Dynamics of Management Development and Enterprise Privatization in Eastern Europe.

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Abstract

Privatization of most enterprises in Eastern Europe is considered essential for the democratic form of government to survive over an extended period. The dynamics of the privatization processes and of management development are very important but they have received very little attention. They are crucial to the success of the attempted conversion of the system in that part of the world. This is stunning because of the several billion ECU's and U$S spent on economic and management advice to the countries in the area.

This paper explores the dynamics of management development to meet the needs as markets are freed and companies are privatized. Particular attention is directed at the fact that many needed skills essential to success may not be taught in the normal management school programs. From this observation emerges the need for a program of management development uniquely designed for recently privatized companies and for those soon to go through the process. In addition the conclusions contribute insights to the current debate whether to privatize all corporations within a very short period or whether to proceed more gradually.

Dynamics of Management Development and Enterprises Privatiztion in Eastern Europe

INTRODUCTION

We hear frequently the statement that adequate enterprise management is essential for adapting East European economies to free market conditions making them more efficient. What this statement implies, however, is generally poorly understood. This lack of precision causes huge inefficiencies in these economies.

The privatization of enterprises and their conversion into more efficient instruments of production appears to be a rather chaotic process suffering of costly delays. A substantial cause of these delays appears to be the insufficient understanding of the many needed management improvements essential but frequently different for each company. The problem is compounded by an insufficient understanding of how to go about introducing these management improvements. The considerable efforts directed at management development consequently produce inadequate results. Eventually the whole process of conversion from state ownership of enterprises to private ownership may be seriously endangered.

Enterprises passing from government ownership to private one must adjust to changing market needs. Simultaneously the social, legal and political framework in which the companies operate evolves. Successful operations in free markets and adaptation to the dynamic social and legal environment are possible only if management is adequate, both, in skills and in numbers. Management needs to know how to adapt effectively, efficiently and as smoothly as possible the company culture to evolving market and social conditions.

This paper explores some aspects of the dynamics of management development to meet the needs as markets are freed and companies become private. Particular attention is directed at the fact that many needed skills essential to success may not be taught in the normal management school programs. From this observation emerges the need for a program of management development uniquely designed for recently privatized companies or for those soon to go through the process. In addition the conclusions contribute insights to the current debate whether to privatize all corporations within a very short period or whether to proceed more gradually.

The model presented here is a subsystem of the complex social, economic, legal and political system. This system is undergoing fundamental change in Eastern Europe as more and more production and service activities are transferred to the private sector. As such this model is subject to future revisions. In its current state, however, it already provides useful insights that may help towards a smoother transition.

MODEL DESCRIPTION.

The underlying assumption is that state enterprises get privatized at a varying rate influenced by many key factors. Once privatized these enterprises are allowed to fail unless they remain competitive. As the enterprises become private they are subject to competitive pressures if the markets play their role. These competitive pressures are shaped by other East European private companies. When the markets become open international companies that offer their products and services in the same markets also participate in the competition.

Salutary competition should force management to tend towards better use of resources and thus towards better company management. To ensure such results certain regulations should exist. For example limits on pollution should be clear and compatible with accepted standards in the industrialized countries. The same should be true with respect to products quality and safety standards. Transparent accounting criteria are also very desirable. In short companies should be made to behave ethically. The absence of such regulations where needed could induce management, motivated by balance sheet results, to attempt shortcuts leading to high profits on individual companies' balance sheets. Frequently much larger costs and inefficiencies stemming from these shortcuts would be unloaded on the economy as a whole.

As competitive pressures are perceived in terms of diminished profits or of impending losses company managements turn to one or more of several ploys to alleviate the situation. They look for the easiest ones to enact first. Roughly the most common efforts follow the order indicated below:

- actions to reduce competition by getting some kind of market protection,
- attempts to obtain more or less overt subvention (from state contribution to investment, passing through low cost credits, foreign exchange manipulations, tax reductions and preferential public services and utilities tariffs to outright currency value adjustment),
- search for more profitable market-product combinations,
- adoption of more efficient production technologies,
- application of management methods aiming at excellent performance in every respect, this usually leads to very high total company efficiency.

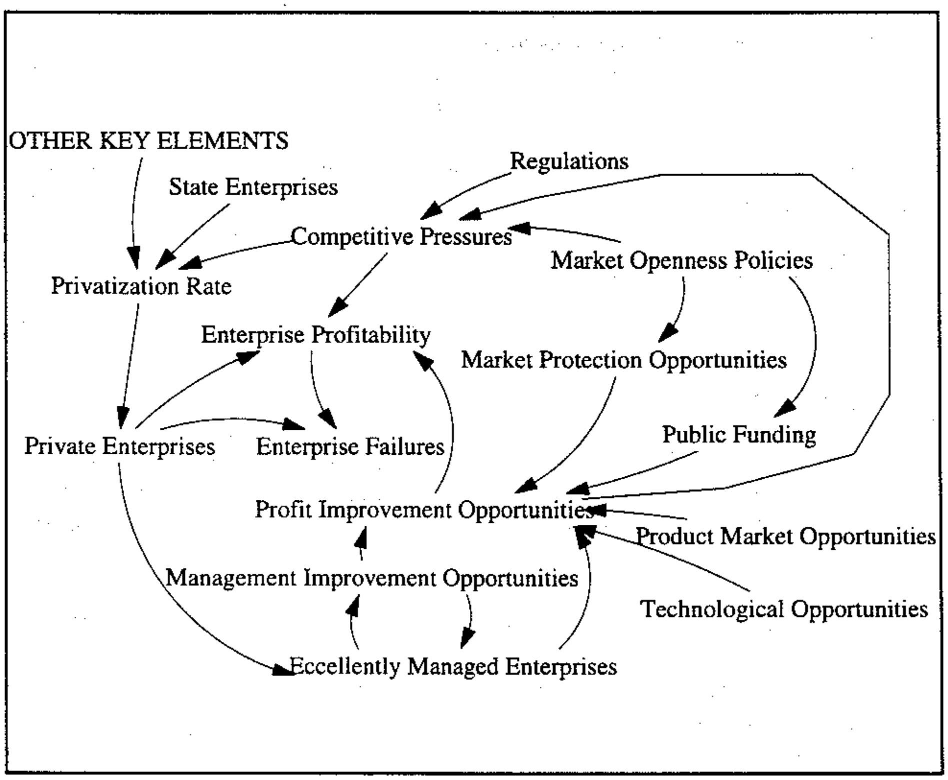

Figure 1.- DYNAMICS OF COMPANY PRIVATIZATION, IMPROVEMENT OR FAILURE.

Managements tend to attempt first two quick solutions that do not require much effort on their part altering operations within their companies. One is to reduce competition through some kind of market protection. The second one is to obtain some more or less overt contribution from public funds. This is true not only in Eastern Europe but almost everywhere. In Eastern Europe the accepted explanation is that the economy having been closed and government planned there was no competition and many industries survived without economic justification. Thus management is just attempting to maintain the state of affairs within which it knows how to operate. This sounds reasonable at first. Then comes to mind the campaign by U.S. automakers in the past decade to obtain protection from the Japanese and a similar campaign that is looming in Europe. There were also similar campaigns by other U.S. industries roughly in the same period. Of course the Japanese market is highly protected but the same is true of some markets in most countries, industrialized or not. The attempts, frequently successful, of various industries in Japan the U.S.A., Western Europe and elsewhere to obtain more or less overt subventions for their industries have nothing to do with having emerged from a planned economy. It may be suspected that almost everywhere management has a marked preference for these tools because they are in a way the easiest to enact. They do not require management to learn to operate in a different way inside their companies. Management does not need to change its ways, alter its habits, values and operating methods. Management resorts to other ways of increasing company profitability mainly when the above two possibilities are unavailable or exhausted. Different countries of Eastern Europe are dealing with the issues of supplying public funds and market protection to their corporations in different ways. Some of these ways appear to be more conducive than others to help the companies adapt to competitive market conditions. Poland has offered the automobile industry limited protection through import taxes while Russia is resorting to cheap credit unlikely to be ever repaid by the receiving companies.

The search for more profitable market-product combinations and for new production technologies is undertaken next. Sometimes alliances with companies preferably in other countries are sought to this effect. If such search comes up with promising results, the implications for changes in company management tend to be more significant than in the cases treated in the preceding paragraph.

When management embraces the new market-product solutions or the new production technologies, these changes rarely pose a perceived threat to its ways of managing, or to its ways of thinking. If satisfactory economic results can be obtained in this way here is where management's intense search for improvement of efficiency generally slows.

Eastern European companies tend to have labor and occasionally raw materials cost advantages. They also tend to have many disadvantages like inadequate infrastructure, frequently inadequate technology, poor knowledge of markets and inadequate information systems. Their management knowledge usually is not in tune with the needs of open, free and competitive economy. This situation in many companies makes it relatively easy to improve profitability by incorporating new technology, exploring better market needs and adjusting to them. Alliance of one sort or another with foreign companies is frequently very fruitful as it helps to cover the gap quickly. Farther improvements of conditions may follow with improvements to the infrastructure very likely in the future.

At some point the results obtainable through new product-market combinations, through adoption of better production technologies and through international alliances will not be sufficient to maintain acceptable profitability. Then shareholders will tend to exercise pressures that may force management to come up with other improvements. At that time the philosophy of excellence in all aspects of management may be discovered and applied. The adoption of these innovations requires dramatic changes in the behaviour of managers and in their attitudes. Many managers unable to adapt need to move out leaving room for better suited men. Others may go through a traumatic period from which they emerge with new vigour, vision and drive.

Pressures on profits causing companies to embrace excellence in all aspects of management are unlikely to occur in most Eastern European companies over the next few years. There simply is too much room for improvement of results through other simpler means that management likes more. Better market-product targeting is frequently possible. New technologies may be incorporated with great impact on profits. Adoption of some simple management tools may also go a long way in improving corporate efficiency. Production planning, product quality improvement, old-fashioned production organization, research management and marketing can also help profitability in those companies. There is too much turbulence on the legal, financial, social political and economic scenes to allow managers to concentrate on excellence in all aspects of management.

Under these circumstances two questions arise:

- What kind of management support and training is needed now?
- How to develop centers of management excellence for the future when stronger competition will force its wider adoption?

We attempt to answer these questions below.

WHAT KIND OF MANAGEMENT SUPPORT AND TRAINING IS NEEDED NOW?

Planned economy was based on instructions passed from top down to be executed. If these instructions were not carried out because of various unplanned but unsurmountable difficulties adjustments were slow to arrive. Adequate personal contacts and well conceived and documented explanations were sufficient usually to guarantee managements' continuity.

Market economy is based on quick perception of market needs or of existing opportunities. Prompt response through supply of products and services under competitive conditions needs to follow. Success or lack of it decides Management's survival.

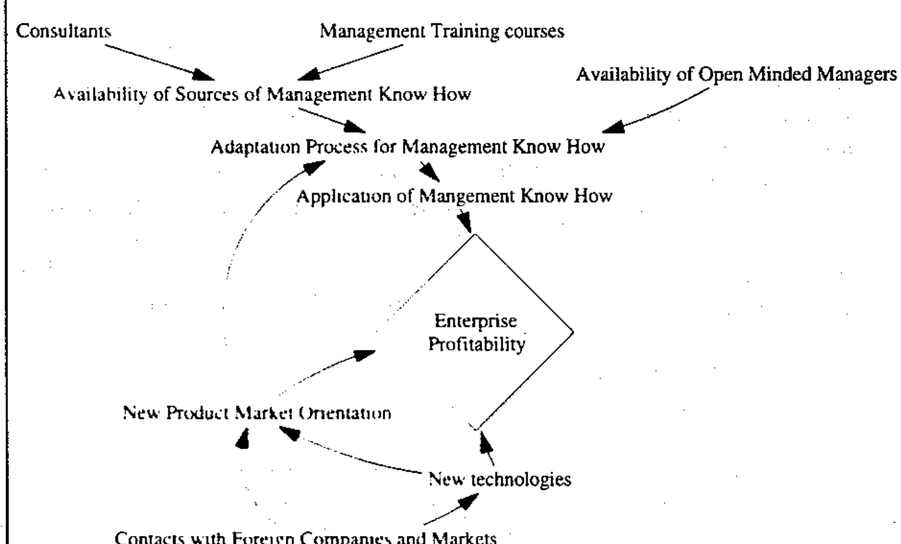

Figure 2.- DYNAMICS OF MANAGEMENT KNOW HOW APPLICATION.

The way in which management needs to adapt its ways to the new situation varies from industry to industry and it differs even among companies within the same industry. The degree of needed change may be smallest in heavy engineering firms and quite impressive in fashion products or consumer durables.

It is essential to adapt the knowledge of specific management processes like production planning, production organization for high efficiency and product quality, marketing and others to the evolving local conditions and to each company. Adapting requires analyzing what elements of this vast knowledge are needed in each case and what conditions they require to be applied with good chance for success. Then it is necessary to create these conditions and to implement the application of selected knowledge in practical operations. This takes time. Time is needed either for the Eastern Europe's managers to acquire the pertinent knowledge or for consultants from industrialized countries to understand the local conditions. Time is needed again for the analysis process to learn what may or may not be applied and what conditions must exist for this application to be successful. It is necessary to create the conditions and only then successful application of the management knowledge can take place. This process can take from several months to a few years and it needs to be constantly updated as local conditions, markets and corporate environments change. Typically all this must be done while international ties are being established to participate in foreign markets, to apply foreign technology and production processes or to establish joint research or product development efforts.

Whoever believes that things can be changed faster can view the damage caused by many less thoughtful attempts at injecting synthetic pills of management knowledge into Eastern Europe's companies.

Management courses and consultants may be useful as sources of management knowledge. Some consultants may also be useful in helping to identify specific management knowledge most urgently needed by each company. The greatest difficulty of getting support to East European companies resides in adapting this knowledge to specific company conditions in each case.

Consultants may be useful at this stage if they have the right background and experience in the industries for which they set out to work. They should also allocate a substantial time to their activities in Eastern Europe - three to five years at a minimum - to be able to develop the necessary expertise and to apply it. They should be capable and successful in their countries of origin. Failed and frustrated consultants are unlikely to produce the results required. Their motivation should have roots in their interest for learning and in the sense of fulfilment through helping to improve the situation of an important area and of its people. Few such men are available. Even fewer men of the right type get drawn into the process of management improvement in Eastern Europe. They tend to be turned off by the current rush by many consulting outfits for the relatively high and easy profits to be made when working for management perceived as too ignorant to be critical. In addition management of East European companies generally perceives that they need not ask for too much since Western sources will pay the bills anyway.

Management schools in the industrialized countries generally have no hands on experience in dealing with the types of problems and environment currently existing in Eastern Europe. They are not prepared to select and help adapt the management knowledge they do have to the needs of individual companies. They need to develop a new approach to deal with this situation. It can be done in a matter of 12 to 24 months. They may not proceed based on current curriculum and training methods as those used for students in the industrialized countries. It is also very likely that very few of the current faculty members are suitably equipped to make a useful contribution. Thus practically new institutions need to be designed, established staffed and run in.

HOW TO DEVELOP CENTERS OF MANAGEMENT EXCELLENCE FOR THE FUTURE?

As the East European companies will progress along the road of becoming more competitive and as local labour costs will increase it is likely that some will find it increasingly difficult to maintain profitability through the implementation of new product-market solutions or through use of new technologies. Excellence in management will become a must.

Management with time will be pressed to increase efficiency of every aspect of company operations. Employees will need not only to contribute their nominal daily work but also their enthusiasm, creativity, perseverance in search of results and colleague support. Information systems will need to supply and carry information much more vast and complete than anything being used today. They will also need to provide a full range of decision support tools. Individual, group and company learning from past situations and from models in anticipation of events is also likely to become widespread. To bring all these innovations to bear fruits new ways for organizing activities will be adopted.

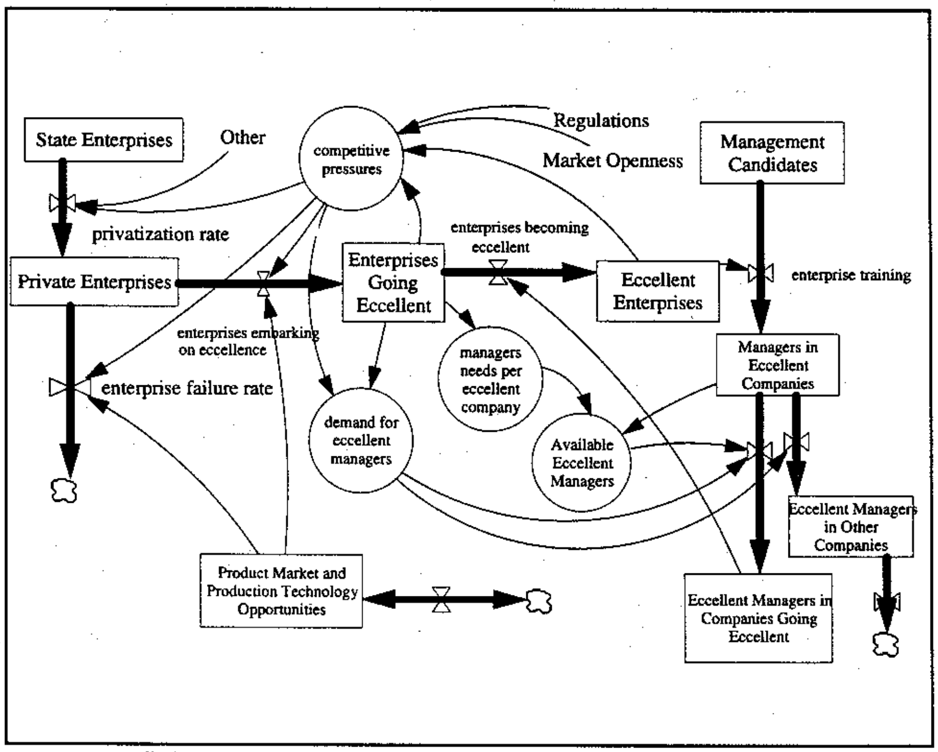

Figure 3.- DYNAMICS IN THE DEVELOPMENT OF MANAGEMENT CENTERS OF EXCELLENCE.

To enable this next phase to proceed new value systems will have to be adopted by companies but first by their management. Employees will need to be considered much less as subordinates and much more as colleagues with different roles to play.

Management groups embarking on the practice of management excellence will need a substantial time to learn this approach. They will also need time to teach it to newer recruits who will join as the companies develop. Based on experience five years may be about the right time for managers to absorb the values and knowledge of processes that take place in a company run according to management excellence principles. Of course an attempt should be made to compress this time but it is hard to see now how it could be pushed under three years.

Given the long lead time needed for developing centers of management excellence it appears essential to start early. It would be an important step in the right direction to have three to five companies in each major country of Eastern Europe on the road to excellence in management within the next year or two. This will not be easy because several conditions have to coexist. The companies in question should be relatively large, they should have a few thousand employees and their revenue should be over 500.000.000.- U$S. They should be operating in such sectors where competition is intense, the labour cost advantage is unimportant and government handouts or market protection are unlikely. They should have management willing to embark on this adventure, whether because of its enlightenment or because it envisions this road as the most promising is less important. The management must have enough power to go on.

Once management has decided to take its company on the road to excellent management it must select and train the managers it needs at all levels. In countries where labour costs are low management is very likely to train an excess of candidates to make the selection on the job later. The excess managers will generally be easy to unload on the market. Companies are always trying to attract managers from companies that have reputation for excellence in management. If with time competition should become more intense as is very likely, other companies will choose to join the initial group in trying to achieve excellence in management. For them the availability of these excess managers may be a very important element allowing them to move faster and more safely towards higher efficiency.

CONCLUSIONS

The rate of successful privatization needs to consider among other elements the availability of adequate management. Eccessive rate of privatization could cause unnecessary collapse of enterprises lacking sufficient management skills. This can only aggravate the overall economic and social situation.

Time and motivation are needed to prepare the needed management skills. The learning process can take place at already privatized companies and in special teams in companies preparing for privatization if top managemnt is induced to establish such teams. Regarding specific management tools it also may take place in seminars and through consultants.

The best learning experience is that acquired on the job in companies already under private ownership. For this learning to be of greatest benefit to the economy an excess number of managers should be trained so as to be available for enterprises to be privatized. Inducements should be provided for this process which can in part be naturally stimulated since more management input is needed during the phase of major company transformation than is required to continue normal development activities.

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