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PRIVATIZATION IN POLAND: OBSTACLES AND OPTIONS-AN ILLUSTRATION

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Not too many years ago, I met Professor Rapaczynski while travelling to Warsaw and again when I was in New York. In those days we were full of hope. The wall was coming down. Poland had freedom. Privatization was going forward. It was all going to happen quickly. As we now know, it does not happen that way because you do not dismantle decades of communist dictatorship in a month, or a year, or five years, or even in a decade. This is not going to be a fast or easy process. There will be reversals; in many countries there will be substantial reversals. We think that the ultimate trend will be forward, but it will not be easy.

I would like to present an anecdote of our experience with Poland's privatization process. It was a project to which we and our United States client devoted a considerable amount of time attempting to establish a venture with the Polish copper monopoly.

Poland is the world's sixth largest producer of refined copper. Copper may be Poland's largest single cash export. Miners in Poland, like miners worldwide, are implacable, and they are not an easy group with which to negotiate. The Polish copper monopoly is one of Poland's most aggressive enterprises. Long before we met with them, they had hired one of the best mining consulting firms in the United States. They were well underway with the privatization process, putting their books in order and trying to arrive at the appropriate valuation of the company. Nevertheless, we encountered several problem areas: management, workers, liabilities of the company, governmental process, and facilities. I will address some of these issues.

First, and perhaps most important, is the issue of existing management. Management of companies, like politicians, academics, and lawyers, have one primordial instinct—survival. The management of this company was virtually independent, and they were afraid that they would lose their jobs if the company was acquired by a foreign interest. Moreover, they formed

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an alliance with the worker's council, who were also afraid of job losses, and the local politicians. As a result, we faced constant sabotage from management. The articles that appeared in the press were unbelievable. The most embarrassing sections from our correspondence, memoranda, proposals, and internal company correspondence were leaked to the press, and we were made to look terrible. The chief executive of our client read a translation of what appeared in the Warsaw Press. He wondered, "Do we need this? Is this something we want to deal with? These people are out to get us."

We experimented with various ways to inspire management to go along with us, but there was one thing we were not going to do: We were not going to put a significant amount of our money into this company without having control over the company. If we could not exert control over the company, then we would invest our money in one of the many more hospitable investment environments in the world, including the United States. The workers, fearful of losing their jobs, independence, and control, were also able to influence events through the worker's council, which is a potent political force within the company. As a result, we also faced sabotage from the workers.

There were, however, factions within the worker's council that favored our investment because of health and safety reasons. We were going to introduce the workers to the most modern Western health and safety programs. We were also going to introduce work rules and mining methods that were designed to protect them from cave-ins. In the end, I think the workers were much more favorable to us than management. A strong minority on the worker's council supported us, and our relationship continues to develop.

Another category of problems is liability for past activities. This area must be watched carefully, particularly with a mining company, because mining is not friendly to the environment. An example is lead pollution of ground waters, which creates a very high incidence of abnormal births and malformed children. Moreover, the smelters belch sulfur dioxide into the atmosphere. Because of the potential environmental liabilities, our proposal included a cap on our exposure for environmental cleanup. We would, of course, fulfill our environmental obligations going forward, but we were not going to be responsible for past environmental damage because it would be too difficult to quantify.

Another aspect of a privatizing a company, particularly a large integrated company, is that when you buy the whole company, you also buy its responsibilities. A good twenty percent of the company we looked at was devoted to manufacturing outdated mining equipment. Clearly, we did not want this part of the company. The same was true for the mining enterprise's research institute. I suppose we needed a few researchers, a small R & D area perhaps, but not 800 scientists and engineers at the research institute and an equal number at the engineering bureau. But again, that came along with the company.

Hospitals, sanitoriums, and schools also came with the company. It was not that we opposed these activities, it was just that we did not know anything about running a hospital. We did not know anything about running a sanitorium. We did not want to pay for them and dissipate our management expertise on activities that were not part of our core business. Our core business is mining, smelting, and refining. We are the best in the world. We know how to mine. We know how to smelt. We know how to refine. We wanted to bring this expertise to Poland.

You must also learn to deal with the government because it responds more to political pressures than the necessities of the privatization program. It is motivated by one fear—they cannot sell to these foreigners too cheaply. This thinking, that somehow the government officials involved will be criticized for selling the crown jewels too cheaply, pervaded many of our discussions, as it pervades the privatization processes throughout Eastern Europe and Russia.

Also, the government often has very little power to make its decisions stick. When dealing with a privatization decision that affects, for example, the mining industry in Poland, which is a vital national industry, the government will back down if the miners decide to strike. Accordingly, we did not know with whom we could make our deal. We thought we had made some progress in Warsaw, but when we went to talk to the worker's council, local politicians, and the management, we discovered that each had its own idea of what the deal should be. Each one believes that it is (or should be) the decision maker. In the end, it turned out that everyone had the right to say no, but nobody had the right to say yes.

One answer to the foregoing problems is to not purchase a privatized company, but consider forming a joint venture. Set up a completely new company. Invest in the joint venture company, and have the existing mining company transfer certain key assets to the new joint venture company as its share of the investment. The entire cash investment, in this case, would go to the acquisition of fresh assets such as new mining equipment, new smelters, new refineries, and new health and safety facilities, rather than to the acquisition of old assets.

Existing management would not lose their positions under such a scenario because the original mining company would continue to exist, albeit in a somewhat slimmed-down version. The new joint venture company would hire the managers who want to join it and whom we want to hire, and we would hire the workers who want to join us and whom we want to hire.

Another option is to set up a wholly-owned subsidiary. It is possible for such a subsidiary to acquire state assets that are being privatized or to construct a completely new factory. Such a transaction can be completed rapidly, with a minimum of negotiations and red tape.

As you can see, investing in privatized industry in an Eastern or Central European country can be a risky and frustrating proposition. However, through joint ventures or establishing wholly-owned subsidiaries, it is possible to reduce obstacles and make a profitable investment.