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EAST EUROPEAN BUSINESS NETWORKS: A REVIEW OF DEPENDENCIES AND STRATEGIES AND THEIR INFLUENCE ON COMPANY SUCCESS

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Abstract

This paper discusses the enterprise behaviour that was observed in the economies in Central and Eastern Europe during the transition period. It analyses the factors that determine the company performance particularly relating to government policies, industrial structures and managerial strategies for survival.

As a result of our comparative analysis of published cases, a classification of the firms responces is proposed. It includes three main groups: a) 'transformed business networks,' b) 'newly established business networks,' and c) 'firms unable to transform their business networks.' In addition, the companies' linkages are grouped into national and international networks following Stephen Young's classification of international modes of market entry.

I Introduction

This paper discusses the enterprise behaviour that was observed in the economies in Central and Eastern Europe during the transition period. It analyses the factors that determine the company performance particularly relating to government policies, industrial structures and managerial strategies for survival in a turbulent environment. The analysis of the companies' adjustment behaviour is conducted through a new methodology for comparative analysis of case studies. The purpose of this methodology is to enable a secondary analysis of large number of published case studies. The methodology is based on the development of a new set of categories, which are used to re-organise the information in the cases and to achieve comparability. These categories are explained in part 4 of the paper and derive from the underlying hypothesis of our research that the adjustment behaviour of the firms is pre-determined by the macro-economic conditions, the position that each firm occupies in a particular industry and the firm's control over its value chain.

The concept of a 'business network' is used in this paper to describe the ***regular and repetitive transactions that an enterprise maintains with suppliers and buyers within its value chain*** (see also Porter, 1991). The term network includes the complexity of relations between companies based on their past contractual arrangements and present ties. The information on these linkages is rarely reported in the cases. However, our careful reading through the text following the new set of categories, and the secondary analysis of the available information highlighted some of the main enterprise linkages.

As a result of our comparative analysis, at the end of the research we were able to classify them in three main groups: a) ***'transformed business networks'*** - all companies that have gone through a period of significant changes that have altered their position on the market, b) '***newly established business networks' -*** all newly established companies that have successfully positioned themselves in the market, and c) '***firms unable to transform their business networks'*** - companies that have not been able to change their structure, market orientation, or product range in order to adjust themselves to the new market conditions.

In addition, the companies' linkages were classified into national and international networks. The grouping of international networks follows Stephen Young's classification of international modes of market entry including: a) exporting, b) licensing, c) franchising, d) management contracts, e) turnkey contracts for establishment of a complete production unit or infrastructure project, f) international subcontracting, or placing orders with specifications, g) industrial co-operation agreements involving government agencies, h) contractual joint ventures, j) equity joint ventures, k) wholly owned subsidiaries. If enterprises report repetitive transactions with partners within the home market only, their business networks are called 'national'. The complete classification, presented in this paper, is an outcome of the research process.

The conceptual framework for the analysis of the firms' adjustment behaviour is based on a number of theoretical arguments. Firstly, this is the role of the Central Plan in establishing the structural links that forced enterprises into vertically and horizontally integrated production systems. Secondly, this is the turbulence in the macro-economic environment during the transition period, which increased not only the business risk for individual firms, but also the dynamics of the market relations.

The collapse of the socialist system at the end of the eighties is most clearly associated with the failure of the administrative system of the centrally planned economies to efficiently co-ordinate economic activities. Its inability to provide incentives for innovation and development, to exercise control over the dysfunctional behaviour of individual managers, or to obtain adequate feedback on the implications and effectiveness of specific policies was evident in each country of the eastern block. The opening of the socialist economies to the world market and the subsequent collapse of the Central Plan further marginalised business activities and transmitted to managers a new message that it is entirely in their hands to establish new business associations, in order to survive in a hostile and turbulent environment.

Almost all Central and East European countries transformed large numbers of state firms into semi-autonomous corporations. The new corporatised form of state companies effectively opened the door for control over the state owned firms to be exercised by individual interests. As Frydman and Rapaczynski (1994) point out, all the efforts to decentralise the economic system both before and after the collapse of the communist regimes did not achieve their objectives.

The reforms unleashed the force of 'special interests': group, professional, institutional and individual interests, instead of introducing incentives and creating productive energies. These reforms as a principle served to re-locate power from government officials to those private firms that successfully replaced the functions of the Central Plan. These new economic agents provided state firms with access to resources and markets.

As a result of that shift, a number of state control mechanisms over the economic activities of firms were lost. The most recent privatisation in this respect has also failed so far to assure effective control over the management of the enterprises, or in the majority of cases, to provide access to foreign capital and expertise, and to facilitate structural changes at macro level. The intense transition reforms created additional macroeconomic instability which raised the risk to business operations throughout the whole region.

A typology of business risks and factors influencing the degree of uncertainty for business decision making is discussed in the following part. It maps out a conceptual framework to assess the magnitude of risk that firms are currently facing in Central and Eastern Europe and allows an interpretation of the variations in the transition paths adopted by different countries in the region.

II Risk Management Through Business Associations and Networks

The main aim of the State Central Plan in the Socialist economies was to develop 'quantitative macro-economic goals for the economy as a whole', and to break them down to branch ministries (Chavance, 1994). In different sectors of the economy there were different numbers of intermediaries involved in the process of disagregating the Plan into quantified figures as 'production sector goals' and 'mandatory targets'. These intermediaries were in charge of the management of all enterprises and as Chavance described them, they supervised all aspects of the production plan at the firm level: "the supply and turnover of goods, the determination of prices, the wage fund, and relations with financial agencies" (Chavance, 1994, p. 13).

The intermediate institutions responsible for the co-ordination and supervision of economic activities comprised of five interdependent agencies: 1) The Politburo and The Central Committee of the ruling party, 2) The Ministry of Planning (responsible for the co-ordination of the Plan), 3) The State Council, 4) The Council of Ministers, and 5) The Central Bank.

After the collapse of the Central Plan the individuals working in these intermediaries were best positioned to take over the role of agents co-ordinating the economic transactions between enterprises. The main governing structure in the former socialist system - The Parliament - usually played an insignificant role in the endorsement of decisions already made.

This shows that what might be called the *nomenclature*, or the individuals that comprise the civil service and part of the 'political functionaries' in the socialist system, possessed the intimate knowledge of the allocation of resources within the economy (Willerton, 1992, Todeva, 1996). The *nomenclature* had the entire control of the information on economic transactions, market demand, differences in prices, and new business opportunities within the home market. As such, it is not accidental that a large proportion of the new private firms was established by former *nomenclature.*

All relationships of the firm in the past were pre-determined by administrative decisions. Kornai (1992) also points out that fundamental decisions for the establishment of a firm, or its liquidation, for appointment, promotion and dismissal of managers, for the allocation of products, materials and labour, for price setting and financial regulation, for investment and technical development, for foreign trade and international economic relations - were made entirely by the nomenclature. The intermediaries served as a buffer absorbing shocks between the state firms and the market.

With the collapse of the Central Plan, the functions of the intermediary institutions were disrupted and the firms were exposed directly to the market. While state firms gained autonomy in this process, they also faced a resource dependency because of previous relationships. The firms were directly exposed to multiple shocks such as the collapse of the COMECON market, the drastic decline in demand at the home market, price liberalisation raising the costs of all inputs, trade liberalisation increasing foreign competition in almost all sectors of the economy, and intensive tax reforms attempting further to de-capitalise firms.

The instability of the business environment exposed enterprises to multiple risks, such as:

- *market risks* (determined mainly by changes in demand, increased variations in consumer tastes and confidence, decline in individuals' spending power, changes in government regulations);
- *financial risks* (determined by exchange rates, taxation, the level of bad debt, subsidies and relieves);
- *resource management risks* (induced by availability of raw materials, labour, technology).[1]

Ritchie and Marshall (1993) suggest that business risks affecting firms are multiplied by the ***degree of uncertainty*** under which managers make choices and decisions. The factors influencing the degree of uncertainty according to the authors are both exogenous and endogenous and comprise of seven type of

[1]Ritchie and Marshal (1993) suggest that business risk comprises of four types: market risks, financial risks, resource management risks and environmental risks.

barriers: 1) *the availability and adequacy of information*; 2) *the clarity (or lack of) in structuring the problem* (including the scale of the problem, the degree of complexity and ambiguity); 3) *the inability to identify alternative solutions*; 4) *the futuristic nature of decision making*, including its significance to the organisation, the degree of irreversibility; 5) *the objectives to be satisfied*; 6) *the post-decision stage of implementation*; 7) *the personal quality of the decision makers* (Ritchie and Marshall, 1993).

If we look at the transition process, we can see that the managers of both state and private firms faced all these barriers. However, the state sector was affected deeper than the private sector. The abandoning of the Central Plan caused a serious disruption of information flow previously utilised by managers of state firms. The ambiguity induced by alternative transitional policies made it difficult for managers to define long-term and short-term threats to business enterprises. Their personal and professional insecurity as managers prevented the majority from setting clear objectives for the firms.

Macro-economic policies in Central and Eastern Europe aimed at revising the enterprise 'decision-making unit' and placed an enormous pressure upon the management structure. A number of challenges were posed for managerial adaptability to the new market conditions. If we look at these policies from the risk-management perspective, the liberalisation of trade and prices dramatically increased market risk. The shock therapies in Poland and Bulgaria for example, had a much more dramatic impact on firms compared to the more gradual liberalisation policies in the Czech Republic and Romania. The liberalisation of prices is seen as one of the major factors that led to massive increase of inter-enterprise debt. The collapse of the Central Plan exposed all disproportionate relationships that enterprises maintained with buyers and suppliers. The monetarisation of the economy increased the financial problems and difficulties in obtaining credits. The disrupted communications and trade relations (particularly with the collapse of COMECON) led to multiple resource management risks. All these risks varied across industries and across countries, and this is one of the major differentiating factors determining the different speeds of the decline and recovery of the transition economies in Central and Eastern Europe. For example, the Czech Republic was able to attract early foreign direct investment and to write-off the bad debts of a large number of its state enterprises. This reduced their financial risks and as we can see from the case studies, these selected firms increased their chances of a successful adjustment to the new market conditions.

III Managerial Response to Business Risks During the Transition Period

Focusing on the response of the enterprises, it was expected that the move towards a market economy would automatically establish pre-conditions for rational economic behaviour. However, a detailed analysis of the factors determining the degree of uncertainty suggests that with this extreme level of unpredictability of outcomes faced by managers during the transition period, rational and long-term decisions are impossible.

The lack of adequate information caused by the institutional vacuum put an immediate extra value on informal sources of information and links that the managers had from the past, inspite of their bias. The official governmental sources became an inadequate means of acquiring information about the business environment. The interpretation of messages from policy makers signalled to firms a distorted picture of intentions and threats in terms of financial management. From being directed, protected, and developed by governments and bureaucrats, enterprises became overnight single autonomous units exposed to the hostile macro-economic environment. This explains why managers enhanced former links based on personal contacts in order to re-negotiate their own position and the position of their enterprises. As our case studies indicate, some of the managers were able to transform their dependencies on resources and information, and to acquire access to new markets, while others failed to do so.

One of the main weaknesses of the unprepared management teams was their inability to structure the problems within their company and to identify alternative solutions. Only individuals with non-traditional thinking were able to assess the challenges and to generate alternative company strategies. Examples of this are shown in the comparative case studies of two shipyards in Poland discussed in the paper. The difficulties of dealing with problems were intensified by the rapid changes in the legal environment, sudden competition (mainly from abroad) and the inherited mis-allocation of resources from the past.

Managers found that many business decisions could not easily be reversed as in the past, and decisions taken had real commercial consequences that were often irreversible. The lack of experience in market relations put managers of state companies in a position of being unable to assess future outcomes of business activities, or to define alternative strategies.

Research with managers in Central and Eastern Europe identifies a list of contradictory objectives that companies had to pursue in relation to enterprise restructuring: 1) They had to develop new business functions (particularly marketing and sales), while reducing the labour force; 2) They had to reduce costs, while diversifying into new products and markets; 3) They had to increase internal financial accountability under a dramatic decline in available working capital; 4) They had to reduce the labour force, while some of the methods for mass privatisation suggested a strong interest of keeping it intact. If we add to this picture the time and resource constraints, one could understand why managerial decision making was not up to the complexity of pressures stemming from the business environment.

In this context the quality of decision makers should not be judged so harshly by the outcomes, but by assessing the circumstances in which decisions are made and the type of managerial experience acquired in the past (see Todeva, 1996). The dependency on past experience and networks was also reinforced by the need to secure scarce and expensive resources, and achieve some business success that would ensure the survival of the business.

Risk management in Central and Eastern Europe is a feature of the transition period which has not attracted enough attention in the academic literature. The inadequacy of managers to respond to the 'new' market signals delivered through macro-economic policies is a dominant assumption. The 'irrational' behaviour of the managers is attributed usually to knowledge, experience and culture, and it overlooks the role of structural factors in the business environment. Some of the cases discussed below put emphasis on the circumstances in which each business operates, both industry specific and country specific factors that have influenced the formation of co-operative business strategies.

IV A Methodology for the Classification and Analysis of Different East European Companies

The case studies used in this paper originate from a number of publications and research reports (Estrin, 1995, Hirschhausen and Hui, 1995, Johnson, et. al., 1996). The cases of firms in Bulgaria and Romania stem from unpublished research reports used with the permission of Estrin (1997). The qualitative and quantitative information in these cases has been analysed for the purpose to compare different companies in Central and Eastern Europe.

It is known that the collection of information for company case studies is usually directed by different methodologies. However, the content of the cases provides significant information about the organisation of the companies, their place in the industrial structure, their relationship with government agencies, with other businesses, and the effect of the business environment on their performance. These published case studies are treated as the main source of information for secondary analysis of qualitative and quantitative data.

For the purpose of our secondary analysis seven new categories are developed that allow comparability between companies. These categories stem from our underlying **hypothesis** that ***the adjustment behaviour of firms during the transition is pre-determined by the macro-economic conditions, the position that each firm occupies in a particular industry, and its control over the value chain***. We interpret the effect of macro-economic conditions as related to *dependencies on government decisions*. The information available on industrial structure is interpreted as dependencies on *intra-industry, inter-industry, and inter-firm linkages*. A reported personal and professional linkages that affect business decisions are interpreted as *personal and professional networks*. Information on firms structure, organisation and capabilities is extracted under the categories *intra-firm dependencies and accumulated resources*. The market conditions are described under the category *uncertainty of resources*. The strategic response of the particular company is described under the category *strategic behaviour, adaptation, and repositioning*.

These categories facilitate the analysis of the dependencies which each firm experiences in relation to its value chain, to its markets and to the government.

1) ***The dependency of firms on government decision***: The proper functioning of the market is a result of a systematic political process that involves government intervention through taxation, subsidies and regulations. The effect of government policies on company re-orientation during the transition period in Eastern Europe is reported by managers mainly in reply to questions about barriers and difficulties experienced by the company. Usually in their account managers refer to macro-economic policies such as price and trade liberalisation, exchange rate adjustment and convertibility of the home currency, privatisation law and bankruptcy procedures, administrative and governmental decisions regarding company status and ownership structure, and other detailed aspects of the regulatory framework.

2) ***The dependency of firms on inter-firm, inter- and intra-industry linkages***: The socialist industrial system was build up with a high degree of integration of processes and operations across different industrial sectors of the economy to achieve economies of scale. The management control and the strategic skills for the co-ordination of vertical and horizontal transactions were located in industrial holding companies and branch Ministries (Kornai, 1992,

Chavance, 1992, Todeva, 1997). Therefore, there was a market design structure, which pre-determined intra-industry mobility, directed by the state holding companies (called industrial associations and combines), and established high entry barriers to new business. All input and output markets (determining the value chain and value system of individual enterprises (Porter, 1991)) were pre-designed and facilitated repetitive transactions. Managers usually report information relevant to this category (such as problems of industry structure, main suppliers and other intermediaries in the production chain) when asked about the difficulties with suppliers, the changes of customers and the difficulties with distributing their products.

3) ***Professional and political networks***: It is an established fact that the former socialist economies were managed by highly hierarchical political and administrative structures representing the totalitarian state. After the collapse of the Central Plan many of these relations were transformed into professional networks and informal groupings of individuals, that have continued to work with each other. Usually this information is provided by managers who describe personal links that are used for their business. These professional and political networks resemble very much the patronage relations described by Willerton (1992).

4) ***Intra-firm dependencies***: This category refers to the work by Mintzberg (1983) on intra- and inter-organisational power relationships and structures for decision making and control. It also refers to the structure of corporate control. Managers speak of the difficulties they face in the areas of the company itself, its internal environment, departmental structure, business functions, and industrial relations. These characteristics are called intra-firm

dependencies. They usually serve as barriers to organisational change and business restructuring.

5) ***The accumulation of resources***: Usually case studies comprise information about the size of the firm, production capacity, product range and differentiation, or any other strengths that give comparative advantage to the company.

6) ***Uncertainty of resources***: This category collects information about barriers set up by the market. Usually managers report problems related to the main threats perceived by the firm. These include changes in their market demand and lack of particular resources due to market deficiencies rather than government interventions.

7) ***Strategic behaviour***: Usually all case studies in Central and Eastern Europe ask managers about the changes made during the transition period. The reported information includes both intended and implemented changes, or any attempts made for adaptation, re-orientation and re-positioning on the market. This category provides information about which dependencies have been re-enforced, and which dependencies have been transformed by the new market conditions.

All these categories are indicative and they serve mainly to interpret the existing information in a comparable framework. This more detailed secondary analysis produces a different profile of each company from the one portrayed by the main published sources. It is believed the depth of company analysis is positively affected by this additional interpretation and review of the information.

V A Comparative Analysis of Business Case Studies in Central and Eastern Europe

All case studies reviewed in this paper represent different forms of enterprise restructuring. The variety of responses by firms suggest that there are a number of company specific, industry specific and country specific characteristics that determine the success of the restructuring process. This is evident from the comparison of cases in each group and subgroup. The summaries of our case analysis are presented in the three groups mentioned above: a) business networks based on ***'transformed dependencies'***, b) business networks based on '***newly established business links'***, and c) business networks that were '***not able to transform their dependencies'*** on scarce resources and markets. Each group is divided into two sub-groups referring to national business networks and contractual agreements, international networks.

This classification of firms derives from the overview of all cases. The recent debates on privatisation and company restructuring in Central and Eastern Europe has been entirely dominated by the argument that privatisation is the only means for enterprise restructuring. Our interpretation of the cases aims to highlight a new dimension of the transition processes and to introduce an argument for the structural dependencies and barriers to change usually undermined in the academic literature. Our secondary analysis of the cases includes extracts from the original case studies on the new set of categories, and is presented in appendices at the end of the paper.

The first group of cases represents business networks that have evolved from transformed dependencies. The Lithuanian case of a holding company in the electronics industry demonstrates how a highly centralised and capital intensive business network from the past had transformed itself into a private holding company with effective control over the entire industrial sector of ***Lithuanian electronics***.

There is no information about the internationalisation of the electronics industry as a consequence of this restructuring, and this is why this case is placed in the subgroup of national business networks. The authors argue that the entire process has been facilitated by the rapid privatisation in the country, and the inconsistency of government policies has allowed a highly organised group of 'managers' within one industry to take control of the majority of assets.

(a) Business Networks Based on Transformed Dependencies (see Appendix 1, 2 and 3)

National Business Networks	
	1. LITHUANIA - Industrial Holding Co. in Electronics***
	2. HUNGARY - Hungartextile Holding / Textile / Cloth*
International Business Networks *through:*	
shared ownership	3. LATVIA - RAF Minibus Assembling***
industrial cross - border co-operation	4. CZECH REPUBLIC - PSP - Heavy Engineering / Iron Processing Machinery*
licensing & exporting	5. CZECH REPUBLIC - Spolana / Chemicals*
exporting	6. ROMANIA - Clujana Trading Co. / Leather & Leather Substitute Shoes*
subcontracting	7. CZECH REPUBLIC - Motorpal / Auto Parts, Fuel Injection*

The case does not provide sufficient information whether this transformation of ownership has led to, or has the potential to become profitable. However, it demonstrates how the main group of the largest two manufacturers in the electronics sector, and seven of their major suppliers, have formed an extended business network, comprising of an investment fund, a commercial bank, one or more insurance companies, a distribution network, and a number of trade firms.

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* Estrin, S, et al. (Eds.) (1995) *Restructuring and Privatisation in Central and Eastern Europe: Case Studies of Firms in Transition*, M.E. Sharp, Inc., New York.

** Estrin, S., et al. (Eds.) (1997) [Case Study Reports in Bulgaria and Romania], ACE-PHARE Research Project No. 91-0381-R

*** Hirschhausen, C. & Hui, W. (1995) Industrial Restructuring in the Baltic Countries: Large Scale Privatisation, New Enterprise Networks and Growing Diversity of Corporate Governance, In: *Communist Economies and Economic Transition,* Vol. 7, No. 4, pp. 421-443.

This case shows that the restructuring of the entire electronics industry has been driven by the regulatory reform in Lithuania, and the opportunistic behaviour of a professional group of well-positioned managers, rather than a market led change. This case also demonstrates that a professional network of individuals have transformed the business network in the electronic sector reinforcing previously existing dependencies on supplies and markets. The dependencies on centralised government subsidies and regulations have been used as opportunities for the establishment of control over the entire sector, and many of the old inter-industry dependencies have been re-enforced. It is also evident from this case that the new business formation is lobbying government to conclude commercial agreements with CIS countries, and in this way to facilitate access to international markets.

The second example in the group of transformed national networks is ***Hungartextile Holding***, which controls 30% of the total output of the Hungarian textile / cloth industry. This example shows in contrast that the actual ambitions of these managers are not to run the holding company, but to use it as a legal entity that bears the liability of the loss making firms that are to be closed by the government to clear their debts.

The devolution of administrative control in Hungary has changed the ownership status of the members of the group. However, the case does not suggest a major change in the suppliers and buyers network of the firm, has not led to the diversification of products and access to new markets. On the contrary, the case shows that inspite of the significant changes in the structure of ownership and control, the loss of CMEA's markets (43% in 1991) had made all its subsidiaries into loss making firms.

The high level of technology (60-70% up to western standard) has created overcapacity which poses challenges for a further rationalisation of the business. The changes in ownership has not altered the dependency of the firm on government decisions, on the structure of the textile / clothe industry, or the intra-firm linkages between subsidiaries.

Both case of the Lithuanian Industrial Holding in Electronics and the Hungarian Hungartextile Holding demonstrate 'successful' privatisation from an economic perspective. However, the brief review of the cases highlight further barriers to their re-positioning on the market that go beyond arguments of ownership structure.

More successfully transformed business networks are presented in the sub-group of firms that were able to internationalise. An interesting case of internationalisation of a business network through *shared cross-border ownership* is the ***Latvian company RAF***, operating in minibus assembling. From the original case it is evident that the Latvian company was formerly heavily dependent on Russian suppliers and the Russian market. This has forced the company management and the Latvian government to initiate a cross-ownership deal between RAF and the Russian company GAZ. The internationalisation of ownership and the re-enforcement of the former dependencies, within the production chain has helped the company to maintain its position on the international market.

The ***Czech company PSP Heavy Engineering*** is a very good example of how an influential management team in the sector, and an appropriately selected Board of Directors and Supervisory Board have, succeeded in lobbying governments for a number of favourable decisions. This is an example of Young's type of international market entry through *industrial cross-border co-operation involving governments* on both sides - The Czech Republic and Ukraine.

It seems that the firm has survived through extracting financial resources from the Government in a variety of ways, rather than through re-positioning itself in the market. Through its political network the company has turned its dependency on the Ukrainian market, and inter-governmental negotiations of cross-ownership into an advantage, by sheltering itself from the shocks of inflation and exchange rates.

Another ***Czech company - Spolana*** - in the heavy chemicals industry, demonstrates further the point that without a major transformation of ownership, or changes in relationship with its suppliers, the company has survived through increased exports to western markets, and through the internationalisation of its business network. Their main form of internationalisation is *licensing* and *exporting*.

There are interesting examples of transformed business networks within the boundaries of the home market. The ***Romanian company Clujana*** in the footwear industry, maintains its national business network, that secures both financial resources from two Property Funds - through the State Property Fund and a Private Property Fund called IV Muntenia. Even though the company management reported no formal networks and dependencies it is striking that the company has newly gained access to foreign markets (for nearly 50% of their production in 1994). It could be argued that the major change for the company is the shift of control - from a ministerial control - to a control by the two ownership funds who also facilitate the access to the foreign markets. This is an example of a successful internationalisation through *exporting*.

The ***Czech company Motorpal*** operates in the automotive industry, producing auto parts and fuel injection. In comparison with the other cases in our selection they are the largest firm and one of the most experienced in conducting business across borders. However, their survival also has been determined not so much by the managerial competencies in restructuring and adjustment, but by their almost monopoly position in the sector, by their technical expertise and know-how, their capitalisation by the former socialist governments and their business ties with the car manufacturer Skoda through which they accessed business partners in Germany. Even though the managers do not report specific business linkages, it is evident that in addition to their reputation as a former COMECON market leader, they have benefited from subcontracting to Skoda's aquirers, Volkswagen. It is clear in this case that the main revenue of the company comes from their *exporting and subcontracting* activities.

Within this group of newly established business networks, we have grouped firms that have appeared on the market as new business start-ups with the liberalisation of the business activities in Central and Eastern Europe, or new joint ventures and co-operative agreements. Of interest is the ***Czech company*** working in the footwear industry, named ***'Tipa'***. It is unclear why the company has classified itself as operating in the footwear sector as it is actually involved in business in ten industrial sectors, including agricultural production, travel

(b) *New Established Business Networks*

(see Appendix 1, 2 and 3)

National Business Networks	
	1. CZECH REPUBLIC - Tipa / Footwear Industry (*)
International Business Networks *through:*	
contractual joint venture	2. HUNGARY - Elegant Charm / Textile / Garments*
equity joint venture	3. HUNGARY - Interchokolade KFT / Food Processing / Chocolate*
equity joint venture	4. SLOVAK REPUBLIC - CS-07 / Food processing / Chocolates & Sweets*
subcontracting	5. POLAND - Szczecin Shipyard / Shipbuilding****
exporting	6. ESTONIA - Tarmenco / Furniture Industry***
exporting	7. BULGARIA - P-05 / Textile / Cloth**

services, construction (also export of labour in construction), agricultural machinery sales, foreign trade, shoe production, frozen food and ice-cream production and sale, bakery, retail and wholesale and a real estate agency. This small business start-up in the retail sector with a regional focus, has rapidly grown through extreme diversification, achieving high profit margins identified by their well informed managerial team. It has managed to establish two

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* Estrin, S, et al. (Eds.) (1995) *Restructuring and Privatisation in Central and Eastern Europe: Case Studies of Firms in Transition*, M.E. Sharp, Inc., New York.

** Estrin, S., et al. (Eds.) (1997) [Case Study Reports in Bulgaria and Romania], ACE-PHARE Research Project No. 91-0381-R

*** Hirschhausen, C. & Hui, W. (1995) Industrial Restructuring in the Baltic Countries: Large Scale Privatisation, New Enterprise Networks and Growing Diversity of Corporate Governance, In: *Communist Economies and Economic Transition*, Vol. 7, No. 4, pp. 421-443.

**** Johnson, S. et al. (1996) Complementatities and the Mangerial Challenges of State Enterprise Restructuring: Evidence from Two Shipyards, In: Economies of Transition, Vol. 4, No. 1, pp 31-42. (Only the two cases in Shipbuilding industry in Poland).

privatisation funds with ambitions to establish a regional savings bank, and a number of cross border joint ventures with German, Italian and a Russian partners. At the centre of this business network stands a group of nine formerexecutives from local state and co-operative farms who have known each other for many years. It seems that the business has grown around the personal network of individuals.

Very similar in this respect is the case in the textile industry of the ***Hungarian company Elegant Charm Ltd***, a spin-off of a major industrial group of ten plants, which manages to survive through a co-operative agreement with Levi Strauss. This is an example of an unstable business network and shows both the efforts of Central and East European firms to access western markets and the interest of the western partners to expand eastwards in this highly labour intensive sector of the textile industry.

The internationalisation of the company is achieved through the *contractual joint venture* with Levi-Strauss and *exporting* (as much as 60% of its output is exported). However, the company itself has no marketing or sales department and this demonstrates its dependency not only on the international partner, but also on the trading houses that facilitate its international dealings.

The ***Hungarian company 'Interchokolade KFT'*** in the food processing industry has been gradually acquired by a Swiss multinational company 'Globalfood'. This *acquisition* obviously brings international expertise and market opportunities for one of the four largest Hungarian manufacturers in this sector. However, in this case it is suggested that by joining the international network of Globalfood subsidiaries the company has lost autonomy, and has become a dependent division which provides manufacturing facilities and access to the

Hungarian market to the Swiss multinational company. The main advantages seem to be the maintained core labour force, and the stable financial situation.

This however, is not the case with the ***Slovak company 'CS-07'***, which had agreed an *equity joint venture* with Jacobs-Suchard, but only after they sacked 27% of the labour force. Of note is that the interest of the foreign company was instigated primarily by the presence of their international competitors (Nestle and BSN/France) in the Czech Republic. This shows that the expansion of international business networks in Central and Eastern Europe should be considered more as due to the effect of the a wider competitive environment, rather than an evidence of enterprise adjustment to the new market conditions and to the regulatory reforms in the region.

An exemplary case of internationalisation of business network is the ***shipyard in Szczecin.*** It has emerged from a deeper crises than its neighbour the ***shipyard in Gdansk*** and had outplayed it. This is due to aggressive marketing strategy addressing a niche market in the world in medium size containers, the internal re-organisation of the production line, the remuneration system, and the shedding of non-productive assets. It also could be argued that the success of the company is due to the business relationships with the Polish Development Bank, with which a joint equity venture of 50% for each partner has been established. In fact, this new access to financial resources is a growth of their business network, and reduces their dependency on working capital. However, the most important part of their network are the *contracts with German ship owners*, which provide them with an access to important new customers. The numerous contracts with German ship owners also could be due to former personal and professional contacts and business links, as well as their expertise in negotiations. This case is an example of a successful transformation of the firm's business network both nationally through a joint equity venture with a financial institution, and internationally through *subcontracting* in a niche market.

The case of the ***Estonian firm Tarmenco*** in the furniture industry, is an example of a successful internationalisation, switching from the former Russian and COMECON markets to the western markets. The *export* activities are organised through joining international distribution and sales networks.

The ***Bulgarian company P-05*** also has identified a network of customers, but mainly national trading companies, that manage for them the *export* of 80% of their production and 20% of their imported inputs.

In principle, the last three companies in this group represent more transformed business networks, rather than newly established ones. However, we have placed these cases in this group to stress the argument that there is a clear brake in the structural linkages that companies maintain within their value chain.

Three companies are included in this analysis as examples of an inability to transform heavy structural dependencies, or drastic losses of market demand. The ***Polish firm Pafawag*** is an engineering company manufacturing railway rolling stock. In the beginning of the reforms in Poland they were able to achieve high profits due to their monopoly position, but their rapid decline after 1990 suggests unavoidable bankruptcy.

(c) Unable to Transform Business Networks (See Appendix 1, 2 and 3)

1. POLAND - Pafawag / Engineering / Railway Rolling Stock*
2. POLAND - Gdansk Shipyard / Shipbuilding****
3. HUNGARY - Radion / Electronics / Radio & Electrical Works*

The case of the ***Gdansk shipyard*** is another example of a large firm that traditionally operated on international market. The transition reforms had induced changes in the management structure of the yard, but not changes in the main orientation of the firm. The company maintains its intra-firm structure. During the transition period it increased its revenue for a short period and protected its labour force. This is an example of a strong resistance to change and a gradual shift in business operations. Recent difficulties of this company suggest that without dramatic change of the business linkages with suppliers and buyers survival is not guaranteed.

The ***Hungarian firm Radion*** in radio and electrical works is a case where an already declared bankruptcy in 1991 still does not have to mean the end of the firm. It seems that the firm has been unable to reposition itself on the market due to a lack of competitiveness in a capital intensive industry, dominated by firms with rapid technological change and quick adjustment strategies.

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* Estrin, S, et al. (Eds.) (1995) *Restructuring and Privatisation in Central and Eastern Europe: Case Studies of Firms in Transition*, M.E. Sharp, Inc., New York.

**** Johnson, S. et al. (1996) Complementatities and the Mangerial Challenges of State Enterprise Restructuring: Evidence from Two Shipyards, In: Economies of Transition, Vol. 4, No. 1, pp 31-42. (Only the two cases in Shipbuilding industry in Poland).

VI Conclusions

The cases included in this analysis aim to demonstrate the wide variety of business networks and co-operative relations that have evolved during the transition period in Central and Eastern Europe. Some of the cases obviously reassemble and re-establish former dependencies, designed by the central planing system. However, the variety shows the creativity of managers to find niches for survival, opportunities for internationalisation and profitable activities. Most of the managers have shown themselves to be remarkably adaptable under difficult conditions.

Further analysis is required to establish a more detailed classification of the co-operative business networks that have evolved in Central and Eastern Europe during the transition period. Additional analysis also could establish patterns of adaptive company behaviour and the variations across industries, regions and countries. However, the case studies in this paper demonstrate the variety of responses in terms of enterprise restructuring that are observed in Central and Eastern Europe. The differences in transformation of structural links established by the Central Plan is seen as being driven mainly by external forces to the enterprise. The result of the restructuring strategies produces three groups of behaviour (transformed business networks, newly established networks, and unable to transform the business linkages). The firms included in our analysis show also that inspite of the general similarities at industry level, Central and East European companies are not homogeneous by history and present business strategy.

The companies that have transformed their former dependencies into managed business networks show their ability to control their external environment primarily through lobbying governments (PSP Heavy Engineering) and influencing the regulatory arrangements (Lithuanian Industrial Holding in Electronics). For most of the companies in this group the transitional policies have not affected their dominant position in their industries, in spite of the collapse of market demand (Spolana, Motorpal). Their strategic responses have been to consolidate further their central position in the value system (RAF, Hungartextile Holding). Their former industrial linkages and personal and professional relationships have heavily determined the outcome of their adjustment to the new regulatory regimes introduced during the transition period in Central and Eastern Europe.

The companies with established new networks demonstrate examples of blurred firms' boundaries (Tipa), increased dependency on foreign trade firms (Tarmenco, P-05), joining international business networks through joint ventures, and acquisitions and subcontracting to foreign firms (Interchocolade, CS-07, Elegant Charm).

The three cases of dramatic decline in company performance (Pafawag, Gdansk shipyard and Radion) exhibit the consequences of a managerial failure to re-position the company in a more competitive environment, to restructure its linkages with suppliers and customers, and to restructure its assets and costs. The externalisation of costs through business networks is a strategic behaviour applied both in developed market economies and in transition economies.

The lack of a marketing function by the former socialist enterprises has been one of the most evident reasons for the managers failure to adapt to the drop in demand and the increase of costs. Most of the cases show that an access to new markets facilitates company restructuring. This suggests that the discussions on value chains and the extent to which companies control the elements of the entire value system are critical and important in explaining many of the difficulties in enterprise restructuring experienced in Central and Eastern Europe.

The transformation in Central and Eastern Europe has been treated mainly as a transition to a market economy. However, the literature addresses primarily issues of macroeconomic policy and fiscal policies of transition. Only recently it had focused on the building of institutions to support the major changes in the mechanisms for co-ordinating economic activities. This is seen as a replacement of co-ordination by a hierarchy, with co-ordination by a market. This paper argues for the complementarity of markets and bureaucracies, and highlights the importance of networks as strategic formations that facilitate successful enterprise restructuring, and the adjustment to competitive forces. Further research on industrial linkages and their effect on company business decision making is clearly needed.

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Appendix 1 BUSINESS NETWORKS BASED ON TRANSFORMED DEPENDENCIES

(Extracts from the published cases)

Company	Dependency on Government Decisions	Inter-firm / inter-industry / intra-industry dependencies (production chains)	Professio-nal & political networks	Intra-firm / dependencies (the internal environment)	Accumula-tion of resources (size, market share, reserves)	Uncer-tainty of resour-ces	Strategic behaviour adaptation, re-positioning (reactive vs. proactive)
1. LITHUANIA Industrial Holding Co. in Electronics	Lithuanian government carried the most rapid privatisation programme in eastern Europe - in Dec. 1990 adopted 'Law on the Accumulation of Private Capital of Employees in State Enterprises', and in July 1991 - ' Initial Privatisation Programme'; however, the government demonstrated inconsistency of approach & in 1994 had to bail out all 260 bankrupt combines; the distribution of vouchers and the absence of bankruptcy procedure facilitated the creation of industrial holding companies; most investment funds established in 1992 with no regulatory framework on the composition of assets, creation of multiple funds by the same people, or price and competition control	The industry comprised of two large producers and seven major suppliers (Screen, Tube, Chip-1, Chip-2, Scheme, Broad and Resdev); the industry depended 79-80% on deliveries from the FSU; 80-90% of the production for the Soviet market; in 1992 their sales fell by 65% in three years due to increased competition on the Russian market from south-east Asia, China & Western Europe); in 1992 EBSW investment fund (which is owned by managers of the electronic industry) bought 40% of the shares of TV-2, 30% - of TV-1; in addition managers acquired directly another 25% of TV-2	The Association of the Electronic Industry is trying to push the government to conclude commercial agreements with CIS in order to re-establish old production and trade connections			Production and sales shrank by 50-80% between 1991 and 1994	A common strategy for attracting foreign investment is being prepared by the EBSW

		shares and 30% of TV-1 shares; 5% of the investment funds hold 52% of the invested vouchers; each investment fund controls a commercial bank, one or more insurance companies, distribution network and trade firms; in this way, an investment fund with the smallest possible amount of capital have become the majority owner of a large network of enterprises					
2. HU - Hungar-textile Holding / Textile / Cloth	The 1988 Act on economic Associations transformed the former economic associations into holdings with independent subsidiaries; the intention of creating the holding was to create an assets management structure which will perform many administrative functions including some from the subsidiaries	Highly labour intensive industry which exported 25% of its output; very segmented sector, which comprised of many small & medium size firms with limited product mix & therefore not necessarily competitive between each other		In June 1989 established as a Holding, or a self administered enterprise - an assets managing centre for the subsidiaries; manages 90% of the assets; in March 1992 - supervised by the Government through State Property Agency; the holding lost all of its production, but kept part of its predecessor's purchasing and sales functions; cross-ownership between subsidiaries, while the holding controls between 80-98% of the shares in each subsidiary	Reduced labour force with nearly 50%; 60-70% of the technology is up to the western standards while the product mix is at 50% compared; it is the largest cotton textiles firm in Hungary after a merger in 1963, comprising of 30% share of the total output of the Hungarian	In 1991 the subsidiaries became loss-makers themselves; lost export to CMEA markets equivalent to 43% share of its sales	Possible goal for the new owner might be to raise capacity utilisation by increasing the current level of combined output of the group; however, more output could not be sold competitively on the domestic market & therefore the capacity has to be reduced by subleasing the plants

					textile industry		
3. LATVIA PAF Minibus Assembling	Latvia is the most industrialised of the Baltic countries and most enterprises are stuck in former supplier-client relations; political instability and absence of established legislation on land ownership and restitution blocked the reform between 1992-94; a broad range of institutions were developed to deal with restructuring - two state property departments and a short-lived Ministry of Economic Reform; a complicated voucher-compensation scheme allowed citizens to purchase their flats and therefore no demand for industrial objects led to trading value of the vouchers to fall continuously; 78% of privatisations have been carried out through long-term lease	The company PAF is a centre of a large network of 10 major and 100 minor suppliers of materials and components; 10% of suppliers from Latvia and 80% - from FSU - the most strategic one - GAZ; after the monetarisation of the economy most suppliers demanded advance payments; 93% of its production distributed in the FSU; at least three of its major suppliers decided to start minibus production themselves (GAZ, Bratsk, Uliyanov)			The company is a supplier of minibuses to the entire SU; until 1992 - the only producer in FSU of 12-seat passenger and ambulance vans		In order to ensure input supply, the firm decided to intensify relations with its strategic supplier GAZ: in 1995 the government offered GAZ a 30% share in the company
4. CZ - PSP - Heavy Engineering /Iron - Processing Machinery	In the past supported by government orders through a state foreign trade firm, which subcontracted work for a large multi-governmental investment project in Ukraine / Russia through an investment engineering group; the state provided long-term, low-interest, government guaranteed bank loans; in 1993 the outgoing	Supplying low liquidity foreign markets; the state foreign trade firm bare all risks; in 1988 the investment engineering group split into several parts and The Principal Contractor unit became a division in PSP; The state foreign trade firm was liquidated in 1991;the privatisation	able to put pressure on the Czech government to solve the case of ownership & liabilities; maintaining official and unofficial contacts with the newly privatised	Almost all plants in one location - a town of 50,000 population; all members of the Supervisory Board and the Board of Directors were selected by the company and included representatives from the Ministry of Finance, the Commercial Bank, the Institute of Economic Law, the Institute of State Law, chartered accountant and experts from	Size-5,000 / 10,000; most overdue receivables were recovered and the irretrievable ones were sold; 20% reduce of employment by 1992; privatised at share price	Sharp increase in prices of inputs due to liberalisation of prices; loss of CMEA markets	The company used the unclear relationships on the multi-governmental investment project in Ukraine as a secure market, utilising the cheaper loan and completing its part of the investment; the company intends to move away from capital intensive, energy consuming and over-

	Czechoslovak Government agreed to stop its investment in Ukraine, to pay the loan collateral and the interest payments in yearly instalments for 10 years and to pay PSP lost profits; the government transferred ownership of the assets to all major suppliers to the project and one potential buyer of the products from the Ukrainian venture (all newly privatised)	program includs 10% shares to a customer (or FDI), 15% shares to commercial banks and 5% shares to local administration	customers (construction companies) with an attempt to grow in a niche market of environmental technology	universities (all used as channels of information and contracts), and one appointment from the Ministry of Industry; since 1991 management introduced a Holding structure	14% of the original value; produces technological equipment for coal power stations, cement and ceramic industries		diversified production
5. CZ-Spolana Heavy Chemicals - the forth largest firm	Become independent in 1990 after a split of one of the conglomerates; cancellation of depth in 1991 by the government	Dependent on cheap crude oil from Russia and a range of imports; significant proportion of products are made under the license of foreign firms; R&D co-operation with University for Chemical Technology in Prague			Size-10,000; 17% reduction of labour force; 55% of exports to Germany & Benelux countries		Highly diversified production in industrial chemistry, man-made fibres, plastics, agrochemistry, gastrochemistry, synthetic hormones for the medicine; the loss of domestic markets was compensated by rapid growth in exports; obtained credits secured by immovable assets exceeding 1.3 times the credit
6. RO-Clujana Trading Co. / Leather & Leather Substitute Shoes (former Cluj-Napoca)	Founded by government in 1992 taking over the patrimony of the former Leather & Shoes Factory of Cluj; the Shareholders meeting includes two representatives from the State Ownership Fund and one representative from the Private Ownership Fund - IV Muntenia	High degree of production integration - the company has the capacity to ensure all necessary semiproducts for its own use and for other shoe producers; the company is one of the most important exporter in leather industry		The company specialises in design, manufacturing and selling of leather goods and synthetic leather substitute shoes, adhesives, shoe metallic accessories, spare parts; the company produces the thermal energy for itself and for other industrial firms; the company is managed by Shareholders Meeting (appointing the General Manager & the Managing Board and	Size-9,000 employees in 1993; started to upgrade its technological base between 1992-94		Decrease of production for sales on domestic market from 63.7% (in 1991) to 50.5% (in 1994) and a forecast of 33% (by 1998); increase of production for foreign markets from 36% (in 1991) to 49.5% (in 1994) and a forecast for 67% (by 1998); planning re-

				approving the yearly program of activities), Managing Board, comprising of seven members (controls the responsibilities structure and the operations of the firm), Directing Committee (approved by the Managing Board) and Auditing Committee (approved by the Shareholders' Meeting)			technologisation of the factories with the support from the State Ownership Fund
7. CZ - Motorpal / Auto Parts, Fuel Injection	Developed as a priority industry in the past as part of the extension of the automobile industry; had priority in obtaining financial resources; in 1990 became a joint stock company; now impossible to obtain long-term credit; non-effective banking system, which delays operations with foreign partners; the two major changes that affected trade were 1990 currency devaluation through changes in exchange rates and 1991 price liberalisation; as a part of the macro-economic stabilisation wages were frozen for the first half of 1991 and remained regulated until the end of 1992, which led so social unrest in the firm; the government cancelled part of the debts to the firm and many of its suppliers and customers, but the banks applied this credit to the interest, not to the liability of the firms	Several trading companies are trying to re-establish barter transactions with the countries from FSU to ease the hard currency shortage; active participation of fuel injection producers in R&D with engine producers	Managed by two boards (as all other state firms) - Board of Directors (five members - CEO, the finance director & one representative from the Czech Ministry of Industry, from Investicni Banka, & a Professor from Prague School of Economics), Advisory Board (consist of three members - the Head of Control Department, a rep. from Czech Ministry of Industry and a rep. from	High precision and high quality production, sophisticated technologies, economies of scale, all of which create significant entry barriers; main supplier for automotive and tractor industries, industrial engines producers & spare parts suppliers - many of them faced insolvency; the adjustment to a low level of demand had not yet been finished; individual plants are looking for whatever orders they could find and were adjusting accordingly their production programmes;	Seven plants in six towns - 3,800 employees high product quality, competitive price advantage, high brand loyalty because of high substitution costs, a monopoly producer in Czechoslovakia & CMEA countries; undisputed leader in the Soviet block countries and known in 70 countries; the firm was not affected much by the depreciation of national currency because it had	The collapse of CMEA market and the decline in the domestic market led to 60% cut in orders; delayed payments by clients cause secondary indebtednes s and shortage of cash.	The firm was able in 1990-1991 to seize new opportunities in the areas of design, technology, operations and personnel, but did not give consideration to costs, benefits, capitalisation; minimal 'slim down' including selling under-used universal equipment, materials, spare parts & tools (with almost insignificant effect), reducing labour force only through retirements and release of Vietnamese workers; in 1991 had to introduce part-time work or temporary layoffs, followed by difficulty to re-hire people because of the skills required; keeping average wage below the national average; recognised inertia, but unable to change towards higher

			Komercni Banka); the management of the firm had not changed in the last six years - all top executives are respected by the workers, strong personality of the CEO & strong links between the members of the management team		positive trade balance; the shock of price liberalisation and the subsequent cost liberalisation also was not very severe in the automobile industry		responsibility and cost consciousness; in 1991-92 two new products were produced for the West European market, which is a proof of good technical skills; exploring new markets in Middle East, North Africa, India, Indonesia & China; seeking partners to co-operate in production, technology & sales, marketing & distribution

Appendix 2 NEW ESTABLISHED BUSINESS NETWORKS
(Extracts from the published cases)

Company	Dependency on Government Decisions	Inter-firm / inter-industry / intra-industry dependencies (production chains)	Professio-nal & political networks	Intra-firm / dependencies (the internal environment)	Accumulation of resources (size, market share, reserves)	Uncertain-ty of resources	Strategic behaviour adaptation, re-positioning (reactive vs. proactive)
1. CZ - Tipa - Footwear Industry	Bank loans are for a maximum of four years and with high interest rate; a general lack of money in the economy meant that other resources were blocked as accounts receivable after their maturity; to offset the burden of taxes the firm received subsidies in 1991	Started in the retail sector in 1990 with additional focus on services and construction; established by a group of nine former executives from nearby state and co-operative farms in the area of Trade, Travel, Information, Production, Agriculture; registered two investment funds for the privatisation and trained the managers of the funds; operating within regional boundaries	The group of nine founders of the business are former executives from nearby state and co-operative farms and they knew each other for many years from the High School	The founders serve as top managers and divisional managers of seven divisions - cost-centres; they serve on Boards of Directors and Supervisory Boards of the subsidiaries and the established joint ventures and appoint the presidents and directors of the subsidiaries; this is aimed to maintain a uniform strategy	Size - 600 in 10 industrial sectors; accumulation of different technologies & contacts which allowed diversification; relying on their information of the market opportunities and the available skills; rich network of contacts and connections which facilitated finding sources of inputs, leasing offices and work spaces and identifying profitable market niches and take-over opportunities	Decline in demand for footwear and collapse of CMEA markets for leather industry	The company owns agricultural production facilities, a fruit farm, a travel bureau services, a construction firm; it is involved with agricultural machinery, foreign trade, shoe production, frozen food and ice-cream, telecommunications and security services; it ownes a bakery & retail shops, a real estate agency; it is constructing a plant for wood processing with second hand machinery from a bankrupt Swiss co-operative; all investments have been made using loans or leasing service; planning joint venture with German and Italian partners and a joint venture with a Russian partner to facilitate barter deals; exporting labour to Germany; planning to expand into a milk processing plant, an acquisition of a packaging plant and establishment of a regional savings firm or a bank; planning to expand in Slovakia, acquiring businesses in a particular town looking for businesses with high profit margin

2. HU-Elegant Charm Ltd./ Textiles / Garments	The government authorised to set domestic prices on the same level as competitive imports; Elegant Charm ltd. was established in 1990 as a spin-off from the main Group of ten plants; some of these plants had obsolete technology and become financially a drain on the firm; initially the largest shareholder was the main group - with 48,9% equivalent to the machinery and equipment arbitrarily overpriced; the second shareholder was OTP Bank with 25.5% and three smaller private firms (a small trading house, an agricultural co-operative & a small private firm) with 25.6% combined; later on the equity stakes of the three smaller firms belonged to only one private firm	Provides 12% of the output of the light industry; 60% of its output is exported; there are a large number of firms on the domestic market which compete with imports rather than between themselves; the intensity of competition is caused by the narrow specialisation of producers and their direct access to retail market, therefore the retail firms determine their network of suppliers	Appointment of a very effective management team of four; two of them from the old Group and two from competitors; the present Director General has been the former head of trade & co-operation department at the old Group, who initially disagree of splitting the Group; the management of th company did not sign the collective bargaining agreement with the trade unions	Co-operation agreement with Levi Strauss for jeans; produces leather clothing, which is capital intensive and takes a lot of firm's profit for re-financing routine short term credits; a deep gap between production & marketing capabilities & lack of co-ordination between the two; relatively low waged labour when unemployment benefits were slightly less than after-tax wages; lack of governmental funds available in the past for apprenticeship training; low wages were linked to poor profitability, which was affected by high taxes; increased competition in its subcontracting-based export market with a shift of competition from Hungary, Poland, Yugoslavia - to Bulgaria, Czech, Slovak Republic, and Ukraine; poor relationship between the main Group and the company; the company rents premises from the Group at very high rent; there is a signed agreement between the two firms that the company can not enter	Size - 292 in 1992 following a number of voluntary leaves and lack of replacement for 200 jobs; the new company inherited only part of the product mix and the markets of the old Group; its output structure and access to markets depended on the factors of its establishment	The company is under-capitalised due to its smaller collateral, necessary for credits; the domestic market for finished products had shrunk due to fall in household consumption; the Group utilised only small part of the capacity of the company and this created need to find new markets outside the orbit of the Group; uncertainty of ownership - some of the small share holders were liquidated, others sold their shares & the Group was also in liquidation; costs (like for materials, depreciation, bottlenecks) had increased	Lack of marketing department and as a result the company is loosing 4-5% added to the final sale price dealing through trading houses; aggressive subcontracting to utilise up to 108% of the capacity; gradually creating an independent design department, which made of up to 15% of the sales; gradually closing down several loss-making product lines, such as leather clothing and fur products; these capacities were converted to textile-sewing; the management would like to acquire the shares owned by the Group after the Group's liquidation - at a price of 75% of their value, offering to take 50% of them and the other 50% to offer to the workers; the management also had started negotiations to acquire the shares from OTP Bank; planning a take-over of one of the plants of the Group, or to purchase the facilities rented by them

				into business relations with a Group's partners for 5 years & in return the Group will utilise 120% the capacity of the company		faster than sales compressing profits	
3. HU - Intercsoko-lade KFT / Food processing / Chocolate	Nationalised in 1947, integrated into an industrial trust in 1963 & decentralised in 1981 into a forced merger with a sugar factory until 1985, which led to depletion of company's reserves due to world crisis & depressed prices for sugar industry; taxes on profits were not paid in 1991 due to extremely high taxes on wages introduced with the new income tax system in 1988; received export subsidies until 1990 & a significant decline in export performance after	The Hungarian confectionery industry was highly competitive since 1987 with 4 state enterprises, 37 bakery firms owned by municipalities and 30 co-operatives; by 1991 the industry was dominated by three firms which were ranked 19, 32 & 98 on the Hungarian industry list of the top 200 firms; the company was also ranked 7 on the list of joint ventures according to the size of foreign equity - the Swiss partner 'Globalfood' who became an almost exclusive owner in 1992; exogenous factors are quite strong, because price fluctuations on the sugar market are large and this affects profits	The new owner retained the top management & the technical staff for two years to test them; the former Director General (appointed in 1977) became Deputy Director General; the new Director General was a Hungarian, experienced in international trade of food products, fluent in several languages and well networked abroad and in the country; a new marketing manager appointed from abroad	Total increase of costs between 1988-91 - 77%, including 138% - wage, 142% - fixed costs, 43%-materials & 62%-energy; rapid increase of wages without significant lay offs; 10 times increase of bank debt (1988-91) due to higher interest rates, inflation and delayed payments; low level long-term debt reflecting a conservative investment policy based upon self-reliance; irredeemability of most receivables which doubled between 1990-91 and increased more than 10 times after 1988	maintained the same level of labour force, decreasing the size only by retirements and elimination of part-time employees; offered overtime which led to increase of personal income with 51% between 1990-91; technical staff had 100% & management - 300% increase in salaries; the firm increased its export possibilities, its capacity for expansion & technical development & maintained its employment	The firm lost completely its autonomy & was integrated into the world market with its access to the Hungarian domestic market for chocolate products, the firm is dependent to operate only through Globalfood group subsidiaries abroad	In 1992 introduced a new accounting system which will provide more accurate screening of the cost structure of each product & will assist in firm's price restructuring; half of the funds after privatisation were spent on new equipment and the other half - on a new storage building and social facilities, which increased workers' loyalty to the company
4. SL-CS-07 Food Processing / Chocolates	the legal system provides weak penalties for not fulfilling a contract; The Ministry of	80% of production was purchased by wholesale organisations; their collapse led to increase of inventories; the firm	Rigid behaviour of managers and administrative staff	The company has too long innovative cycle of packaging (one year); reduced work force which led to increased	Size-587 employees after a loss of 27% of the work force including 40	Above 70% of exports were to CMEA markets; the collapse of	Most recent strategies include diversification of production and discontinuity of some product lines, merger with Jacobs-Suchard, build-up of

& Sweets	Agriculture and Grocery had no power to manage the firm with exception of appointing the General Director and evaluating the economic results annually; in 1992 the firm became a joint-stock co., administered by the Fund of National Property who appoints the Board of Directors (a General Director and four Vice-Directors) and the Supervisory Board (with one representative from The Fund and two from the firm)	now access the market only through small businesses; however one of the Czech manufacturers provides 70% of the industry capacity of the former Czechoslovakia and there is an approved sale of 65% of this CZ firm to a consortium of Swiss (Nestle) and French (BSN) investors		internal flexibility (doing more than one jobs); agreed a sale of 32% of the shares to a Swiss firm (Jacobs-Suchard) - to increase to 66% through future investment; obsolete products and packaging were replaced by purchase of packaging materials from Austria, Germany & Italy	members from the administrative and managerial staff; the firm is the only supplier of chocolate mass to the monopoly producer of durable biscuits in Slovakia	the system for integrative sales in 1990 led to discoordinatio n of production and sales (in a situation when demand exceeds the supply) and the need for planning by the firm; it subcontracts to a German company against delivery of technology & ingredients	new distribution channels through new domestic and foreign partners, acquisition of technology, and expansion into CMEA markets
5. POL Szczecin Shipyard	the new managing director secured co-operation of the Polish Development Bank (PDB), a government bank designed to assist in large scale enterprise restructuring administered in the past by Industrial Shipbuilding Union, directly accountable to the Ministry of Industry; governments used to locate clients & negotiate with	in 1991 the yard and the Polish Development Bank created a joint venture 'Container Ship' with 50% ownership each; the PDB operated as a guarantee for fleet owners' prepayments and to provide working capital major customers in the past were Eastern Bloc countries, particularly FSU; the trading company paid the yard in domestic currency upon completion of a project	a new dynamic and market oriented manager appointed in 1991	created a new marketing office in 1989 to pursue clients; by 1991 had $150 mln dept because of expensive bank loans and Soviet insolvency; forced to delay payments to over 1500 suppliers and a number of commercial banks; assembled a new market research team with the task to identify a niche world market; in 1992 the production value was $182 mln and required 5,000 workers	reduced labour force from a peak of 13,000 (in 1970s) to 6,000 (in 1991); in 1988 signed a contract for four container ships for German ship owners and the first one being delivered in 1991; in 1992 signed contracts with German fleet owners for another 13 container ships worth $300 mln; total contracted ships for 1992 -		aimed to narrow its product focus and develop a niche market - for container ships particularly in medium class; closed two out of six slipways and a number of other departments comprising 1500 workers which were transferred to the main production line; reduced product cycle time for a single ship from 2-4 years to 11 months; changed remuneration from paid in piece rate per task to hourly wages adjusted by qualification category; reversed the compensation hierarchy and put highly qualified workers on top; no overtime work was

	customers through state operated trade company 'Centromor' - for a 2% commission of a ship's selling prise; government provided all finance for a new ship construction, which included subsidies for unprofitable projects (often up to 50% of the total construction cost)			the yards had no marketing or sale function and at the beginning of 1990 had to develop individual supply network and assumed responsibilities for locating all future clients	48, or 40% of the international market for medium size containers;		permitted; the new average salary was two times the national average; eliminated many of the employee amenities; developed competitive advantage by focusing production; by increased productivity through reduced production cycle; by implementation of performance enhancing compensation scheme, by shedding of non-productive assets and by reducing number of employees directly involved in ship assembly
6. ESTONIA Tarmenco / Furniture Industry	Adopted the most drastic approach to restructuring with Estonian Privatisation Agency as the major administrator of privatisation	The privatization led to almost instantaneous reorganisation of production structures and networks in industries close to final demand and less capital intensive like the furniture industry; upstream, the supply of wood and other inputs from Soviet sources was largely cut off and had to be replaced with payments for supplies in hard currency; downstream, the entire distribution system collapsed			In 1991 96% of the production was for FSU, while in 1993 88% of the products were sold in western countries		The survival strategy includes to diversify production (from 5 - to 150), to develop new products, and to hook up to existing distribution and sales networks; in 1994 six directors of the enterprise took over two-thirds of the property
7. BU-P-05 / Textile / Cloth	In 1991 the enterprise was transformed into a public limited company under the supervision of the	Compared to 1990 the volume of production in the sector decreased by 46% in 1993; the firm holds 40% of the internal woollen yarn	In 1992 under the pressure of a trade union organisation 'Podcrepa' a new executive	The firm has large production capacity; the long production cycle is not sufficiently flexible for the European market; there is a	Size in 1994 - 2,000 employees; the volume of production is growing and in 1994 the demand		The company has access to new markets and new resources and bigger independence in setting prices; it has diversified production as a result of its own design projects; it has

	Ministry of Industry; a main burden is the rise in energy prices and the decline in domestic demand, rather than competition from imports; the devaluation of the currency has a positive effect on the firm; the firm was included in the list for mass privatisation without any consultation with the management team	market and 25% of the worsted cloth market; a presence of a lot of new contractors since the start of the reform	director was appointed (with vast experience in the same firm), who formed a new management team	surplus labour and insufficient quality level; lack of financial resources and unclear responsibilities of the management with regard to the future development of the firm	exceeded the supply		created a network of customers which provides opportunities for exports of 80% of its production, and on the other hand importing 20% of its raw materials; investment in new technology is not a priority for the managers and the firm could maintain its market position on the basis of present equipment and by putting in operation non-utilised reserves; management is preparing an alternative project for privatisation promoting a more active managers' participation

Appendix 3 UNABLE TO TRANSFORM BUSINESS NETWORKS

(Extracts from the published cases)

Company	Dependency on Government Decisions	Inter-firm / inter-industry/ intra-industry dependencies (production chains)	Professio -nal & political networks	Intra-firm / dependencies (the internal environment)	Accumula-tion of resources (size, market share, reserves)	Uncertain-ty of resources	Strategic behaviour adaptation, re-positioning (reactive vs. proactive)
1. POL-Pafawag Enterprise / Engineering / Railway Rolling Stock	Rapidly shrinking subsidies for the Polish State Railways; the drop of domestic demand occurred relatively late (in 1991-92) but it was much sharper than in other industries and unevenly spread among the various product groups; the legal regulations still do not allow a switch from a system based on central allocation of production supplies to a market-oriented behaviour; frequent changes of economic conceptions & programs partly due to unstable governments made impossible to develop & implement a consistent strategy; The Ministry of Privatisation approved a plan for privatisation including establishing a joint venture with foreign partner & foreign capital to restructure the production & to upgrade the products to western standards	The industry consists of ten enterprises that produce railway rolling stock for the Polish railways, for the city transport, for internal industrial transport & for export; some firms exported about 70% of their output to CMEA countries & FSU; technical & organisational backwardness led to inability to launch a competitively priced modern product; large under-utilised & obsolete production capacity; there is a demand but main customers are railway companies that rely on governmental subsidies, & therefore unable to place new orders;	Most directors had started their professiona l career at the firm strait after graduation & they have extensive technical knowledge & production managemen t skills; however insufficient presentatio n of economists & lawyers; no changes of top managemen t staff since 1984	Production capacity utilisation in 1988 was 86%, while in 1992 - drop to 54%; depreciation of fixed assets in 1991 was 63%; it took 10 years for the R&D department to develop a new model of electric locomotive; the management structure includes three Deputies - one for production, one for economics & accountancy, & one for technology, development & marketing	Size-2,184 in 1991; decrease of employment with 30% between 1988-92; the largest firm in the rolling stock industry, the largest producer of electric locomotives & the sole Polish manufacturer of multipartite electric sets; previously exported to USSR, China, India, Iraq, Bulgaria, Hungary, Yugoslavia, Czechoslovakia, Morocco & Syria; a large portfolio of social assets - a large housing district, medical clinic, vocational & technical secondary schools, cultural centre,	Lack of financial resources to replace obsolete machines & in this way to reduce production costs; the management needs to find other means to reduce costs so to make the firm more attractive to foreign buyers	The management introduced changes in the remuneration system in 1992 according to which the premium for technical staff depends on the attainment of planned level of gross profit & sales; the premium for workers is incorporated in their salaries; the deputies receive a premium equivalent to 25% of their basic pay & no premium for the managing director, as the principles were determined by the worker's council; the company was able to raise prices & to reap profit until 1990; it did not use long-term credits after the increase of interest rates in 1990; however, the interest on short-term credits to finance its working capital mounted up to 10% of the total costs; the firm was able to find suppliers who offer either cheaper products, or more favourable terms of payment & recorded high profitability rates until the end of 1990; the firm increased production of items

		difficulty in separating various elements of the technology lines & lack of potential buyers for them; had two subsidiaries which became independent in 1992			sports clubs, holiday resorts and canteens; had began to diversify production beyond the typical industry profile; did not carry the burden of long-term credits		unconnected with the rolling stock market; however, the potential is limited, because of other firms from the same industry who could offer lower prices for the same items & services; the firm attempted to lower costs of materials, energy & transport, but because of inter-dependence of technological lines the firm was unable to sell unnecessary assets; part of the social assets were leased; increased number of employees in marketing & accounting; increased financial & marketing autonomy of particular departments; liquidated in 1992 one department for casting
2. POL - Gdansk Shipyard	administered in the past by Industrial Shipbuilding Union, directly accountable to the Ministry of Industry; governments used to locate clients & negotiate with customers through state operated trade company 'Centromor' - for a 2% commission of a ship's selling prise; government provided all finance for a new ship construction, which included subsidies for unprofitable projects (often up to 50% of the total construction cost)	major customers in the past were Eastern Bloc countries, particularly FSU; the trading company paid the yard in domestic currency upon completion of a project	50% of management replaced in 1990	produce internally as many components as they could - to be independent, even though some could be purchased at lower price from western countries; in 1992 the production value was $177 mln and required 9,000 workers the yards had no marketing or sale function and at the beginning of	had the last order from FSU in 1988; in 1993 the yard had still three unfinished vessels with non-standard technical specifications which the FSU has ordered, but was unable to pay for; continue to maintain a vast infrastructure of workers' amenities - vacation resorts, housing, hospital, sports club, transport; revenue has increased from $55 mln in (1990)		focused on revenue, rather than on profit, because management believed that the fixed costs play a more significant role rather than variable costs; continuously increasing production, but not being able to reach break even; believe in full employment

				1990 had to develop individual supply network and assumed responsibilities for locating all future clients	to $77 mln in (1991)		
3. HU - Radion Radio & Electrical Works / Electronics	Liberalisation of imports flooded the market with competitive products; slump in economic activity by 25-30% & the consequent decline in living standards led to a shrink of domestic sales with 50% (between 88-91); in 1991 - forced to declare bankruptcy; in the future privatisation the main factors should be guarantees regarding employment, production and infusion of capital and technology, not price; no real co-operation could be expected from the domestic banks who are not able to judge the crisis management perspectives of heavily indebted manufacturing firms; there is a need for a definite industrial policy, debt-relief programs &/or injections of funds for technological renewal & temporary protection of the domestic market; the abolition of the import-licensing system was not accompanied by the imposition of any significant tariffs on imports, & the sudden liberalisation of imports did not leave time for the domestic manufacturers to	High R&D competitive industry which requires quick adjustment strategies and continuous investment policies to keep up-market	All managers have high degrees in economics and engineering and extensive experience in the firm; the marketing manager is with experience in a trading house	Maintained training expenditure until the very end of 1991; no major restructuring due to favourable economic situation of the firm until 1990	Size - 1776 (in 1991) decreased with 46% since 1988; the R&D expenditure in 1990 was 64% of the 1988 level, which meant that the firm had given up its ambitions to remain competitive	The growth of material & inventories exploded in 1991 & this weakened the financial basis of crisis management; dramatic increase in corporate debt linked to former defence industry - investment with its accompanying interest and payments; closure of all military outlets; lack of funds and unavailable credits; under-capitalization, accompanied by rapidly increasing technology gap; serious market &	Before the collapse of the CMEA market there was a decline in exports to western markets - an indicator of loosing competitiveness; the liquidation makes the firm debt-free, however potential buyers are interested only to use its sales channels to the CIS market to sell their own goods

	adjust					sales problem; strict bankruptcy & liquidation legislation	