of the previous system of supply and distribution, the high level of debts, etc. For the coming years 1995-1997, the main objectives of the enterprise are those of survival and growth through restructuring. Schematically the enterprise's objectives are shown as follows:

##### Objectives of the MCME.

Category	Since reform began	For the next year	For the next 3 year
Survival	1	3	3
Continuity	2	1	2
Growth and Restructuring Marketization	3	2	1

Note: 1 is the primary objective.

During the first stage of the reform, to fulfill the objective of survival, the enterprise defined the strategy of solving problems such as: to prevent bankruptcy, to provide adequate cash flow, to maintain the level of employment, to maximize profit, to increase access to the market, to find foreign partners, etc.

One of the short term objectives of MCME is the privatization of 8 out of 10 plants, spread throughout the country's territory. The MCME in Tirana together with two other plants, will be transformed into a stock holder company beginning September the first, 1995, in order to make possible its gradual privatization.

In the short and medium term, the enterprise's strategy for achieving the objectives of continuity and restructuring, is focused in solving problems such as: investments in new technology, profit maximization, increasing access to the market, finding foreign partners, finding new markets, solution to the problem of debts, etc.

The increase of the technical level of production through new investments for applying modern technologies, is presented in one of the highest priorities to achieve the future objectives of the enterprise. But, this is hindered by the lack of new investments for restructuring, that the enterprise hopes to realize through attracting foreign capital.

There have been many offers to the enterprise by foreign investors, but until now no agreement has been signed, because the offers have not been attractive enough.

Actually, the enterprise is characterized by obsolete technical equipment. The machinery and equipment as part of the assets are physically worn out as well as depreciated in value. While the level of the physical depreciation of the basic assets of the enterprise, averages 48,4%, that of machinery 93%.

### 5.3. The Pharmaceutical Enterprise (PROFARMA)

#### 5.3.1. General information and history of the enterprise.

The Pharmaceutical Enterprise (PROFARMA) is the only one of its type in the country. It was established in 1948, implementing a decision made by the Government, and is composed of only one plant, located in Tirana. Since its establishment it has been and still continues to be a State enterprise, under the Ministry of Public Health.

The Pharmaceutical Enterprise was established to meet the country's needs for the most needed medicines used in health prevention as well as in the health care institutions. In the course of time, it extended the production of various medicines and started to produce other products for consumption, especially cosmetics. It is worth mentioning that from the beginning, this enterprise has relied entirely on imported raw materials.

The reform for macroeconomics stabilization as well as measures taken for the transformation of the enterprise, have brought about a series of consequences. For most of State industrial enterprises, the process of their transformation was characterized by a drastic reduction of production and of the number of employees, while in the PROFARMA Enterprise, the reduction was not as great and soon, within a period of one year some kind of stabilization and an increase in production were reached but these levels did not reach the level of 1989. The following data show the progress of this process for the period 1989 - 1994.

**Table 1.**

*Sales and number of employees in the PROFARMA Enterprise for the period 1989-1994.*

Year	Sales in millions of leks at current prices	Number of employees
1989	271	344
1990	180	334
1991	254	307
1992	163	203
1993	262	214
1994	298	217

### **5.3.2 The management of the enterprise.**

During the process of carrying out the reform, in order to better adopt to the laws of the market environment, a series of changes have taken place, aiming to improve the management of the economic financial activity of the enterprise. The Managing Board composed of four persons was set up: the Managing Director, the Finance Manager, the Marketing Manager and the Production Manager.

**The Director**, graduated in Pharmacy, from the Faculty of Medicine. She has 25 years experience in this enterprise. She was nominated by the Ministry of Public Health in 1992. She is 48 years old.

**The Finance Manager**, graduated in Finance from the Faculty of Economics. He has 16 years experience in various enterprises. He was nominated by the enterprise. He is 48 years old.

**The Marketing Manager**, graduated from the Faculty of Economics, Industry Branch. He has 11 years experience. He was nominated by the enterprise in 1992. He is 36 years old.

**The Production Manager**, graduated from the Faculty of Medicine, on the Pharmacy Branch. He has 23 years experience. He was nominated by the enterprise. 56 years old.

The Managing Board was set up and functions based on the Law for the State Enterprise issued in July 1991. Three of the members of the Board have been replaced. All four members of the Board have received university education, their average age is 45 years, and all of them have an average work experience of 21 years.

The members of the Board have adequate training and very good work experience. But, taking into consideration the marked changes as well as the requirements of the economic reform in the management and administration of the enterprise, they must extend their economic knowledge. They need especially to be trained and get acquainted with the new concepts and experience in the field of marketing and of improving the system of economic - financial information.

The salaries of the managing and technical staff are based on Government

regulations and they are controlled according to the respective branches. In 1993, these salaries increased 50%, while in 1994 they increased 30%. The average monthly level of the salaries of the Board members is 14.000 leks (approximately 140 USD), that of the managing staff 6.500 leks (approximately 65 USD) and of employees is 4.700 leks (approximately 47 USD).

### **5.3.3 The consequences of economic reform and the behavior of PROFARMA Enterprise.**

The process of implementing the economic reform brought about changes of different size and characteristics. Among the most important changes we mention the following:

- ✓ lack of raw materials that previously were imported
- ✓ marked competition by the marketing private firms of pharmaceutical products

- ✓ liberalization and price increase of raw materials and finished products
- ✓ price increase of fuel and electricity
- ✓ the breakdown of the previous system of supply and distribution.

The lack of imported raw materials was the first and most noticeable consequence of the reform. In 1992 compared to 1991, output (at current price) and the number of employees fell about 35%. A new situation was created, for the enterprise did not pose sufficient currency to provide the raw materials, on which the whole production of pharmaceutical products depended. In 1991, the raw materials and supplies constituted 71,6% of the total cost of production of the enterprise.

The enterprise suffered another shock from the competition of imported pharmaceutical products. The liberalization of foreign trade, created conditions that together with the existing State network of drug stores, enlarged the private retail system of pharmaceutical products. The increase of prices of raw materials, of fuel and electricity, brought about changes in the cost level and in the structure of the enterprise. During 1991 - 1993, it turns out that while the total cost is increased 10,8 times, the cost of raw materials increased 19,1 times, electricity and fuel are increased 13,3 times, while wages 2,5 times and general expenses 4,6 times.

Changes have also been experienced in the cost structure, according to various constituent items. In 1991, in the cost structure, expenses for raw materials constituted 43,4% of the enterprise total cost, in 1993 they increased to 73,4%, while the wages as well as the general expenses of the enterprise decreased from 28,2% to 9,7%. The changes in the cost level and structure according to the constituent items for the period 1991 - 1993, are shown in details in the attached Exhibit No 1.

With the breakdown of the previous system of supply and distribution, in order to maintain the level of production, the enterprise was forced to sell its products, by orders issued by the Ministry of Public Health, which controlled the enterprise's operations. The debts of the enterprise increased and the ratio of debt/credits changed. Thus, while in 1991, the ratio of creditor's debts to the number of debtors was 26,8%, with the passing of time, it reached to 197,2% in 1993, and then it drastically fell during the following year.

Together with the economic and social difficulties, the implementation of the reform created for PROFARMA Enterprise new and favorable opportunities, for the further functioning of the enterprise in the conditions of the market economy. The most significant of these opportunities for the enterprise were:

- ✓ the finding of new financial resources
- ✓ access to inputs and new markets
- ✓ the increase of autonomy in setting prices as well as employing people and dismissing them
- ✓ the establishment of a market within the country.

Short of currency to import the necessary raw materials, in 1991, the enterprise either stopped or reduced production and this continued even during 1992. But in 1992, in the framework of PHARE Program of the European Community, the enterprise was

given a credit of 1 million ECU. The enterprise used this currency to restart production, making thus possible its survival and the resuming of production. The enterprise began to pay off the credit gradually, and at present it is functioning relying on its own resources.

It should be noticed here, that the enterprise considers the finding of financial resources through credits, as the main factor, that created the basis for rapidly overcoming the difficulties brought about by the economic reform. In 1992, the enterprise was able to provide the necessary financial resources to import raw materials, and by the end of 1993, output increased and continued to increase even during 1994.

Due to the domestic market as well as the access to inputs and the finding of new markets, the enterprise was able to expand production and to improve the economic financial indicators. By reducing the range of products to only 130 of the most effective medicines, the enterprise was able to strengthen its positions in the competitive fight, through the State Center of Pharmaceutical Supply (FUFARMA).

The enterprise increased its autonomy in setting the prices and it was free to employ and dismiss the employees, and due to the reform these changes were facilitated. The prices set by the enterprise have brought about a marked increase in profit and effectiveness indicators as well. In the area of employment, the enterprise has set a limit on the number of employees and has signed short - term contracts of 3 and 6 months as well as of one year.

In answer to the question "Have you benefited from the favorable conditions created by the reform?", the PROFARMA Enterprise has answered "Very much".

The progress in transforming the economic - social functions of the enterprise, showed the following:

First, that both, the provision of inputs from abroad and their use, made possible the survival and continuation of the productive function of the enterprise.

Second, the existence of the domestic market, the liberalization and autonomy in setting prices, provided the necessary conditions to increase profit and the productivity of the enterprise. In 1991, the level of effectiveness, expressed as a ratio profit/cost, was 22%, in 1993 it reached 86,8%. Analytical data are shown in Table 2. Improvements have been made in the economic financial situation as well as in the ratio of debts/credits.

**Table 2.**

*Cost, profit and effectiveness of the PROFARMA Enterprise in Tirana for the period 1991 -1993.*

Year	Cost in millions of leks	Profit in millions of leks	Profit/Cost(in %)
1991	14,5	3,2	22,0
1992	61,8	53,2	86,1
1993	156,4	135,4	86,8

### 5.3.4. The objectives, the strategies applied by the PROFARMA Enterprise and restricting factors.

The provision of financial resources through the PHARE Program, created the conditions for the enterprise to reach some kind of economic - financial stability, and to gradually start to move from the survival objective to the objective of continuity (1993 - 1994). For the period 1995 - 1997, the objective of continuity is primary. For the coming 3 or 4 years (up to year 2000) its main objectives are: marketing, growth and reconstruction. The objectives of the enterprise are shown in a summarized way according to priority, in Table 3.

**Table 3.**

*Objectives of the PROFARMA Enterprise in Tirana.*

Category	Since reform began	For the next year	For the next 3 year
Survival	1	3	3
Continuity	2	1	2
Growth and Restructuring.			
Marketization	3	2	1

Note: 1 is the primary objective.

However, we should emphasize that as it turns out from the survey conducted with the Board of the Enterprise, and this is the case with all the other enterprises surveyed, they find it difficult to define clearly the objectives for each respective phase. The reason is that the three objectives exercise a different intensity on each of the phases and the place of priority can only be defined approximately. Thus, for e.g., considering the continuity as a primary objective, we don't ignore growth, marketing and reconstruction. The definition of short and long term objectives becomes more difficult because the detailed and qualitative data needed in such cases, are lacking. This fact hinders the enterprise in formulating and applying a clear strategy for the short and long run.

Since the beginning of the reform, the main objectives for the PROFARMA Enterprise, have been: to provide raw materials, to avoid bankruptcy, to maintain the traditional market created by FUFARMA Enterprise, and to maximize profit.

The following strategies will have priority in the future: to maximize profit, to invest in new technologies, to find new partners, etc.

Old machinery as well as backward technology constitute the main difficulties the enterprise PROFARMA faces and will continue to face in the future. The inherited machinery is not only depreciated in accounts' terms but also physically work out. The machinery has been brought 3 or 4 decades ago from the ex - URSS and China. The machinery constitutes about 60% of the value of the capital and cannot respond to the requirements of an open and liberalized economy.



The principal factors that have played an important role in determining the strategy to achieve the objectives set by the enterprise, are shown as follows, according to their degree of importance:

Factors	Since reforms began	In the near future
Shortage of funds	1	3
Unclear responsibility of management for firm's long - term future	4	5
Information systems inadequate	2	2
Barriers to shed/restructure labor	5	4
Barriers to restructure capital, production.	6	1
Unclear property rights	3	6

*Exhibit 1. Level and structure of cost of the PROFARMA Enterprise in Tirana.*

Cost Structure	1991		1992		1993		1993/1991 (in times)
	Mil. of leks	In %	Mil. of leks	In %	Mil. of leks	In%	
Raw Materials	6,0	43,4	43,5	70,6	114,8	73,4	' 19,1
Components and Supplies	4,1	28,2	11,3	18,2	22,4	14,3	5,5
Electricity and Fuel	0,3	0,2	1,6	2,5	4,0	2,6	13,3
Wage	1,7	11,7	1,7	2,7	4,2	2,7	2,5
General expenses	2,4	16,5	3,7	6,0	11,0	7,0	4,6
TOTAL	14,5	100	61,8	100	156,4	100	10,8

#### **5.4. Electric Industry**

The electric industry, during the previous system, was one of the most dynamic branches of the economy, which has preceded the industrial and overall development of the country. During 1950-1989, the electric power production rose about 200 times from 21 million kw/h to 4122 million kw/h. On the establishment of the hydro-powerstation and centrals, in 1957 was set the unique distribution system of the electricity. Since 1972, the energetic system has covered the territory of the whole country, fulfilling the economy and population needs and exporting a part of it to the neighboring countries.

Actually, this is one of the branches of the industry, which was hit during transition, that is connected more with the distribution than the production of the electricity. This is the result of the change of the consumption structure, the considerable measure, the clients payment inability and the increasing defects to the distribution network.

In 1992, the electro-energie system was reorganized to create the Albanian ElectroEnergetic Corporation, which is composed of 47 units out which 6 are for the energy sale.

#### **5.4.1. The Enterprise History**

The electric enterprise of Tirana was founded in 1951 on the special decision of the government, based on the existing electric central and the extension of the distribution network, after the establishment of the first hydric power station in the country, that would supply the capital with electricity. But the enterprise history starts earlier. The first generators for the electricity production were set in Tirana in 1924. Three years later it was created an Italian company (SITA), shared by Austrian, which was the first electric enterprise, that was totally managed by the foreign experts.

Immediately after the war, in December 1944, the electric station of the city, as the property of the foreign capital was nationalized.

The electric enterprise of the city was extended and strengthened parallel with the quick industrial development and growth of the city. During 1960-1970 the distribution electric network of Tirana was totally renovated and were also build 10 outskirts substation of 35/6 kw and 110/35/10 kw.

After 1990, as the result of the reform for the macroeconomic stabilization and transition, came out two contradictory processes to the electric enterprise.

On one hand the industry, that was the major electric energy consumer is in continuous regress, and on the other hand the change in the heating sources structure, passing from the coal, wood etc. to the electric power. As the consequence of changing of the combustible price structure, the public electricity consumption is considerably increased. This is also influenced by the mechanic increase of the city population, due to internal immigration, especially from the villages of north-eastern zones and the development of the tercial sector. This phenomenon is observed not only in Tirana but also to all cities of the country. According to the published electro-energie corporation statistics, the public consumption of the electric energy as the country, during 1990-1994 is grown as follows:

**Table 1.**

*The public consumption of the electric power, compared with the national overall gross production.*

Year	Public consumption (kw/h)	The percentage compared gross production
1990	292 million	6,5
1991	511 million	14,0
1992	859 million	24,0
1993	1293 million	36,2
1994	1600 million	40,0

These changes caused problems to the electric enterprises, from which should be stresses the economic problem, considering that a number of consumers aren't able to pay the electricity bills, as the consequence of the economic stabilization, and steal it. This phenomenon has started since 1991, when the consumers themselves destroyed a great number of the electricity meters. This made impossible checking of the electricity consumption for each consumer, at a time when the produced kw/h was known. In the country degree, the electricity energy loss accounted to be 30% of its output, causing an annual loss of approximately 20 million \$US to the electro-energetic corporation, while for Tirana, the difference between purchase and sale of the electricity from the electric is even greater. This is presented here below:

**Table 2.***Purchase and Sale of the Electricity (in 000/kw/h)*

Years	Purchase	Sale	Loss in percentage
1991	267985	219311	18,6
1992	299692	155047	45,5
1993	368404	198151	45,2
1994	409221	197505	50,8

The second problem is technical, and this has to do with distribution network, which is totally amortized, incapable to stand the galloping rise of the public consumption of the electric power. Consequently the frequent technical defects and the electricity interruption, especially in winter have become a common phenomenon. While in Tirana, in 1990 were only 10 defects for 100 km cable to the middle tension lines, at present there are 95 defects for 100 km cable. This led to the increase of the material expenses and the workers member, necessity to maintain the distributing network for the period between 1990 and 1994, which are indicated in the following table.

**Table 3.***Workers number of the electric enterprise*

Years	Workers number
1991	361
1992	463
1993	483
1994	498

The electric enterprise is a branch of the electro-energetic corporation, which nominates the director and the Managing Board, fixes the employees wages, gets a part of the profit, makes investments etc. In the frame of the corporation, the enterprise autonomy is limited.

### **5.4.2. The Enterprise Management**

Basing on the new law for the state enterprises of July 1991, the enterprise is managed by the managing Board, which is entirely altered in 1992. It consists of 5 people: the managing director, the finance Manager, the marketing manager, the production manager and the chief of failures.

At the moment of the interview the managing director was an electric engineer, who was nominated on that post before 3 months, by the electro-energetic corporation. He has an experience of 18 years in the energetic section, but he felt himself provisional in this post because since 1992 the managing director has been altered 6 times. For the economical-technical problems of the enterprise the corporation would find recurring directors and their discharging as the easiest solution.

**The finance manager** is graduated from the economic faculty of Tirana University in finance, in 1978. He has an experience of 17 years to different economic sectors. He is appointed manager in 1992 by the enterprise. He is 41 years old.

**The marketing manager** is graduated from the economic faculty of Tirana University in finance. He is 32 years old with an experience of 8 years in the enterprise. He is nominated manager by the enterprise.

**Production manager** is graduated from the faculty of electric engineering of Tirana University. He is 39 years old with an experience of 12 years. He is nominated manager by the enterprise. The chief of failures is graduated from the vocational middle school. He has an experience of 20 years and is appointed by the enterprise. He is 40 years old.

The salaries of the director, the managers and other employees are precise in compliance with the limits of the Government decision for the electric industry branch. During 1991-1992, due to the syndical movement in the enterprise, could be obtained a payment increase while the payment addition of 50% in 1993 and 30% in 1994 is made as per Government decision.

The managers payment level of the enterprise is almost twice higher than the average payment of the workers. By the end of 1994 the director's wage was lek 9800 (\$US 98) per month, that of the managers was lek 9000 (\$US 90) and the other administrative employees was about lek 6000 (\$US 60), while the average payment of the workers is about lek 5000 (\$US 50). The respective wages of the private sector are 2-3 times higher.

#### ***The Main Influence of the Reform to the Electric Enterprise of the City***

As it is mentioned above, the structure of the electric power consumption has changed with the initiation of the transition. The major industrial users in 1994 were reducing their demand for the electricity, as the consequence of the production fall. On the other hand the public consumption has been increased, due to above mentioned factors. The total amount of the electricity that the electric enterprise bought from the producer is risen from 267985 thousand kw/h in 1991 to 409221 kw/h in 1994 while the electric power sale is reduced. The difference between electricity purchase and sale is because of the technical loss and thefts that are increasing.

Furthermore a certain number of the consumers, such as the state enterprises and institutional, private companies and domestic consumers are not able to settle bills. By the end of 1993 the unsettled amount to lek 67661000 (in fact lek 40 million considering that December bill is paid one month later) and by the end of 1994 they amounted to lek 192437000 (which is really about lek 90 million). The electric enterprise can interrupt electricity supply to the private firms but it can't do so with some state institutions such as Radio-TV (RTV), hospital centers, Telecom, water works, dormitories etc. to avoid social and political problems.

In such circumstances the electric corporation has frequently increased the price of the electricity sale, for instance in 1993 it was 2 lek for the state enterprise and 0,3 lek up to 250 kw/h for the population. Beyond this upper it was increased to 8 lek per kw/h. While in 1994 the price structure was 2,1 and 4,5 lek for the population and 8 lek, during winter, for the private firms. All the clients pay 10% over the bill for the enterprise expenses.

The major part of these incomes obtained from the electricity price increase in remitted to the state budget. For instance, during 1994, the electric enterprise used to buy electric power at 0,25 lek per kw/h and sell it at 4,5 lek per kw/h for the domestic consumers. The enterprise shared with the corporation the difference between 1,1 and 0,25 lek per kw/h while the difference between 4,5 and 1,1 lek per kw/h was remained to the state budget. Although the enterprise profits are increased only because of the electricity price increase (see table 4), they are insufficient to reconstruct the electric network.

**Table 4.**

*The profits of the enterprise during 1991-1994*

Years	The enterprise profits
1991	11379
1992	
1993	1552000
1994	34404000

In the short term strategy of the firm, up till now, has counted in taking the measures for the electric network reconstruction, prevention of thefts and settlement of the obligations by the debtors. In 1993 the work started to buy a line 20 km in Tirana, which is considered as the base of all lines installment in the future. This was realized through the cooperation with an Italian firm (ENEL), in the frame of a 4 million \$US credit, submitted by the European Community. The second phase of the project will start in 1995. the enterprise has also set a group of inspectors to check the electricity usage, to prevent its theft but up till now there isn't any evident result.

For the future these problems are assumed to be solved through the privatization, basing on the existing.

## 5.5. Textile Industry

The textile industry is one of the branches of the industry, that in the planned economy system would take an evident place to the country industrial output. Its specific weight to the country industrial production from 40% in 1953 reached to 15% in 1990.

Actually, it is one of the industry branches, that is hit more during the transition. And this mainly due to the internal demand decrease and the competition of the import goods.

### 5.5.1. The History of the Enterprise

The woolen textile enterprise in Tirana is founded in 1953. Since its initio, it has been part of the textile mill, which was built in 1951, in the frame of the Soviet economic aid. The textile mill was one of the greatest works of the light industry, where used to work 8000 workers when it reached its full projected capacity.

In 1991, with the initio of the transition process towards market economy, the textile mill was derided into four production enterprises plus mechanical base, this division was motivated with the perfection of the enterprises of the mill, function only some small lines, where work no more than 1/20 of their labor power. The enterprises are in the dependence of the Enterprise Reconstruction Agency (ERA).

The woolen textile industry has rather backward Russian technology. A part of its machineries are German production of 1911-1912, that the USSR took from Germany in the frame of the economic aid, the enterprise received a number of machineries from China, in 1982 it imported a few loom machineries from Poland and in 1988 it bought a second hand line from Greece. The enterprise was established mainly for the army needs. It used to produced thick textiles (blankets, fabrics) and woolen yarn.

The woolen textile enterprise is considerably effected from the economic reform and since November 1994, its activity has been interrupted, except the yarn production line, where actually work only 6 workers. In the following table it is presented the production dynamic and the workers number for the period 1991-1995.

**Table 1.**

*The realized sale and the workers number*

Years	Realized Sales (in 000/lc)	Workers Number
1991		350
1992		300
1993		250
1994		200
1995		40

### 5.5.2. The Enterprise Management

Basing on the law for the state enterprises of July 1991, the enterprise is ruined by the Managing Board. In woolen textile enterprise it is composed of 5 people, and it is

partially altered in 1992. Its members are:

The Managing Director is graduated from the textile engineering in China. He has an experience of 17 years. He is nominated director by the Ministry of Industry.

The Finance Manager is graduated from the economic faculty of Tirana University in finance. He has an experience of 7 years and he is nominated by the enterprise.

The Marketing Manager is graduated from the economic faculty of Tirana University in industry. He has an experience of 20 years and is appointed the manager by the enterprise.

The Production Manager is graduated from the textile engineering faculty of China. He has an experience of 19 years and he is nominated manager by the enterprise.

The Chief of the Sector is also the member of the Managing Board. He is graduated from Tirana University in engineering and has an experience of 14 years. He is nominated by the enterprise.

The payment level of the managers is about twice higher than that of the average payment of the workers. In November 1994 the director's wage was lc 10000 (\$US 100), the Managing Board members' was about lc 4500 (\$US 45). These wages are fixed in accordance with the limit of the government order for the branch of the textile industry. The rise in the wages of 50% in 1993 and 30% in 1994 are made in compliance with the government decision.

### 5.5.3. The Hits of the Economic Reform

As it is mentioned above, the army was the principle client of the enterprise, which used to buy about 70% of the ready product, mostly blankets and fabric for the military uniform. From 1991 the army budget began to reduce and in 1992 it canceled the contracts with the enterprise. The aids and lower prices of these articles from the foreign market also influenced in the contracts cancellation. Furthermore, the demands of other budgetary institutions such as hospitals, students, dormitories, nurseries and kindergartens etc. were for the similar reason deducted. The artistic enterprises of cellist and carpets production, that used to export these items to the Eastern European Countries also reduced their inquiry for yarn, as the secret of the sale - market closure, while the demands of the trade enterprises fell, as the consequence of low prices of the fabrics and ready made clothes, imported chiefly from the Eastern countries.

**Table 2.**

*The clients' debts against the enterprise for 1991-1994*

Years	Debts in 000/lc
1991	5137
1992	8051
1993	9056
1994	8602

The enterprise short-term strategy of the survival was the production and labor power elimination through the assistance but not at the same rate with the demands decrease. The social aspects and the pressure of the garden over the enterprise managers to maintain the employing level would influence to this problem. In such circumstances to maintain the employing level the enterprise would prefer to sell to the clients especially to the cellist and carpets enterprises a part of the production by credits. The client's debts were risen as follows:

The enterprise passed a part of the ready product which was over the demand to the workhouse, the value of which was increased as follows:

Years	The ready product (000 lc)
1991	2326
1992	12067
1993	22719
1994	18686

The normalization of the ready product considerably lowered the enterprise payment ability which caused debts accumulation towards the suppliers the social insurance and the state budget. Thus, it was created the chain of debts among the enterprises. The enterprise debts structure towards the fiscal is as follows:

	1991	1992	1993	1994
Suppliers	1258	2775	4967	3928
Social insurance	1526	2139	1797	2162

This difficult economic-financial situation of the enterprise was further complicated by the misuses and thefts, the uninterrupted price rise of the electricity and steam as well as the inherited technological backwardness. Furthermore, the short-term strategy of woolen textile enterprise for the survival has fully been passive. It holed not use its very favorable financial condition of before reform, the very big quantity of raw material resources left after the textile mill division, its independence increase etc., to obtain new markets, foreign partners, to do reconstruction etc. Being in such circumstances, it's actually since 1991 has resulted with loss:

Year	Losses in 000 lc
1991	- 5467
1992	-3393
1993	-2524
1994	-2562



The Enterprise Reconstruction Agency (ERA) decided the enterprise closure and its preparation for the privatization, realizing its hopeless economic-financial situation. Basing on the decision in 420 of the Council of the Ministers from 15.08.1994, all the enterprise employees that have uninterruptedly worked in it not less than 2 years, have the right of full payment for one successive year. Then they pass to the social assistance. At present, in the enterprise work about 40 employees, including the administration, guards, warehouses keepers and 6 workers of the yarn production line. It is also set a commission near the enterprise, to make its estimation.