



# Phare

Progress and strategy paper

## Enterprise Restructuring and Privatisation

Series: PHARE -

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Progress and strategy paper

# Enterprise Restructuring and Privatisation

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# Foreword

This paper is part of a series which will cover each of the main areas of Phare activity. It describes the nature of the problems faced in Phare's partner countries during their transition from planned to market economies. It goes on to examine actions undertaken to date, and to assess their impact on the transformation process.

There is clearly a need to ensure that the approach being taken in any given sector is relevant to the longer-term goals of economic transformation. For this reason, these papers also contain the thinking of those responsible for operating Phare on actions for the future and how Phare should contribute to the next phase of the transition.

The papers do not reflect any official position of the European Commission. They have been written by the Phare Operational Units and are intended as a stimulus to discussion for all those involved in the debate on economic transformation in central and eastern Europe.

Alan Mayhew

Relations with central and east European countries

# The Phare Programme

The Phare Programme is a European Union initiative which supports the development of a larger democratic family of nations within a prosperous and stable Europe. Its aim is to help the countries of central and eastern Europe rejoin the mainstream of European development and build closer political and economic ties with the European Union.

Phare does this by providing grant finance to support the process of economic transformation and to strengthen newly created democratic societies. Phare also provides grant finance to help countries with Europe Agreements integrate with the European Union.

In its first five years of operation to 1994, Phare has made available ECU 4,283 million to 11 partner countries, making Phare the largest assistance programme of its kind.

Phare works in close cooperation with its partner countries to decide how funds are to be spent, within a framework agreed with the European Union. This ensures that Phare funding is relevant to each government's own reform policies and priorities. Each country takes the responsibility for running its own programmes.

Phare provides know-how from a wide range of non-commercial, public and private organisations to its partner countries. It acts as a multiplier by stimulating investment and responding to needs that cannot be met by others. Phare acts as a powerful catalyst by unlocking funds for important projects from other donors through studies, capital grants, guarantee schemes and credit lines. It also invests directly in infrastructure, which will account for more Phare funds as the restructuring process progresses.

The main priorities for Phare funding are common to all countries, although every one is at a different stage of transformation. The key areas include restructuring of state enterprises including agriculture, private sector development, reform of institutions and public administration, reform of social services, employment, education and health, development of energy, transport and telecommunications infrastructure, and environment and nuclear safety. Under the Europe Agreements, Phare funding is being used to make laws compatible with European Union norms and standards, and to align practices.

# Table of contents

<b>Executive Summary</b>	<b>7</b>
<b>Introduction</b>	<b>9</b>
<b>Section 1 - Background</b>	<b>11</b>
The importance of privatisation and restructuring for market reforms	11
Main obstacles to privatisation and restructuring at the outset of the reform process	11
The wider policy framework for privatisation and restructuring	12
<b>Section 2 - Phare assistance programmes</b>	<b>13</b>
Phare commitments by country, 1990-1993	13
Phare assistance and the process of reform	13
Core areas of Phare support in restructuring and privatisation	14
<b>Section 3 - Impact assessment of Phare support</b>	<b>15</b>
Examples of privatisation/restructuring achievements	15
Donor coordination	17
Constraints	17
External	
Internal	
<b>Section 4 - Strategic orientations for future actions</b>	<b>18</b>
Phare and the Europe Agreements	18
Strategic orientation and conclusions	18
<b>Annex I - Main areas of activity in privatisation and restructuring by country, 1990-1993</b>	<b>21</b>
<b>Annex II - Programme summary sheets</b>	<b>22</b>



## Executive summary

The privatisation of state enterprises, including restructuring, is a central element in the establishment of a market economy as well as for increasing production efficiency and output. Since 1990, Phare has provided the largest source of grant assistance in this field, with a total allocation of over ECU 250 million for various actions in support of enterprise privatisation, restructuring, de-monopolisation and facilitating investment through transactions and joint ventures.

As a result of this assistance, a significant impact has been achieved by Phare in the central and eastern European countries both in establishing their basic institutions and related legal framework, as well as in effectively privatising enterprises which may not otherwise have survived. The impact can be felt not only at the level of each enterprise concerned, but also in terms of setting models and creating momentum.

This paper begins by defining the importance of the privatisation and restructuring processes for the success of the wider transition to a working market economy in the central and eastern European countries. It also identifies the main obstacles which existed at the outset of reform, and the importance of the wider policy framework.

It goes on to assess the role played by Phare in these processes. Reflecting the needs of the reforming countries at that time, this initially took the form primarily of traditional know-how transfer (i.e. technical assistance such as studies, consultancy services, short-term training). This helped create the necessary legislative, regulatory and institutional framework, to formulate policies, and to prepare and initiate structural reforms in key economic sectors. However, after short-term stabilisation, the central and eastern European countries have now embarked on a more fundamental medium-term restructuring of the economy, in order to create the basis for recovery and long-term growth, including a substantial shift of production to the private sector. The type of support required is changing accordingly, a process in which the entry into force of the first Europe Agreements in February 1994 must also be taken into consideration. These association agreements create a new framework which prepares the central and eastern European countries concerned for future membership of the European Union.

In the light of these changes, the paper concludes by putting forward future orientations for Phare action in support of privatisation and restructuring:

- resources need to be concentrated on stabilising and encouraging investment in the large number of enterprises which remain in state hands, given the difficulties inherent in seeking to privatise many of them quickly over the short term
- more assistance should be disbursed directly to the enterprise sector. In the areas of enterprise support and prevention of enterprise failure, investment-oriented mechanisms (restructuring funds, investment-support funds, etc.) should be used
- know-how transfer should concentrate on institutional reform and development. These objectives gain a new importance under the Europe Agreements, with their focus on approximation of laws and reduction of state aids.



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# Introduction

Since 1990, the number of Phare partner countries has expanded to 11 (Poland, Hungary, Czech Republic, Slovak Republic, Estonia, Latvia, Lithuania, Romania, Bulgaria, Slovenia, Albania) and the total financing committed under the programme has increased from ECU 300 million in 1990 to ECU 1,004 million in 1993, coming to a total of ECU 3,294 million over the period. Phare is now recognised as a major contributor to reform and the largest source of grant assistance in the central and eastern European countries.

Development of the private sector is crucial to ensure that the macro-economic stabilisation measures pursued by most central and Eastern European countries are sustainable in the long term. Broadly speaking, private sector development is defined as including the following areas:

- **enterprise support:**  
privatisation and restructuring of state-owned enterprises
- **small business support:**  
establishment and promotion of SMEs
- **regulatory framework/incentives:**  
sectoral and large enterprise de-monopolisation  
investment promotion  
establishment of a liberalised financial and banking sector.

Financial assistance made available by Phare since 1990 specifically for privatisation and restructuring amounts to over ECU 250 million, and certain factors have changed over this time. The place of privatisation and restructuring within the broader process of private sector development is now better understood by national governments and donors alike. In those countries where Phare has the longest experience of supporting privatisation and restructuring (Poland, Hungary and the Czech Republic), experience has shown that the processes are more complex than initially expected.

The stage has now been reached where it is necessary to assess the role and impact of Phare support, bearing in mind the wide variations between the circumstances and experiences of the different beneficiary countries. Given also that most programmes are still underway and that the process of restructuring in the central and eastern European countries is still in its early stage, this report aims to assess to what extent Phare assistance has been delivered effectively, and immediate targets met (e.g. restructuring studies completed and their recommendations accepted, privatisation transactions taken place, training courses completed). Such an assessment will allow the foundations laid over the past three years to be built upon, and general orientations for the future to be derived.



## Section 1 - Background

### The importance of privatisation and restructuring for the market reforms

Because of the economic, social and political importance of the state-owned enterprise (SOE) sector in most central and eastern European countries, privatisation and restructuring of SOEs has been one of the authorities' top priorities for ensuring a durable transformation from a planned to a market economy. The aim of privatisation is not transfer of ownership per se, but enterprise survival. Emphasis should be placed on the speed of privatisation, which must be pursued while controlling the social consequences of reform. Furthermore, while rapid privatisation must remain a fundamental objective, it must be seen as only one part of the process in developing a viable private sector. Establishing new enterprises and new employment opportunities are of paramount importance as well.

Privatisations have been delayed mainly for social and political reasons. Indeed, it has proved very difficult for central and eastern European countries governments to strike a politically acceptable balance between economic efficiency and the social costs associated with its pursuit. Privatisations have also been delayed for technical and structural reasons, mainly due to the lack of a functioning financial sector as well as to the absence of alternative employment opportunities.

While privatisation remains the overall objective of enterprise reform, pre-privatisation restructuring could be a necessary step for some specific SOEs or sectors. Indeed, in some cases an enterprise will need to be restructured prior to privatisation and will need stabilisation finance and turn-around management to supervise its transfer into private ownership. In addition, other enterprises which will remain in state ownership will need to be restructured in view of their importance for the overall economy.

Privatisation and restructuring are increasingly regarded as two integrated steps in a process leading to the sustainable development of the private sector. The priorities will vary from country to country depending on their current stage of economic reform as well as on other, country specific, socio-economic factors. The stage in the reform process reached by most of the Phare partner countries is quite different from one another as is the level of economic development which varies considerably among these countries. Privatisation methods and strategies pursued by national authorities are therefore taking into account this diversity.

### Main obstacles to privatisation and restructuring at the outset of the reform process

The transfer of ownership from state-owned to private sector requires the establishment of transfer mechanisms and institutions which did not exist at the beginning of economic reform in the central and eastern European countries. Other factors which emerged as constraints to the rapid completion of the privatisation process include

- the absence of clear property rights: who actually acts as owner of the SOEs; is it the government, the founding ministry, the workers' council, the management?
- the lack of local financial intermediaries or domestic investment capital combined with a perception of high risk by foreign investors, and, in some cases, a lack of political support towards foreign investment
- the poor financial and physical condition of some SOEs which would make rapid privatisation unattractive to prospective buyers and imply sharp decreases in production, liquidation and high unemployment
- the difficulty in valuing assets for privatisation: this process has turned out to be lengthy, expensive and not always accurate or relevant
- the difficulty in reaching a social and political consensus on privatisation methods and strategy: the price at which state assets have been sold and to whom, have been often questioned afterwards
- the difficulty and time required for establishing a regulatory framework which could sustain the privatisation process have been often underestimated
- the difficulty and time required for establishing the institutional capacity to manage the privatisation process were also initially underestimated.

## The wider policy framework for privatisation and restructuring

The need to take account of the problems set out above in order to accomplish successful programmes of privatisation and restructuring has confirmed that such programmes cannot exist in a vacuum. The framework which is created at macro, meso and micro level has a determining influence on the outcome. The key elements are summarised below.

Experience to date in central and eastern European countries has shown that three levels can be identified during the process of privatisation with key elements of success in each one of them.

Macro level: macro-economic reforms have to be well underway while in parallel a regulatory framework aiming particularly at the establishment of a stock-exchange and at the design of privatisation laws must be set up. Most important of all is the socio-political consensus on how to proceed and at what speed.

Meso level: public awareness campaigns, at the enterprise level as well, are essential elements of success. In parallel, social safety net provisions should be incorporated in large privatisations, particularly where there is a regional or employment dimension to them. Foreign investment has depended very much on the fiscal incentives and perceived transparency of the process.

Micro level: attention to institutional issues, as well as setting up a transparent process, have proven important. Maintaining diversity and flexibility for privatisation transactions has been a successful method although the problem of corporate governance for either privatised or to-be-restructured enterprises remains throughout the region. Thus pre- and post-privatisation support through training of managers and supervisory board members is essential. Finally, some form of mass privatisation scheme has been shown to be necessary to promote private ownership in the central and eastern European countries.

Section 2 will illustrate the contribution of the Phare Programme in each key area identified above on a country specific basis.

## Section 2 - Phare assistance programmes

### Phare commitments by country, 1990 -1993

The Phare Programme has considered private sector development as a priority from the beginning of the reform process and has made available over ECU 250 million between 1990 and 1993 to a number of country programmes in support of privatisation, restructuring, de-monopolisation and investment promotion. This is shown in the table below <sup>1</sup>.

Table 2: Phare support for enterprise privatisation and restructuring 1990-1993, by country

	ECU million
Poland	80
Romania	45.6
Hungary	45
Slovak Republic	17.5
Bulgaria	17.5
Lithuania	7
Czech Republic	23
Slovenia	6.3
Latvia	6
Estonia	3
Albania	1.6

<sup>1</sup> Cumulative amounts made available per country for 1990, 1991, 1992 and 1993 including support to restructuring, privatisation and foreign investment promotion. Detailed information is provided on a country basis in annex II. The figures for Poland, Hungary, Romania, the Slovak Republic, the Czech Republic, Latvia, Lithuania, and Estonia include investment promotion activities.

### Phare assistance and the process of reform

The first stage of the transformation process includes short-term macro-economic stabilisation (such as measures to reduce the budget deficit and inflation, align exchange rates and reduce subsidies to state-owned industries), combined with an opening up of the economy by liberalising trade, prices and foreign exchange. The legal, regulatory and institutional framework needed for a market system must be established, and reform programmes formulated and started in key sectors. Up to 1992, the focus of Phare assistance for privatisation and restructuring, as for other sectors, reflected these requirements. Support was concentrated on traditional forms of technical assistance, such as the studies, training and expertise needed for policy, legislation, institution-building or for initiating reforms.

#### Example 1: the process of transformation - stage 1

**Background:** in Poland, Hungary, Romania, Bulgaria and in Estonia, Latvia and Lithuania, the first stage of the economic transformation process implied addressing the absence of privatisation laws, regulations and policies. Other key elements missing include: (i) no institutions to carry out reforms; (ii) no capital markets; as well as (iii) a huge need for training both for staff of those new institutions and for enterprise managers.

**Outcome:** in Bulgaria and Romania, the legal framework for privatisation and de-monopolisation of state industrial conglomerates has been achieved partly with Phare support. The Mass Privatisation Law in Poland was drafted with assistance from the Phare Programme: it set up the Budapest Stock Exchange, which now has a market capitalisation of about \$1 billion. In all countries mentioned above, Phare provided know-how, training, equipment and information technology to establish privatisation ministries or agencies.

The second stage is more complex. It concerns the fundamental long-term restructuring of the national economy, involving, inter alia, a substantial shift to private ownership, and reorganisation of remaining state enterprises. As countries move into the second stage of reforms the need for traditional technical assistance will diminish, and the requirement for investment and direct financing for the above purposes will increase.

**Example 2: the process of transformation - stage 2**

Background: once macro-economic measures to stabilise the economy have been taken, and after the regulatory and institutional frameworks are in place, the second stage of economic transformation includes longer term issues such as: (i) sustainability of reforms; (ii) strengthening the private business sector emerged in stage 1; as well as (iii) measures to mobilise investment and upgrade infrastructure.

Outcome: in Lithuania, the Phare Programme is providing funding for the setting up of an enterprise restructuring agency. The importance of this programme is that, after the initial stage of transformation, there are a number of medium-sized and larger enterprises which may need varying degrees of restructuring in order to make them attractive to new investors. Thus the agency would provide pre-privatisation support. On the other hand, post-privatisation support will also be provided by the agency in order to ensure that companies already privatised have a chance to survive commercially.

## Core areas of Phare support in restructuring and privatisation

Through the provision of technical and financial assistance, Phare-funded privatisation and restructuring programmes aim to support the governments' efforts to restructure and reform ownership of state enterprises. As illustrated in table 2, major programmes have been financed in almost all central and eastern European countries, with the mix of operations tailored according to the policies, strategies and needs of the particular country concerned (see annex I). The assistance provided includes policy formulation, privatisation strategy and techniques, establishment of the institutional framework, industrial sector strategies, enterprise restructuring and design and preparation of privatisation transactions.

## Section 3 - Impact assessment of Phare support

### Examples of privatisation/ restructuring achievements

Following is a selected list of activities in the area of privatisation and restructuring which have been undertaken with substantial support from Phare. A more detailed summary is provided for all Phare countries in annexes I and II.

In Poland, Phare provided external expertise, in the early years, which contributed to the establishment of the Ministry of Privatisation. At the enterprise level, Phare-supported advisory work has led to the conclusion of important privatisations in Poland including, but not limited to, Fabryka Samochodow Malych and Tarpan (automobiles), Huta Warszawa (steel) and Huta Sandomierz (glass). Some other Phare-supported transactions occurred in the medical equipment, shoe and cement sectors. The example below illustrates major investor-led privatisations in several central and eastern European countries.

#### **Example 3: preparing for major, investor-led privatisations**

**Background:** preparing the ground for major foreign investment into a state-owned company ranges from complete enterprise diagnostic, to the search for strategic partners, and includes legal and financial advice on behalf of the recipient country during negotiations. On average, the large deals described below have taken two years to negotiate and Phare has provided assistance during negotiations, setting up regulations and incentives as well as assisting during enterprise screening and valuation.

**Outcome:** in Poland, successfully negotiated privatisations with a strategic investor include the \$2 billion FIAT-FSM and Volkswagen-Tarpan car ventures, the \$300 million Lucchini-Huta Warszawa steel joint-venture, as well as the Pilkington glass acquisition of Huta Sandomierz with anticipated plant and equipment modernisation of \$65 million. In Lithuania, Klaipeda Tobacco Factory was privatised through a joint venture with a transaction value of \$40 million (of which \$30 million in new investments), as was the Kaunas Confectionery Company with a new investment of \$12 million foreseen by Kraft Jacobs Suchard. Altogether over 15 large Lithuanian enterprises in textiles, electronics, agro-processing, construction and leisure are currently for sale to foreign investors. In Latvia, a consortium of Cable and Wireless and Finnish Telephone Company has purchased 49 per cent of Latelekom (Latvian telephone company), a privatisation expected to digitalise the Latvian network with a user penetration equal to that of western Europe within ten years.

Other examples of success in promoting the establishment of the private sector in central and eastern European countries and the privatisation process have included not only investor-led privatisations, but also provision of training or establishment of a conducive regulatory framework and are shown overleaf.

In summary, a significant impact was achieved by Phare in central and eastern European countries both in establishing their basic institutions and related legal framework, as well as in effectively privatising enterprises which may not otherwise have survived. The impact can be felt not only at the level of each enterprise concerned, but also in terms of setting models and creating momentum.

When measuring impact in terms of short-term objectives, such as studies completed and implemented at the enterprise level or establishing the regulatory framework for privatisation, Phare assistance in central and eastern European countries has indeed acted as a major catalyst for reform. The box below illustrates the continuous support provided by Phare since 1990 for one specific programme in Poland which ranged from legal support, providing high level policy advisers all the way through to funding a major public awareness campaign and funding the printing of share certificates.

#### **Example 4: continuous support for mass privatisation**

In Poland, the Phare Programme provided initial support for the preparatory work leading to the Mass Privatisation Law (now called Law on National Investment Funds, NIFs) as well as providing two high-level policy advisers to work within the Privatisation Ministry on designing the mass privatisation programme. Support to the programme was provided in cooperation with the UK Know-How Fund and the World Bank. Following adoption by the Polish Parliament last year of the NIF law, Phare is now continuing its support to the process by funding a major public awareness campaign, the setting up of a fiscal agency, and the printing of share certificates which will be eventually distributed.

## Examples of achievements in various central and eastern European countries with contribution from Phare

In Hungary, the programme assisted in setting up the State Property Agency, the organisation responsible for privatisation, and provided funds to prepare enterprises for privatisation, as well as for restructuring, management and staff training. In addition, Phare assistance to the Budapest Stock Exchange will have an impact upon privatisation through facilitating public share offerings.

In the Czech Republic and the Slovak Republic, the focus has been on support to enterprises and training. Core sectors such as steel in the Czech Republic and armaments in the Slovak Republic have received direct support from the Phare Programme. Other areas for which restructuring advice was provided in the Czech Republic include the steel, pharmaceutical, textile, chemicals and metallurgy sectors. Environmental issues were specifically emphasised in the pharmaceutical and chemical sectors. In the Slovak Republic, restructuring advice was provided for companies in the armament, textile, chemicals, metallurgy and mechanical sectors.

In Romania, Phare provided extensive institutional support for a mass privatisation scheme and also contributed to policy and strategy formulation, the creation of basic institutions, screening enterprises and supported active privatisations involving foreign investment. Phare support has led to the first two large-scale privatisations in the country in the clothing and brewery sectors involving Italian and German international investors.

In Bulgaria, Phare has helped with key steps such as the establishment of the regulatory framework for privatisation, developing accounting systems, and screening enterprises for privatisation as well as organising a roundtable in order to facilitate consensus between the government and parliament on the adoption of the Privatisation Law.

Phare has contributed to setting up the basic legal framework and institutional structure in Estonia, Latvia and Lithuania, screening enterprises, restructuring, and supporting active privatisations. In Estonia assistance has been provided to the Privatisation Agency for drafting privatisation and contract laws and for establishing the new statutes of the Agency. In Lithuania, Audeas textile company was privatised through a management buy-out and training for local privatisation consultants was provided. More recently, work was launched to design an Enterprise Restructuring Agency within the Lithuanian Ministry of Industry, specifically for provision of pre- and post-privatisation support to larger enterprises to make them more attractive to investors.

## Donor coordination

Coordination with other donors (other bilateral donors and international financial institutions such as EIB, EBRD, World Bank) is important to maximise policy impact and avoid duplication.

Cooperation with the EBRD is already rather advanced in areas such as industrial restructuring, provision of venture capital and establishment of investment funds as well as in the high-level privatisation advice given by the EBRD Privatisation Team to the Phare Programme, covering countries such as Estonia, Latvia, Lithuania, Poland, Bulgaria, the Slovak Republic, Romania and Hungary. Coordination with the World Bank has proved particularly effective in Poland, where the support provided by Phare for the banks' bad loan portfolio units complements the efforts of the World Bank Enterprise and Financial Restructuring Adjustment Loan. Furthermore, Phare is exploring the possibility of further developing cooperation with European Union Member States' administrations and institutions in order to promote greater efficiency in the provision of know-how.

### Example 5 : successful donor coordination and co-financing

In Poland a major programme to recapitalise banks with a substantial bad loan portfolio and restructure those enterprises is being co-financed with the World Bank, EBRD, and UK, French and US aid, involving a total donor contribution in excess of ECU 500 million. A similar programme is under discussion in Hungary.

In Lithuania, Drobe Wool Company at Kaunas is being restructured with assistance from both Phare and the EBRD in preparation for subsequent privatisation. Furthermore, the Enterprise Restructuring Agency currently being set up in Vilnius is under joint financing from Phare and the World Bank.

Other coordinated activities in the privatisation area include possible co-financing with the EBRD on establishing an enterprise-restructuring vehicle in Poland, the Slovak Republic and Slovenia, and providing know-how as a complement to the World Bank Enterprise and Financial Sector Adjustment Loan in Poland and Hungary.

## Constraints

### External

As an examination of the examples of privatisation and restructuring achievements (section 3 and annexes I and II) illustrates, there has been considerable progress in overcoming the main obstacles to privatisation and restructuring which existed at the outset of the reform process (see section 1). Nevertheless, there are a number of ongoing difficulties in this regard.

- **policy commitment and political, social, and economic considerations:** policies have changed as political consensus on privatisation strategy could not be reached, since the social cost of enterprise closures became high
- **public support issues:** public support for privatisation has lessened in some countries in connection with concerns over national ownership and reductions in the level of employment
- **turnover rate:** since 1990, a high turnover rate amongst government counterparts and ministries has made continuity on policy dialogue for the Phare Programme implementation more difficult.

### Internal

Delivery mechanisms: Phare is designed so that each of the central and eastern European countries, in the light of its own reform programme, decides priority areas for funding, within a framework set by the European Union. Each country also takes responsibility for implementing its own programme. However, this has meant that Phare assistance to privatisation and restructuring has been provided primarily for and through the government institutions which play a part in this process, rather than directly to the enterprises concerned.

## Section 4 - Strategic orientation for future actions

### Phare and the Europe Agreements

Six countries (Poland, Hungary, the Czech Republic, the Slovak Republic, Romania and Bulgaria) have signed Europe Agreements, which are the frameworks which prepare them for membership of the European Union. At the Copenhagen summit in June 1993, the European Council of EC heads of state and government offered the associated countries the prospect of membership. Phare has taken on an extra dimension as a result, in that it is one of the main financing instruments for the necessary transformation process.

In the context of the progressive integration which is provided for under the Europe Agreements, private sector development, and private ownership/entrepreneurs in the central and eastern European countries will additionally benefit from

- approximation of laws, reduction of state aids, and de-monopolisation
- integrated regional reconversion and development programmes to address restructuring of large industry sectors (such as steel, coal or textiles)
- European Union measures to improve access to its markets (as provided for under existing agreements, and accelerated at the Copenhagen summit).

For the six central and eastern European countries who have signed Europe Agreements, convergence criteria will also have to be taken into account when designing integrated programmes, particularly in areas related to private sector development which have a direct link with, inter alia, macro-economic and trade liberalisation issues.

Finally, integrated and more targeted programmes for enterprise support providing a mix of technical and financial assistance directly to end-users will require a greater concentration on fewer priority sectors when country specific multi-annual programming is considered.

### Strategic orientation and conclusions

The main conclusions from this report on the impact of Phare support for privatisation and restructuring state industry centre around the following points, which also provide orientation for future action.

- On the basis of experience so far, the Phare Programme should continue its support for industrial restructuring and privatisation, whilst understanding that there is not one particular form of privatisation which is appropriate in all circumstances and that the subject is highly political in all central and eastern European countries. For the six associated countries, the introduction of competition and state aid rules and trade liberalisation measures, as foreseen in the Europe Agreements, should also complement financial and technical assistance for the enterprise sector.
- Know-how transfer (technical assistance in the form of studies, consultancy services, short-term training) will remain an important part of Phare. Training in particular will remain of great relevance. It is likely, however, that greater impact will be achieved if transfer of technical know-how to targeted, well-defined programmes increasingly replaces the broad-based large technical assistance programmes which proved useful in the early stages of reform.
- Furthermore, know-how transfer should concentrate on institutional reform/development, particularly as they relate to the crucial issues of corporate governance and state asset management. Preparation of the associated countries for membership is also important. Finally, in the central and eastern European countries and for all sectors, continuing Phare-financed training programmes on a large scale is seen as essential to sustaining reforms.

- However, at a time when restructuring state enterprises and related state asset management schemes are the crucial next steps in the reform process in the central and eastern European countries, insufficient resources are going directly into the stabilisation of enterprises awaiting privatisation and into stimulation of investment. Phare resources are available to support investment in recipient countries and to design financial mechanisms to support investment which would benefit end-users directly. Therefore, Phare must continue to move finance towards investment-related activities for pre- and post-privatisation support, as well as towards fast disbursing medium-term mechanisms.
- Indeed, in areas dealing directly with enterprise support the need for management skills and physical investment (such as pre- and post-privatisation support) will increase. There are four main types of operations in support of the enterprise sector where Phare could increase its impact on end-users:
  - restructuring funds: including stabilisation finance, turn-around management and privatisation activities, such as the Special Restructuring Funds in collaboration with the EBRD
  - investment support funds mixing know-how and financial assistance on an individual enterprise basis through a financial intermediary and on the basis of a business plan
  - possibly also in certain countries, interest rates bonification for infrastructure development
  - small and medium-sized enterprise financial schemes, at least for the next three years, since the market does not yet address the needs of small firms and start-ups.
- Schemes aimed at providing enterprises, public or private, with access to investment, management skills and other expertise to increase efficiency are therefore needed. Experience has shown that the government-to-government nature of Phare assistance may need to be complemented by other mechanisms delivered to end-users through a financial intermediary such as a bank in order to reach end-users effectively. Clearly, though, this would have to be done in a way compatible with prudent use of public funds. In this area, continued cooperation with the EBRD, the EIB and with business organisations (for instance chambers of commerce) can play an important role.



## Annex I - Main areas of activity in privatisation and restructuring by country, 1990 - 1993

Type of support	Albania	Bulgaria	Czech Rep.	Hungary	Poland	Romania	Slovak Rep.	Slovenia	Estonia	Latvia	Lithuania
Policy, strategy and regulations (a)	■	■			■	■			■	■	■
Institution building (b)	■	■		■	■	■			■	■	■
Transaction support (c)				■	■	■			■	■	■
Industrial sector strategy		■	■	■	■	■	■	■	■	■	■
Enterprise support (d)		■	■	■	■	■	■	■	■	■	■
Training (e)		■	■	■	■	■	■	■	■	■	■

(a) Including privatisation laws and mass privatisation schemes

(b) Including support to new privatisation ministries and agencies, and state-owned organisations

(c) Including legal and financial assistance in negotiating privatisation or joint-venture transactions

(d) Covering support to enterprises for establishing business plans and for implementing restructuring

(e) Includes training for enterprise staff (accounting, management training, etc.) and staff of government institutions

## Annex II - Programme summary sheets

### Albania

Phare has, from an early stage in the reform process, been involved in helping Albania to reform its economy. Within the context of integrated assistance for private-sector development (with projects in small and medium-sized enterprises' development, banking and tourism also now underway) support connected with privatisation and restructuring has included:

- **accountancy:** training-the-trainers programme targeted at public and private accountants, officials at the Ministry of Finance's accounting department, and accountants within state-owned enterprises; pilot project introducing new chart of account into ten major state-owned enterprises; assistance for Ministry of Finance in introducing a formal accountancy profession (including a Court of Auditors, and a professional body - cf. France's Ordre des Experts Comptables)
- **privatisation:** adviser to National Agency for Privatisation, assisting in establishing valuation procedures for privatisation, initiating light restructuring for state-owned enterprises through management support, industrial specialists' support, etc.

### Bulgaria

Phare initially played a major role in assisting the Bulgarian government with the establishment of the regulatory framework for the privatisation process, notably in fostering a consensus on the Privatisation Law, as well as in setting up and supporting the Privatisation Agency itself. More recently:

- support has been granted for privatisation in certain sectors (road freight, cement, pharmaceuticals, and tourism). The first two of these operations are presently in their final phase
- municipal privatisation has been supported through assistance to the Municipal Privatisation Agency, in Sofia, and a programme of information and training on privatisation management for other municipalities. Pilot programmes of assistance to two more municipalities are foreseen
- know-how has been provided for the design of a revolving fund to facilitate privatisation (through loans to buyers). Following the recent decision to establish the Fund, provision of initial funding to it is envisaged.

In the field of restructuring:

- the main initial actions of Phare have been an analysis of competitiveness in the most important industrial sectors, followed by a number of sector-restructuring studies. Such work is proceeding, and more or less close to completion in pulp and paper, machine building, electronics and steel. The final phase includes working closely with enterprise managers on the restructuring measures to be adopted, together with prospection for joint-venture partners (in some cases)
- a system of financial monitoring of state enterprises has been established to begin to address financial restructuring concerns. Additional assistance will be provided to support the process of reducing losses in the state-owned sector
- a programme of management-led restructuring was initiated at the end of 1993 to help volunteer state enterprises, especially in the middle tier, to design and implement their own restructuring plans with assistance from European Union managers from the same sectors. It has received a very encouraging response from enterprises in its starting phase
- a complementary programme for the training of managers has been run successfully over the last two years.

## Czech Republic

Phare support started before the split of the Czech and Slovak Federal Republic. The Czechoslovak federal authorities decided to set up a mass privatisation programme which did not specifically require transfer of know-how to government institutions. Phare support for private sector development in the Czech Republic has therefore been targeted at the enterprise level rather than towards building the institutional set-up for privatisation. Given the fast transformation of the ownership structure of the country, assistance has covered both state-owned and privatised companies.

- an emergency sector study was performed on the steel industry, which is of particular importance to the economy of the Czech Republic. It has been the basis for discussion of an overall restructuring programme for the sector
- other sector studies have included the pharmaceuticals and textiles industries. A study of the knitting industry is about to be launched
- company restructuring advice has been provided. The main sectors covered include steel, pharmaceuticals, textiles, chemicals, metallurgy and mechanical. Environmental issues were specifically emphasised in the pharmaceutical and chemical sectors
- privatisation of gas and electricity networks. Consideration is underway of a project to support this important privatisation.

Overall, 43 projects have either been completed or are underway.

## Estonia

Phare has provided a team of lawyers and accountants who gave advice on the creation of the legal framework for privatisation, the setting up of an accounting system and the screening of companies for privatisation.

In addition, Phare is helping to provide a resident privatisation adviser to give Estonia ready access to a large pool of expertise in the areas of policy formulation, implementation and the strengthening of institutions.

The following concrete achievements can be noted:

- **institutional:** Phare has contributed to the establishment of Estonia's Privatisation Agency
- **legal framework:** privatisation and contract laws have been adopted with Phare assistance
- **studies:** diagnostic study for Krenholm Textile Mill, as precursor to restructuring study (a turn-around management team has also been put in place at this enterprise). Balance sheet study for 400 state-owned enterprises to establish inter-company debts and receivables
- **training:** local privatisation consultants were recruited and trained. Training has also been provided for the owners of formerly state-owned enterprises.

## Hungary

Phare support for privatisation and restructuring in Hungary began in 1990-1991. It has included the following elements:

- **direct assistance to the State Privatisation Agency:** training for key personnel, equipment, and know-how
- **transaction support:** after setting up a general framework (procedural guidelines, tendering of framework contracts), Phare is now supporting a regular flow of three to four medium-sized privatisations per month and working on larger-scale sectoral operations
- **support to small-scale privatisation:** this includes active marketing of assets, fostering domestic investment, monitoring and turn-around of companies to be privatised
- **state-holding company:** extensive know-how and other assistance provided over two years. Currently, support is provided for strategic reviews of selected companies in the holding's portfolio, in the automotive and telecommunications sectors
- **training for managers of state-owned enterprises:** 1000 top-level managers have been trained so far
- **Restructuring and Privatisation Investment Company:** the HYFERP, effectively a hybrid fund for enterprise restructuring and privatisation providing a mix of know-how and financial assistance, is already operating
- **assistance to the Budapest Stock Exchange:** This was the first stock exchange to begin trading after the collapse of communism in eastern Europe. It reopened in June 1991 after a closure of 43 years, and saw the successful installation of its new trading system on 11 March 1993. The new trading system, funded by Phare, Britain's Know-How Fund and the Budapest Stock Exchange members themselves, aims to provide market capacity to handle the planned privatisation of more Hungarian companies, as well as attracting a higher volume of market turnover by holding trading costs down to competitive levels.

## Latvia

Phare has provided a team of lawyers and accountants who gave advice on the creation of the legal framework for privatisation, the setting up of an accounting system and the screening of companies for privatisation.

In addition, Phare is helping to provide a resident privatisation adviser to give Latvia ready access to a large pool of expertise in the areas of policy formulation, implementation and the strengthening of institutions.

The following concrete achievements can be noted:

- **review and amendment of legislation:** this took place so as to support domestic and foreign investment in privatisation. The British Know-How Fund, World Bank and EBRD are also involved in this project
- **privatisation agency and State Property Fund established:** the complete statutes and functional and organisational plans were drawn up through Phare assistance
- **databank and classification system for enterprises to be privatised**
- **recruitment and training of local privatisation consultants.**

## Lithuania

Phare has provided a team of lawyers and accountants who gave advice on the creation of the legal framework and institutional aspects related to privatisation, the setting up of an accounting system and the screening of companies for privatisation. As a result, a Privatisation Agency and State Property Fund are being created and important new legislation introduced.

A resident privatisation adviser has given the Lithuanian authorities ready access to a large pool of expertise in areas of policy formulation, implementation, and institution building. This has assisted the Central Privatisation Committee (CPC) in planning and preparing large state-owned enterprises for privatisation (foreign sales), and allowed adjustments to be made to the voucher-based domestic privatisation scheme.

The following concrete achievements can also be noted:

- **pilot large-scale privatisations:** with co-financing provided by USAID, Phare contributed to the privatisation of Klaipeda Tobacco Factory with a transaction value of \$40 million (of which \$30 million were in new investments). Kaunas Confectionery Company was privatised with new investment of \$12 million foreseen by Kraft Jacobs Suchard. Altogether, some 15 large companies in textiles, electronics, agro-processing, construction and leisure, are currently offered for sale to foreign investors with the support of Phare
- **best-business plan project:** development of guidelines for handling state companies which have not found buyers
- **training:** separate projects covering training of local privatisation consultants and of managers of state owned enterprises.

## Poland

In 1990-1991, Phare supported both the establishment of the Ministry of Privatisation and the development of the legal framework for privatisation. Initial assistance has also been provided to set up the Warsaw Stock Exchange. Perhaps the most concrete examples of the contribution made by Phare to privatisation in Poland is the support to the government during negotiation of the financial and legal aspects of three major successful privatisations during the second half of 1992 in the following sectors:

### Automobiles

In late 1992, FIAT of Italy signed an agreement to take a 90 per cent majority stake in FSM, Poland's largest producer of small cars, and to invest \$2 billion in plant rehabilitation. Under the terms of the deal, FIAT has agreed to assume FSM's debts and liabilities, worth approximately \$1 billion, and to contribute the remaining \$1 billion in capital and investment for plant modernisation. The FSM factory, which currently builds FIAT's Cinquecento model, is planning to reach an output of about 250,000 units a year in three years' time.

The \$2 billion deal is the largest ever foreign investment in Poland and, apart from the sale of the Skoda car maker in former Czechoslovakia, the largest privatisation in the whole eastern European region. Its impact on Poland's credibility in the field of privatisation and foreign investment will expand the economic benefits of the deal well beyond the Polish car industry.

Another significant joint-venture agreement was concluded in May 1992 between Volkswagen of Germany and the Polish carmaker FSR Tarpan. Volkswagen is taking a 26 per cent equity stake in the privatised company for contribution of machinery, equipment, know-how and training. VW's total investment in the company is in excess of DM 10 million.

Funding for the advisory work on the two major privatisation agreements above was entirely provided by Phare. The advisory work, which started in the summer of 1991, included legal and financial advice during negotiations as well as strategic partner-search for the Ministries of Privatisation and Industry.

### Glass

Following lengthy negotiations, a major joint venture agreement to privatise Poland's largest sheet glass manufacturer, Huta Sandomierz, was concluded with Pilkington of the UK in late December 1992. Pilkington will have a 40 per cent equity stake and subscribe \$64.2 million in equity to the overall financing of the deal. The restructuring plan includes replacing old technology with modern flat glass production systems, privatising Poland's largest glass manufacturer, developing local management and improving environmental compliance.

The project will be one of Poland's largest privatisations, achieved with the close support of international institutions. Phare provided legal and financial advisory services to the Polish authorities during negotiations. The IFC and the EBRD are also providing \$58 million and \$34 million respectively in debt finance.

### Steel

Following two years of intensive negotiations, the joint venture between Lucchini, the Italian steel maker, and the Huta Waszawa steel mill was officially signed in December 1992. The privatisation of Huta Warszawa gives Lucchini a 51 per cent majority stake in the company. The deal with Poland's most important quality steel producer foresees a \$200 million modernisation plan for the mill, to be followed by a further \$100 million investment in its rolling mill. It is the first significant privatisation involving foreign investment in eastern Europe's steel industry. Lucchini's modernisation plan aims to produce 600,000 tonnes of quality steel per year.

Phare contributed financial and legal assistance to the Polish authorities during the joint venture negotiations. It was also instrumental in mobilising other international donors to provide a further \$159 million in investment capital for the newly privatised company. Indeed, the IFC will provide \$37.2 million in loans and \$5 million in equity while the EBRD is also providing \$37.2 million in loan finance. Another \$79.2 million is to be provided by SACE, the Italian international trade insurance corporation.

The other main concrete achievements of Phare in Poland to date are as follows:

- **mass privatisation:** Phare is supporting the overall design of the Mass Privatisation Programme (now called the National Investment Funds - NIFs) through policy formulation, setting up and organisation of the Investment Funds as well as legal and financial aspects. It is also fully supporting the marketing and public awareness campaign currently underway, and which will educate the general public and enterprises about the benefits of the scheme. Finally, the Phare Programme is supporting the printing of share certificates for the NIFs and the establishment of an independent fiscal agent
- **support for restructuring:** evaluations of 21 state-owned enterprises completed; sector studies on component and packaging industries; training of managers of state-owned enterprises; institutional support for the Industrial Development Agency; major sectors in which Phare-supported restructuring activities have taken place at enterprise level include pharmaceuticals, leather and shoes, glass, agricultural machinery and textiles.

## Romania

Romania's privatisation efforts are supported mainly by two multilateral donors: Phare and the World Bank. Phare has been the dominant source of assistance received specifically for privatisation. The most notable examples of such support include:

**Voucher privatisation scheme:** Phare assistance was instrumental in preparing and implementing the voucher privatisation scheme in Romania. It financed legal advice for setting up the status of the Private and State Ownership Funds through which the vouchers for mass privatisation have been distributed. Phare also financed the preparation of the guidelines for the sale of shares and assets and seminars for enterprises on asset valuations, and contributed to the establishment, organisation and setting up of Ownership Funds themselves. In addition, it financed the printing and distribution of 17.5 million voucher certificates. The voucher scheme has been successfully implemented so far, and all voucher certificates have been distributed to the public.

**Pilot privatisation transactions:** Phare also financed the preparation for sale of ten pilot state-owned companies. Asset valuations, information memoranda and prospectuses have been completed for all ten companies, two of which were successfully privatised over the last year:

- the clothing company Vranco, which was acquired by the Industria Confezioni Montecatini (INCOM). The Italian company INCOM is taking 71 per cent equity stake and has agreed to invest \$5 million over five years to maintain Vranco's employment at its current levels and to establish measures to protect the environment
- Romania's largest brewery, URSUS, acquired by Brau & Brunnen of Germany in late December with a 49 per cent equity stake. Ownership of the remaining 51 per cent of shares were transferred by public offer to Romanian citizens.

Industrial experts on retainer have also been supplied to the Ministry of Industry, with a view to supporting restructuring of enterprises in Romania. They have been involved in training managers and ministry staff, a pilot project for regional restructuring, studies on waste recycling and on the social costs of restructuring and the restructuring needs of particular sectors (automobiles, hard coal, metallurgy, agricultural machinery and food processing).

## Slovak Republic

Phare support started before the split of the Czech and Slovak Republics. The Czechoslovak federal authorities decided to set up a mass privatisation programme which did not specifically require transfer of know-how to government institutions. Phare support for private-sector development in the Slovak Republic has therefore been targeted at the enterprise level rather than towards building the institutional set-up for privatisation. Given the fast transformation of the ownership structure of the country, Phare assistance has covered both state-owned and privatised companies.

- the armaments industry has been a key priority of the programme, given the high degree of specialisation of Slovak industry in armament production
  - a major sector study was conducted to identify the course of action to be followed by the federal authorities first and the Slovak government afterwards
  - as a follow-up of the study, an international conference on conversion of the Slovak armament and mechanical sectors was held in Brussels in November 1993, giving the CEOs of Slovak firms the opportunity to establish contacts with European entrepreneurs, with a view to identifying joint-ventures, commercial ties, etc
  - three of the armaments companies have been directly assisted in the conversion process (Vihorlat Snina, Povazske Strojarne, VSS Kosice)
- restructuring advice has been extensively provided at company level. The main sectors covered include textiles, paper, chemicals, metallurgy and mechanical, distribution and tourism
- sector studies have been conducted on the steel, textiles and construction industries
- the programme is cooperating closely with the World Bank in the preparatory work for a \$150 million World Bank loan to recapitalise the banking sector
- management training and assistance to set up a subcontracting exchange have been provided.

## Slovenia

Phare has provided an integrated package of support for private sector development. On privatisation and restructuring, the aspects covered include the following:

- **support to privatisation agency:** assistance in developing transaction techniques and manuals has been provided, as has in-house training of staff
- **direct support to privatisation of enterprises:** this has been delivered through the privatisation agency and the Development Fund, and has taken the form of searching for domestic and foreign investors to buy specific enterprises, no longer socially-owned, but owned by the Development Fund
- **sectoral support:** this has taken the form of analysis of an industrial sector, and preparation of restructuring plans for enterprises accounting for at least 80 per cent of its output.



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