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PANEL 1. INDUSTRIAL RESTRUCTURING: CAUSES, CONTENTS AND MODALITIES

Topic 2. Stages and Modalities of Industrial Restructuring

INDUSTRIAL RESTRUCTURING AS A COMPONENT OF STRATEGIC PLANNING*by Mr. **Claude Potelle** , Chairman, Corporate Resources International, Inc.
Austria**Restructuring and privatisation**

The term “restructuring” has been widely used by Western technical assistance professionals to describe the changes that the countries of the former Soviet Union needed to undergo for improving their competitiveness and compete in their new global world. On the macro-economic level, it has been seen as a way to reduce the burden of large loss-making enterprises on state budgets.

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Most restructuring was expected to result from privatisation. However, private ownership did not really change much in many cases, as it soon became clear, particularly in countries of the former Soviet Union¹. Results have been much more positive in countries of Central and Eastern Europe, where an econometric analysis indicates that productivity increased 3-5 times more in privatised enterprises than in similar firms still under state ownership².

Some post-privatisation restructuring programs were started, while other programs were designed to accelerate the pace of privatisation, which was still seen, with whatever the imperfections existed, as the best available way for enabling positive future developments. At the same time, bankruptcy laws and institutions were developed and empowered for dealing with extreme cases that could not be treated otherwise.

The most positive impact of these efforts came in the form of a reduction of the financial burden for state budgets. On the industrial side, a number of success stories could be cited, but also many enterprises were liquidated, sometimes with negative social (if not political) impact. The extent to which these restructuring policies could enable the recipients of Western technical assistance to take part in the global economy, remains generally unclear.

Accessing the world economy

The main objective, it should be recalled, is to assist Russia and the other CIS countries to participate and to take advantage of the global market economy. At this point of experience, we should ask the following questions:

- Is enterprise restructuring enough for redeveloping an economic area of almost 300 million people?
- Would the surviving restructured enterprises be strong enough to have a macro-economic impact?
- How can existing scientific and human potential be used to develop other parts of the economy?
- To what extent should the development of CIS countries depend on foreign investors as partners of or substitutes for local actors?

These questions are not unjustified, especially if we consider the case of the former East Germany - where the legal and institutional framework may be considered best one could dream of: Federal Republic of Germany and European Union. Still, no impressive developments could be identified other than West German and foreign initiatives.

The main lesson from the East German experience is that the institutional framework helps, but does not create local industrial actors. It only allows them to emerge and to develop. In both Russia and the other FSU republics, only small-scale enterprises and service companies have been changed for the better. This has occurred particularly for consumer products and services, mainly in the food industry. For the larger enterprises that were the backbone of the Soviet economy, it cannot be said that privatisation and restructuring have revived economic activity on a broad scale.

Divergent industrial structures

¹ Commander S., Dhar S., and Yemtsov R.: "How Russian Firms Make Their Wage and Employment Decisions", in *Enterprise Restructuring and Economic Policy in Russia*, Economic Development Institute of the World Bank, Washington, D.C. 1996. Also: Earle J.S. and Estrin S.: *Employee Ownership in Transition*; and Blasi J. and Shleifer A.: *Corporate Governance in Russia, An Initial Look*, in *Corporate Governance in Central Europe and Russia*, The World Bank/Central European Press, Budapest, 1996.

² Pohl G., Anderson R.E., Claessens S., and Djankov S.: *Privatization and Restructuring in Central and Eastern Europe. Evidence and Policy Options*. World Bank Technical Paper n°368, Washington, D.C., 1997.

The lack of strong and fast revival is, however, hardly surprising. The point is that demand for industrial products had disappeared almost overnight, together with the implosion of the central institutions of the FSU. No large industrial unit was in a position to restore any demand on its own, as would have been the case in the Western world of “supply driven demand”. Large Soviet enterprises had never been encouraged to learn methods to acquire and exchange information, perform market surveys, design and promote new products, or even decide on investment techniques – all functions that were concentrated in Moscow.

Furthermore, their immediate core businesses were limited to narrow or incomplete ranges of products. A detailed sub-sector analysis had concluded that there was little evidence of industrial concentration in domestic markets, that very large firms were more commonly found in the United States than in Russia, and that competition could best be promoted by improving distribution systems, rather than by recourse to elaborate anti-trust policy schemes³.

Suppliers of the same category of products were actually dispersed all over the territory of the Union, most of them having only production facilities, while applied research institutes (that were in charge of market analysis and technological decisions) were managed separately. After the disintegration of the Soviet Union they were all left to their individual fates. Contrary to what had happened in the West, where vast *branch* restructuring operations had been conducted through mergers and acquisitions over the last decades, the former Soviet power structure did not initiate branch or sub-sector concentration, and maintained all research and production facilities geographically and administratively separated from each other.

The limitations of individual enterprise restructuring

The features of industrial structures in CIS countries have a direct impact on the capabilities of individual industrial units. In other terms these units encounter difficulties from the start in being or becoming “enterprises” in the Western sense of the word.

If Russian enterprises sometimes appear large, this is mostly due to their vertical integration - a basic feature of the former economic system. Once “restructured” following a Western methodology - after careful separation of core business from what is not, after spin off and liquidation of less efficient departments - it is not surprising that some former “big” industrial entities look rather small, poor in management (as opposed to other strictly technical) functions, and very fragile. Only groups exploiting natural resources are in a position to temporarily keep market power based on their monopoly. Even they have to envisage serious reorganisation and development policies if they want to keep their lead.

In reality, the term “enterprise” itself can be misleading, since these industrial units have never been “entrepreneurs” at all. It may be questioned whether this type of misunderstanding did not sometimes lead Western technical assistance to provide inadequate industrial policy advice⁴.

For instance, most presently used restructuring approaches focus on individual enterprises – either taken from a sample for prototype study, or chosen at the suggestion of local authorities as urgent and difficult cases. Almost inevitably, the analysis can easily conclude that there are profound structural problems – without necessarily being able to bring to bear useful information on how to correct these weaknesses in the framework of the sub-sector. On the sole merits of the firm studied, liquidation may be advised.

Branch restructuring

³ *The Myth of Monopoly. A New View of Industrial Structures in Russia*, Policy Research Paper no. 1331, The World Bank, Policy Research Department, Transition Economics Division, Washington, D.C. 1994.

⁴ Potelle C.: *Les entreprises, grand malentendu de la transition dans l'ex-URSS*, Le Monde, Supplément Economique, November 18, 1998.

It seems, therefore, that the type of restructuring that was – and still is – needed is typically a form of *branch restructuring*. Given the characteristics of the former industrial structure, and given the fact that all industrial units in the same branch suffered a reduction of activity at the same time, a traditional industrial approach would be to solve the issue of production overcapacity by concentrating production at the best equipped industrial sites, organizing the necessary transfers of researchers, managers and workers to these sites, designing new technical investment schemes, and to reorganizing the overall management.

Such a branch approach was used by most European countries to resolve structural problems; this was often supported by the institutions of the European Union (one can point to the vast restructuring of the steel industry as an example). Branch analysis for restructuring provides macro- and micro-economic information that can be used for establishing technical agreements among firms of the same sectors, facilitate (or create) the role of the professional associations and, allow an industrial policy to emerge at national or regional level. It can also help determine the way to treat social problems stemming from restructuring decisions.

It should be noted at this point that Western economies do not present standardised models of branch organisation. The analysis of European, American and Japanese industries provides a wide range of sector organization approaches, very different from a country to another⁵, and there is no reason why newcomers to the globalisation game could not determine their own way to get organized in particular industries, so long as they obey WTO rules.

Regional restructuring

Regional restructuring is similar to branch restructuring, but established on a wider basis, and addressing the issues of more than one sub-sector. It generally helps for the participants to improve their knowledge of their environments and the impact of their possible individual policies or objectives. There are many positive examples in Western Europe of local institutions created for studying and proposing solutions to regional structural issues.

Industrial groups restructuring

A recent feature of modern Russia is the emergence and the development of sizeable industrial groups, taking advantage of their cash reserves for diversifying into various branches of the economy.

This development is highly positive and will allow Russia to take part more and more actively in the global economy. Western capitalism is mainly based on large corporations, but being a large corporation is not a guarantee for success. The annual *Fortune 500* is a permanent reminder of the changes that may occur – from explosive success to decay. The *Financial Times* presents its annual classification based more on the qualities of the companies' management. Both listings provide an ongoing mirror for comparing the emerging potential of new countries.

At this level of industrial responsibility, long-term success depends on the quality of management: development policy and strategic planning in particular. There are no ready-made recipes but, rather, examples to study for inspiration⁶.

Large industrial groups make day-to-day adjustments to opportunities and risks; they are able to make fast decisions that sometimes have a major impact onto regional economic activities. In international groups, such as *Rhone-Poulenc* and *Danone*, permanent teams take care of the social and regional impact of strategic

⁵ Hollingsworth J.R., Schmitter P.C., and Streeck W.: *Governing Capitalist Economies. Performance and Control of Economic Sectors*, Oxford University Press, 1994.

⁶ See in particular on the subject the remarkable *Built to Last. Successful Habits of Visionary Companies*, by Collins J.C. and Porras J.I., Century, London, 1995.

decisions made at group level. It can be expected that the new Russian conglomerates will be increasingly involved with the social implications of their decisions at regional level.

Modern State Corporations?

Although controversial, the subject of direct involvement by the state in economic development – investment and restructuring operations - cannot be avoided. Taking into account the relatively limited size of private groups compared to the immense development needs of CIS countries, it actually appears that there is room for a certain number of industrial initiatives to be taken by public authorities, whether at national or local level (oblast, municipality).

It should be indeed remembered that legal and institutional tools exist in the world for allowing such moves. The effective use of holding companies⁷ may allow the state to keep a clear line of separation between its role as a regulator and its responsibilities as a major employer and industrialist. Such institutions may be valuable as platforms for attracting foreign investors and entrepreneurs.

Conclusion

Avoiding *art for art's sake* in restructuring operations means that they cannot be disassociated from clear development policies, conducted by well organized economic actors, whether individual entrepreneurs, large industrial companies or state bodies involved in economic development.

In particular, restructuring actors and advisers in CIS countries should take into account former structural features that still affect individual elements - such as natural management vacuums, and insufficient *built-in* interfaces to markets. Discovering these shortcomings should not be a final conclusion but, rather, constitute a starting point.

Restructuring an individual enterprise makes little sense if it does not result in the *structuring* of a new actor – principally by attachment or addition of external elements. Solutions to structural problems may actually lie outside the firm itself, at branch, region or group level. Searching for these external elements can be the essence of restructuring operations.

As a guideline, strategy for the future should not be derived from restructuring but, on the contrary, it should precede it.

⁷ Kumar A.: *The State Holding Company*, Macmillans, London, 1993

