Employment

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Employee ownership in Hungary: The role of employers' and workers' organizations

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Preface

The three case-studies by Béla Galgóczi and János Hovorka on Hungary (IPPRED-11), Rainer Schliwa on Poland (IPPRED-2) and Dane Brzica on Slovakia (IPPRED-12) form the contribution of the ILO's Social Financial Unit to the ILO's Action Programme on Privatization, Restructuring and Economic Democracy 1996-97. This report is a case-study of the employee buy-out process in Hungary.

But what does privatization have to do with finance? On the surface seemingly little since a transfer of ownership does not always entail a financial transaction; even where former government-owned assets are sold, a functioning financial market is usually perfectly capable of organizing and handling the transactions. In actual fact, however, privatization has a great deal to do with the ease and handling with which capital can be raised to facilitate ownership transfer. As it happens, financial markets in most Eastern and Central European economies are still far from competitive and banks themselves are still state-owned or state-controlled.

This affects different groups of investors in different ways. A category that is seriously hampered is the workforce of former state-owned enterprises when it wishes to organize and implement employee and/or management buy-outs.

This is so for a number of reasons: employees' personal financial resources are very limited; financial needs go far beyond acquisition and also concern the cost of replacing machinery and equipment and other new investments; there is no employee managerial track record; and often there also are risks of a break-up among employee groups participating in the buy-out schemes.

While it is true that in some countries special loan facilities to the workforce (like E-loans in Hungary) are made accessible on "soft" conditions -- subsidized interest rates, grace periods and long repayment schedules -- demand often far exceeds available resources.

The ILO strongly supports privatizations when they can optimize economic efficiency and social equity as can be the case in privatizations that feature worker/employee ownership schemes. For this reason, and -- encouraged by a tripartite conference in May 1993 in Bratislava -- the ILO commissioned case-studies to explore the involvement of trade unions and employers' organizations in Hungary, Poland and Slovakia in such employee buy-out schemes. The special focus was the role (potential or actual) of the social partners in facilitating access to financial sector institutions. The three papers analyse the role of the social partners in employee buy-outs, describe different enterprise cases in detail and also outline the possible involvement of other actors in the process, such as consultancy firms, associations and other bodies of civil society. Special thanks go to ILO Departments ACT/EMP, ACTRAV, EUROPE and ENTREPRISE for their financial support which also made these reports possible.

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I. Overview of "employee ownership in Hungary's privatization process (1989-95)"

1. Introduction

This paper was prepared by Mr. Béla Galgóczi of the Institute for Privatization Studies and Mr. János Hovorka of the Share Participation Foundation of Hungary for the International Labour Organization as part of a study to establish the scope and constraints of employee ownership in the privatization process. Reviewing the experience acquired over the last six years in several Central European countries, the study sets out to offer proposals as to what kind of assistance employers' and workers' organizations might need to enhance company efficiency before and after the acquisition of assets.

This paper is based on the experience of both institutes with Hungarian company case-studies and on interviews with representatives of organizations involved in the process of privatization with employee ownership.

The paper is organized in five sections. The first part gives a general overview of employee ownership in the privatization process in Hungary (1989-95). The second section provides several case-studies. The third and fourth sections review the role of the social partners in the privatization process and the National Commerce and Credit Bank respectively. The final section presents the conclusions.

2. Forms of property acquisition by employees

In Hungary, there are basically two distinct forms of property acquisition by employees. The first is the *preferential acquisition of property* by employees which may be as much as 10-15 per cent of companies' subscribed capital, according to the laws regulating privatization. In this form of property acquisition, the employees and their organizations are primarily motivated by the desire to save their jobs. In big state-owned companies approaching insolvency, employees need not raise cash resources; the preferential acquisition of property is practically free. The situation is quite different in companies with considerable profits, where employees are motivated not so much by dividends but by the return from selling their shares on the secondary market. This can be observed in the major pharmaceutical manufacturers, the national oil company, or gas and electricity works, where employees fight hard for their preferential acquisition of property, sometimes even in the face of the State's resistance. The State is, of course, interested in maximizing the sale price on the largest possible proportion of assets.

The second form of employee ownership is **MRP** (the Hungarian version of the English acronym **ESOP** (Employees Shared Ownership Programme)), regulated by the law on MRP (1992) and the Law on Privatization (1995). Here, employees participate in a tender for purchasing the company's property, along with external investors. In the context of MRP, credits are available to employees on preferential terms.

3. Legal framework

The Law on Privatization, 1995

The Law on Privatization (1995) is the framework for both preferential property acquisition by employees and the MRP/ESOP option.

In the MRP/ESOP, an ESOP organization with a legal personality must be established to handle the shares during the redemption period.

Within the MRP framework, buy-outs of state property are usually funded from credit sources. Own resources must be at least 2 per cent.

The conditions for creating such an MRP/ESOP organization are:

-- At least 25 per cent of the employees have to apply for it in writing. To establish the ESOP organization, 40 per cent of the employees must be in favour.

-- Only employees of companies incorporated in Hungary have the right to establish ESOP organizations.

-- Employees must have been with the company at least six months. The respective law makes it clear that membership in an ESOP organization is employment-related, i.e. with the end of employment the right of participation lapses.

-- A preparatory committee has to prepare a feasibility study.

The ESOP organization is a self-governing legal entity which shall be engaged in the buy-out only. It may carry out no other activities. The ESOP organization therefore ceases to exist after all credits have been repaid. The ESOP organization is a non-profit organization supervised by the Office of Public Prosecutors.

A simplified privatization procedure is applied to small and medium-sized enterprises with equity capital of under HUF600 million and fewer than 500 employees. The Hungarian Privatization and State Holding Company (APV Rt.) publishes the list of business organizations for sale twice a year. A cash offer can be submitted to the APV Rt. within 90 days from the date of publication, at least for the floor price shown in the list. If no offer is received, the simplified privatization procedure is applied, which means that either the board of directors or the management of the enterprise in question propose privatization arrangements to the APV Rt. which seeks the advice of two outside experts. The APV Rt. then decides either: (a) to prohibit the sale or to impose certain conditions; or (b) to authorize the sale usually by tacit agreement within 90 days.

4. Status of ESOPs

By mid-1995, 202 MRP/ESOPs had been completed in Hungary for a total value of HUF57 billion (US$500 million) making up 14 per cent of the total privatized state property assets. In 125 cases, majority ESOP buy-outs were achieved.

Privatization type involving Hungarian investors

Technique	**Total**
ESOP	
No. of sales	202
Book value (billion HUF)	38.29
Leasing	

No. of sales	24
Book value (billion HUF)	6.09
E-credit	
Value (billion HUF)	62.93
Compensation voucher	
Value (billion HUF)	66.55

MRP/ESOP (1992-95)

Period	All ESOPs	Majority ESOPs
1992	7	4
1993	126	87
1994	195	120
1995	202	125

By the end of 1994, most ESOPs (73 per cent) had taken place in small and medium-sized enterprises:

No. of employees at the ESOP company	No. of companies
0-50	13
51-100	20
101-200	22
201-300	15
301-500	21
501-1000	19
1001-	10
Source: SPA, Institute for Privatization Studies.	

Employees held 54 per cent of the assets in an average ESOP operation, with some assets still held by the State Privatization Agency, followed by private Hungarian investors.

Insert Pie Chart here.

A recent study by the Institute for Privatization Studies showed that **almost all ESOP buy-outs are in practice management buy-outs (MBOs)**. In most cases five to eight individuals in key management positions hold the majority of shares. In other cases where management does not have the preponderance of actual share ownership, it can still ensure a dominant position in decision-making through unproportional decision rights, laid down in the company's association contract.

As ESOP buy-outs are 80 to 90 per cent financed from credit sources, immediate and sustained profitability is crucial for an ESOP enterprise's financial survival. The performance of ESOP companies is no worse than the branch average; 75 per cent of them were profitable and just 20 per cent made losses.

ESOP companies have to preserve short-term viability and service debts, yet at the same time replace machinery and equipment. The result is a chronic lack of capital.

II. Case-studies

The case-studies presented are selected according to differences along the following criteria:

- success rate of ESOP;
- company size;
- branch/industry.

1. ESOPS and other worker ownership schemes

in companies prior to privatization

1.1 Csepel Tube Factory

The Csepel Tube Factory used to have some 6,000 employees which by 1995 had declined to only 2,000 as a result of an enduring crisis. On the verge of bankruptcy, the company could only be saved from liquidation by renegotiating its debts -- some of which were written off -- and by receiving state support. Prior to privatization, the company had been divided into four parts in 1995. The organizations representing employees preserved their unitary structure, i.e. both the Ironworkers' Trade Union Committee and the works council represent all four sub-enterprises. Employees' membership in this trade union, which had dropped to 40 per cent by 1993, rose again to 70 per cent by the end of 1995. Management -- union relations are close. Trade union representatives say that they receive information from management concerning the company's situation, which is made easier by being on the Board of Directors. The trade union is primarily interested in ensuring employment while wage-related issues are secondary. By 1996 and as a result of the company reorganization, debt cancellations and an injection of state funds, the survival of the group seems to be ensured. Despite, or perhaps because of this, employees display no interest in the acquisition of property, not even a 10 per cent preferential employees' share.

One of the four sub-enterprises, Precision Ltd., proposed for example using dismissal compensation from the former enterprise for the acquisition of shares in the successor company. Neither the employees nor the trade union were interested.

Workers' representatives say that the risks far outweigh the possible benefits. Moreover, good relations with management were sufficient to give them a sense of ownership and a 10 per cent ownership ratio would not give them a say in any case.

The unions in general seek to minimize employees' risks in the course of privatization and to maintain or acquire collective bargaining and other labour rights.

1.2 Csepel Metal Works

In 1991, **Csepel Metal Works** (CMW) was converted into a share company. By 1994, the number of employees dropped from 10,000 to some 1,000 as a result of CMW's losing nearly all of its markets. However, the company sought new markets. Despite a heavy debt burden, the company's solvency is no longer threatened.

In this firm, the Metalworkers' Trade Union represents the interests of employees on the works council. Employees' membership in the trade union dropped from 90 per cent in the late 1980s to 40 per cent by 1993. The head of the company's trade union organization does not consider the acquisition of property by the employees important, especially not in a company operating under market conditions. Employees' partial ownership could perhaps be advantageous, but an ESOP was out of the question since employees would not be able to raise the required capital. The first tender for the privatization of the company prescribed an HUF300 million compulsory increase of capital and proved unsuccessful. A new tender prescribed an HUF500 million compulsory increase of capital. Under such conditions, a significant acquisition of property by employees was not feasible.

In 1990 employees were entitled to buy property coupons under preferential conditions. These coupons were part paid and part free, together amounting to a nominal value of HUF100,000. The free part of the property coupons was linked to the yearly basic wage: with a wage of HUF200,000 per year, the free part amounted to HUF60,000, and above a wage of HUF600,000 per year to HUF32,000. The amount of the free part depended also on the duration of employment: under one year there was no free part, and with more than 35 years it amounted to HUF60,000. The free property coupons could not be sold, while the priced coupons could be sold without restriction.

In 1992 employees started to sell the priced coupons. By 1995, only the free property coupons (worth HUF45 million total) remained, which workers were obliged to keep. The State Property Managing Company promised that these free coupons would be converted into employees' shares. Subsequently, in 1994, ESOP was mooted as an option; 25 per cent of the employees declared their interest in taking part in it, but the necessary 40 per cent threshold was not reached. Workers' representatives tend to see external investors as preferable to ESOPs.

1.3 Dunaferr Metallurgy Works, Dunaújváros

Dunaferr is the largest steel industry complex in the country. Employment in the steel sector was halved (from 40,000 to 20,000 -- half with Dunaferr -- between 1989 and 1995. Dunaferr

could maintain its employment level through continued subsidies and a shift in production to finished products and active exploration of new markets.

Dunaferr Holding is still 100 per cent state-owned but components of the holding have been transformed into limited companies with considerable outside investment. The biggest venture of this type is the cold steel mill, 51 per cent of which was bought by Voest Alpine, the Austrian steel giant.

At Dunaferr, the Metal Trade Union (associated to MSCOSZ) has 8,600 members and exclusive representation. The Metal Union's relationship with management can be characterized as cooperative. The union has strong formal and informal influence and is well informed on all important decisions.

Employee ownership has not yet been established, neither at the holding nor the level of its components.

The attitude of employees toward employee ownership is ambiguous. According to the trade union secretary, their interest focuses on the return from share sales. Other employees believe that owning company shares is a guarantee of employment, an illusion that the trade union has some difficulty in dispelling. But on the whole employees (and their trade union) are determined to fight for their right to acquire preferential shares of up to 20 per cent, half of which would be free.

Management has, however, proposed an interim period to transfer all property rights to a six-person management team which would later convert its property rights into partial employee ownership. The trade union is now seriously concerned that management wants to pump cash out of the holding.

Trade union representatives are especially vocal about their concern that they may be short-changed. In this situation, they have turned to the National Federation of Metalworkers' Unions for advice.

2. ESOPs and other worker ownership schemes

in companies after privatization

2.1 AGROKER

AGROKER used to be a state monopoly firm for agricultural machinery, fertilizers and plant protection chemicals. It operated throughout the country with outlets in each county. Clients were state farms and large agricultural cooperatives.

The changing economic climate, especially the disintegration of state farms and cooperatives, the collapse of COMECON and trade liberalization brought radical changes to the firm, as a result of which its turnover dropped to a third within three years. The workforce also shrank from 126 in 1989 to 89 in 1992.

In 1992, AGROKER converted into a joint-stock company. The management of the firm applied for an ESOP at the State Property Agency (SPA) as soon as the law on ESOP was

passed in 1992. Management's motivation for entering an ESOP bid was to pre-empt other forms of privatization considered detrimental to the firm and to themselves.

Although their initial aim was an MBO, managers realized that, politically speaking, broader employee ownership would be more acceptable. The managers' share should not exceed 30 per cent within the ESOP to ensure that the bid would be accepted.

All employees with more than one year's service (i.e. 70 people) participated in the ESOP. Share purchase options were linked to wages, thus in the first round managers acquired more shares proportionally. The ESOP bid was for 52 per cent of the equity at a rate of 80 per cent. The ESOP organization obtained the promise of a HUF57 million E-loan (i.e. a privatization loan for private Hungarian investors) from a commercial bank. The equity requirement of HUF2.3 million could be paid in compensation vouchers, which meant a further rebate of 50 per cent.

Employees thus did not need much cash for the transaction and AGROKER even gave them six months' interest-free loans to allow them to acquire the compensation vouchers.

There were no conflicts attendant upon the buy-out; employees had a common understanding that it was in their interest to protect the company from a takeover by outside investors. Management found it easy to promote the idea of an ESOP.

In contrast to other enterprises, AGROKER employees were also well informed about the company's economic situation. They were closely involved in the preparation of the ESOP bid. The president of the ESOP organization was the chief accountant and four of the five members of the Board of Directors were delegated by the employees.

As there were no competing bids for the company, the ESOP organization won the tender in December 1992. As, in the meantime, the interest rate of E-loan had been reduced from 21 per cent to 7 per cent, the management, through the ESOP organization, applied for a 100 per cent buy-out of the company. The State Property Agency turned this down with the argument that it wanted to sell the remaining 46 per cent of the equity to agricultural producers. In mid-1993 the SPA invited tenders for the rest of the shares for compensation vouchers, but nobody wanted to buy.

The ESOP organization thus got a second chance of buying the rest of the shares for compensation vouchers, which meant that HUF28 million in cash were needed for the transaction. These terms were, however, beyond the reach of most workers and it was the management which eventually made a new offer with 15 million cash provided. This offer was finally approved by the SPA and the company has got under way with 100 per cent ESOP ownership.

This case illustrates the dominant role which management has played in ESOP transactions involving Hungarian SMEs.

2.2 Metrimpex Foreign Trade Company

Founded in 1956, Metrimpex was one of the big companies with a state monopoly for the foreign trade of machine tools and instruments. By 1989, the state enterprise exported instruments manufactured by some 200 companies to 60 countries and in return imported

technical goods from 30 countries. In 1983, company turnover accounted for 4 per cent of Hungary's foreign trade.

The company lost its monopoly in 1989. With the collapse of COMECON, and the near-total loss of the markets for Hungary's machine tool industry, Metrimpex turnover shrank by 80 per cent within four years. Employment decreased from 585 in 1989 to 193 in 1994.

Not being very capital intensive, this medium-sized enterprise was an ideal candidate for an employee buy-out. In 1991, however, the SPA took the company under direct state control which meant, amongst other things, that the Metrimpex office building (worth HUF400 million) became part of the SPA's tangible assets.

Management was apprehensive about outside influence from the beginning. Indeed, foreign investors had expressed interest in the company in 1991-92. The apprehension was that foreign investors would be interested solely in the company's networks and market information, but not in its workforce.

Management and employees therefore asked a consultancy firm to design an ESOP scheme and a business plan. The report was approved by 90 per cent of employees. As the privatization tender was opened, three bids were put forward, one by a New Zealand trading firm, the second by a Hungarian financial investor and the third by the ESOP organization comprising 321 employees.

The ESOP organization of the company won the tender for 88 per cent of the equity at a rate of 100 per cent financed through an E-loan of HUF630 million, with an own-capital of around HUF5 million.

According to the ESOP statute, only those employees who had been in Metrimpex for more than two years and at least six hours a day were to be eligible to join the ESOP organization. The purchase of shares was scaled according to the post held, i.e. general manager: a factor of 10, deputy general manager: 7, directors: 5, heads of department: 3, team leaders: 2, other employees: 1.

At its inception, employees owned 60 per cent of shares of the ESOP organization and middle and upper management the rest. At the first ESOP assembly, management contended that its 40 per cent share was actually worth 66 per cent of the votes.

Management argued that they needed clear decision-making rights to go ahead with the restructuring of the company.

Employees did not strongly contest this move as they did not wish to become actively involved in managing the company. On the other hand, they were presumably not aware of the implications. Subsequently, the number of employees was reduced to 223 in 1993 and to 193 in 1994. In other words, almost half of the employees with ESOP shares lost their jobs in the two years after the ESOP buy-out.

In sum, the lesson of Metrimpex is that even if a company's profile makes it seem suitable for an employee buy-out, sudden external pressures (drastic loss of business, debt burden accrual, etc.) require a concentrated effort by management, and the actions it takes may depart from

the initial ESOP design. This case again illustrates that employees feel that an ESOP is a guarantee for job security.

Thirdly, in know-how-based SMEs there is also a tendency for middle managers to bypass the ESOP and set up their own business using the contacts and networks of the former state enterprise.

2.3 Csepel Transformer Factory

Csepel Transformer Factory used to be part of the large Csepel Works, once the flagship of the Hungarian machinery industry. After the disintegration of the Csepel Works in 1983, the Transformer Factory became independent. It employed 600 people and enjoyed a quasi-monopoly on the Hungarian market in medium-voltage transformers and switchboards. The collapse of COMECON and the disastrous crisis in Hungarian industry and agriculture in the early 1990s critically affected the Transformer Factory. Several privatization attempts failed; 1993 was the turning point, when the company went through a radical restructuring process as a result of which employment fell to 100. The company consolidated its financial situation and orders saw dynamic growth from 1993 onwards.

In 1992, the SPA invited tenders for the privatization of the company. A Hungarian-Italian joint venture won in early 1993. However, as the joint venture company failed to pay the sum stipulated in the sales contract, SPA cancelled the contract. It then offered the company to its employees within an ESOP framework and without tender, provided an ESOP organization was established at the firm.

Management campaigned to gain the support of the employees for the buy-out. Of the 138 employees, 119 voted for ESOP, i.e. much more than the 40 per cent required by law.

Management's argument was that an ESOP was the only chance to ensure the future of the firm and to keep it safe from outside investors.

The special feature of the Csepel Transformer Factory is that, prior to the creation of the ESOP organization, six managers founded a limited company which rented the two biggest company workshops from the firm. The small limited company was in full control of the inputs, orders and marketing.

Besides the six founding members, 20 employees also had interests and a further 55 had some symbolic shares in the HUF1.2 million founding capital of the limited company.

Interestingly enough, as the ESOP organization had 42 members, with 87 per cent of the HUF270 million equity of the Transformer Company, more employees had a (symbolic) share in the limited company than in the firm itself.

The ESOP buy-out was made at a rate of 57 per cent with HUF120 million (HUF83 million through an E-loan and the rest in compensation vouchers).

Two years after the employee buy-out the firm consolidated its position and market presence. External investors became unavoidable due to the lack of capital for major investment. Csepel management invited its largest business partners (Merlin-Gerin, Siemens and the Hungarian

Electricity Works) to acquire property in the company. Only Siemens expressed interest, but in a 100 per cent buy-out.

Siemens Ag had longstanding cooperation with Csepel Transformer Factory. Since the early 1980s Csepel had delivered medium-voltage transformers to Siemens and had bought electronic parts from the German firm. By the early 1990s, Csepel had developed into a stable supplier for Siemens at a yearly volume of around DM1 million.

In early 1985 the contract was negotiated. Siemens would provide the capital if Csepel, in turn, ensured that its assets were duly registered as a distinct property of the Csepel Transformer Factory. Siemens also wished to see the responsibility for potential environmental damages on its territory assumed by the former Csepel state holding.

Siemens planned to invest up to DM2 million over the next four years to ensure the competitiveness of the firm in a future market expansion. Those investments were necessary to maintain the quality of the products supplied to the German mother firm. Moreover, Siemens wanted to explore new markets in Eastern Europe via the Hungary-based plant.

Siemens was satisfied that the former ESOP management had stabilized the company and could lead it out of the crisis. No dismissals occurred at the second stage of privatization; on the contrary.

Compared to 1993 when the workforce was only 100 people, it reached 150 in 1996 and is expected to grow to 200 by 1998.

As a result of the buy-out by Siemens, the ESOP loan could be paid back early. Employees, however, were no longer shareholders. The limited company founded earlier by management was also dissolved.

The ESOP assembly voted for the buy-out by a large majority. Employees agreed with their management that further investment was needed and the German mother firm would increase business with the company after technological upgrading.

Both transactions (SOP, and the sell-out to Siemens) were management-driven and controlled. Non-union employees at Csepel Transformer Factory were not in a position to develop their own business plan.

2.4 Zelka Electrical Maintenance, Trading and

Services Company Ltd. (Western Hungary)

The company was founded in 1982 after the decentralization of a huge state monopoly for household electronics.

The company employs 100 people and is involved in four major fields of activity:

-- maintenance and repair of household and entertainment electronic devices;

-- establishing and operating cable TV networks;

-- planning and installing central antenna systems;

-- installation of alarm and monitoring systems.

In 1990, the company was declared subject to the new preprivatization law (No. LXXIV.1990) which applied to SMEs in the retailing, consumer services and catering sectors.

The management saw this as a potential risk, in that their best units (e.g. with central location) would be sold off piecemeal, driving the rest into insolvency.

In order to prevent this, management applied for a 100 per cent employee buy-out through a preferential credit (E-loan) and presented a conversion plan to the State Property Agency.

The conversion scheme was put to the SPA in October 1990, although the final decision was taken only in December 1991. The delay was mostly because of a conflict of interest. Although the company still had a centralized organization, the manager of the service unit, in the main street of the city, tried to buy the unit with the capital of some local entrepreneurs and detach it from the company. Although this was not accepted, the uncertainty and delay generated prompted some ten to 15 people, i.e. the best-qualified mechanics, to leave the company.

Of the purchasing price of HUF31 million, HUF0.6 million was needed from the employees as cash own-capital, the rest, i.e., HUF30.686 million was financed through an E-loan. The interest rate was half the basic rate of the Central Bank, redemption being due six years later with a one-year grace period. Redemption would be paid from company profits and according to the decision of the company assembly, if the profit of the company so allowed, redemption would be accelerated at the expense of dividends. No personal guarantees were needed, the company assets were recognized as collateral by the bank.

All employees with more than one year's employment were entitled to buy shares. The legal requirement for own-capital (2 per cent) for E-credit was set higher, because management wished to enhance ownership. The theoretical minimum of HUF5,000 was thus increased to HUF36,000 (which is the equivalent of about two months' salary); the ceiling for any individual shareholding was set at HUF 120,000 own-capital to prevent concentration in the hands of a few. Finally, 38 of the total 97 people took part in the transaction. Zelka is a good example for a successful employee buy-out transaction, with regard to the restructuring of the company, the consolidation of its financial position and to debt servicing.

The company paid a certain price for its success because it could no longer benefit from a new E-credit.

Zelka had a pioneering role in employee ownership in Hungary: the buy-out was made prior to the enactment of the ESOP law and intended as a rescue operation, initiated by management to prevent outside groups from buying the company's assets.

Employees and management together managed to preserve the integrity of the company and thus their jobs. Management pushed through its privatization concept at the SPA and hired a consultancy firm to draw up the company appraisal and a business plan. The employees were informed and involved in the process.

2.5 Junior Catering Plc

Junior Catering Plc is a medium-sized company with registered capital of HUF560 million (100 per cent state owned), sales revenue of HUF3,000 million annually, and approximately 1,100 employees, 84 per cent of whom are unionized (i.e. the Union of Catering Trade Workers).

Junior Catering Plc is the market leader in the catering sector in Budapest, where it offers 120,000 food deliveries per day.

The company was transformed into a share company in July 1993. The first general meeting of the ESOP organization was held on 1 October 1994. The Court of Registration registered the ESOP in early 1995. In the second phase of the privatization process, the state privatization organization turned down the bid from a consortium formed by the Municipality of Budapest and the ESOP organization. Junior Catering Plc is at present one of the companies with simplified privatization status.

III. Social partner organizations

in the privatization process

1. Employers' federations

There are 11 employers' organizations in the country, all of which take part in the work of the National Committee for the Reconciliation of Interests (NCRI) set up on a tripartite basis. A subcommittee of the NCRI deals with privatization.

1.1 National Federation of Hungarian Industrialists (MGYOSZ)

The National Federation of Hungarian Industrialists (MGYOSZ) was founded in 1990 to represent private Hungarian industrialists. MGYOSZ is the second largest employers' federation of the country. Most of its members are large private firms which emerged from successful small and medium-sized enterprises of the 1980s; there are also some privatized firms among them. The main criterion for membership is size.

MGYOSZ took part in the preparation of several privatization laws (e.g. ESOP law, privatization law).

MGYOSZ wanted a clear legal regulation for MBO with similar preferences to those of ESOP and opportunities for property management (like the model of the East German "Management Kommandit Gesellschaft" of problematic state enterprises, which could not be privatized directly.

MGYOSZ did not carry the day with these ideas. As a result the role of management in privatization and property management is a matter of case-by-case court decisions or is linked to other laws, such as the ESOP law.

A major obstacle to any form of employee ownership is the very low mobility of enterprise shares, with the exception of around 20-30 papers traded on the stock exchange. Most company shares have no market value and cannot be traded, which makes them less than

attractive to employees. To overcome workers' reluctance to become involved in an ESOP, MGYOSZ advocates cooperation among workers' organizations (trades unions, works councils) which have a key role in this matter.

This alliance can best be forged to stave off outside investors who may seek to buy the company because of its markets and not because of its production potential. Other dangers could be interference from the State Property Agency in internal company matters (e.g. sacking the management or appointing someone over the present management).

Confrontations between management and employees sometimes generate opportunities for outside investors to win the privatization tender. The PISZKE Paper Factory is a case in point: it was a very profitable, smooth-running company where both management and employees lost their ownership when a Greek investor, taking advantage of internal conflicts in the company, bought out their shares.

MGYOSZ itself does not actively assist ESOP organizations, for example, in preparing business plans or privatization tenders. MGYOSZ thinks that this is the role of management and consultants.

MGYOSZ does help ESOPs through discussions about the role of management in privatization and by sharing the experience gained from already privatized companies with affiliates.

In conclusion, one finds that in Hungary the role of workers' organizations in the privatization process (and in the preparation and execution of an ESOP purchase) is not very formalized. The authority for the preparation and presentation of the ESOP bid rests with the ESOP organization. Still, labour representatives have a role to play in the preparation of employee buy-outs until the ESOP organization has been established. To what extent this is effective depends on individual initiatives, whether from management or labour representatives, or both. The chairperson of the ESOP organization is elected by management and workers, but in practice he is a former manager.

Works councils do not have a formal role in the preparation of an ESOP.

Works councils were created from above by law in 1993. Trade union representatives predominate. In the cases surveyed here works councils are 100 per cent unionized.

Applied to the stages of an employee ownership scheme, the influence of works councils/resp. unions can be graded as follows:

Stage of ESOP preparation	Level of influence of employee representatives (from 1 to 6)
Purchase intention	Were an influence, more than management
Gaining employee support for an ESOP bid	Dominant position

(25 per cent and 40 per cent support)	
Establishing the ESOP organization	Were an influence, more than management
Preparing feasibility study	Equal influence with management
Negotiations with banks	Some influence
Preparing purchase offer	Equal influence with management

Among the various trade union organizations in Hungary, there is wide support for employee ownership in privatization.

The effective support of employee privatization depends on the scale of capital involved in particular sectors of activity and on the profitability expected.

1.2 National Federation of Employers

The National Federation of Employers was founded on the basis of the Hungarian Chamber of Commerce. It is the biggest employers' federation in Hungary, concentrating its activities on the national and sectoral levels and participating in several tripartite bodies. With regard to the participation of employees and management in privatization, the National Federation of Employers strongly cooperates with other employers' federations (such as MGYOSZ).

2. Workers' organizations

2.1. The National Association of Hungarian

Trades Unions (MSZOSZ)

MSZOSZ is the successor to trade union organization under the communist regime. From 1990, it started to convert to a pluralistic trade union federation on a democratic basis so as to preserve its dominant position among other trade union federations in Hungary. Although its membership has been halved to about 1 million, it still has more members than the other seven federations put together. Its dominant position shows in representation on the works councils and in the nationally elected bodies of the health insurance and pension insurance funds.

MSZOSZ played a key role in representing employees' interests in the discussion of the laws regulating privatization. MSZOSZ functions with regard to privatization are as follows:

-- to ensure trade union rights at the macro-, mezzo- and micro-level and at all stages of privatization;

-- to raise (or preserve) income and employment levels and to improve working conditions for employees in privatization;

-- to promote employee ownership;

-- to participate in decisions concerning the distribution of privatization revenue.

MSZOSZ had its views reflected in key instruments:

-- the Law of 1991/119 on the conversion of state enterprises, which stipulates that employees have a right to be kept informed of enterprise conversion strategies, and that the opinion of employee representation must be sought for the approval of company strategies;

-- Privatization Laws of 1992 (LIII, LIV, LV) which extended employee rights concerning privatization, such as employee ownership. The law of LIV, 1992, also gives the unions the right to co-determine the sale of enterprise welfare facilities;

-- the ESOP law (1992) and the Privatization Law (1995).

In 1991 MSZOSZ demanded that 15 per cent of privatization revenue should be used for the creation of new workplaces. Although an agreement was reached in the NCRI, it was not fulfilled.

MSZOSZ has other opportunities to influence the privatization policy of the Government because in Parliament it has a number of MPs on the government bench.

The NCRI privatization committee is a major forum for the discussion of privatization issues with the Government and employers. In addition, MSZOSZ is a member of the Board of Directors of the SPA.

Another opportunity for influencing privatization is participation in the Privatization Committees of the SPA (or its successor, the State Property and Privatization Co. Ltd.).

Practical assistance from MSZOSZ to employees in actual privatization transactions is channelled via the "Interest Defence Consultancy Service (ETOSZ)" (see section below).

The Metalworkers' Union, also issued a guide with the title: "How to establish an ESOP organization".

The biggest problem in representing employees' interests in privatization matters is the weakness of unions and works councils at the plant level. MSZOSZ cannot help directly, as each organization has to fight for its interests on the shop floor.

2.2 The National Association of Autonomous Trades Unions

The National Association of Autonomous Trades Unions accepts and supports privatization as an essential part of economic change, and has no reservations about the acquisition of property by foreign investors. It also supports the acquisition of property by employees, i.e. the ESOP as an avenue towards this goal.

The National Association of Autonomous Trades Unions participated in the work of the NCRI on the codification of privatization laws.

In the early 1990s, the main argument of the National Association of Autonomous Trades Unions was that property acquired by employees was a form of compensation, since state

property had been built up chiefly by the employees. However, subsequently, the main role of the National Association of Autonomous Trades Unions was to help save workplaces.

Moreover, the unions had to confront the fact that two categories of companies were exempted from privatization laws, i.e. those of strategic importance, and others with insolvency problems. When the national oil company was privatized, the Government wanted to provide employees with shares worth only 3 per cent instead of the 10 per cent employees' ownership laid down by law. This subsequently rose to 5 per cent as a result of negotiations between the unions and the Ministry of Privatization.

The National Association of Autonomous Trades Unions works primarily through the Branch Committees on Privatization within the National Committee for the Reconciliation of Interests. Another avenue is the unions' membership in the Board of Directors of the State Property Managing Institution.

At the company level, the unions operate through the works councils.

At the plant level, conflicts arise not so much between employees and management but between employees and the SPA. In this area, local unions have difficulty in making the employees' interests heard. The employees' right to information is prescribed by the Privatization Law, which further stipulates that items concerning employment within privatization transactions (i.e. wages, employment collective bargaining) must be discussed with and cleared by employees' representatives. In practice, however, the SPA shifts this obligation to the management of the companies concerned. However, trade unions have no veto rights.

2.3 Interest Defence Consultancy Service (ETOSZ)

ETOSZ is a business association founded mainly by trade unions as a non-profit organization. It regularly publishes information bulletins, organizes training courses and contributes to numerous lectures and conferences so as to inform member organizations of various Hungarian trade union confederations and works councils at the company level.

Management is usually in contact with the state ownership (holding) organization not the works council. In some rare cases, the initiators of employee buy-outs have turned directly to the state ownership organization.

To compensate for a relative lack of information on privatization matters, ETOSZ regularly publishes bulletins within the unions' information system to reach employees. The bulletins cover two main topics: (1) what rights do employees have and what are the obligations of employers to provide information in the privatization process? (2) What are the options for employee ownership, what are the advantages and drawbacks in each case?

However, applied to a specific company, ESOP unions and company councils are usually not prepared to assess these possibilities and it is up to consultancy firms to carry out a proper evaluation.

Often ETOSZ has to inform employees about the risks of being manipulated in the course of an ESOP or EDO. Outside investors and/or management occasionally encourage a partial preferential employee buy-out because this lowers their capital requirements and means

indirect access to a subsidized E-loan. Soon after the transaction, they buy out the employees who are usually quite satisfied with the extra cash obtained.

ETOSZ provides its services for a fee, which is still below that of commercial consultants. ETOSZ expertise lies in privatization techniques, rules of tenders, ESOP statutes and bylaws and preparing tender applications.

Unlike commercial consultancy firms, ETOSZ has informal contacts with banks.

ETOSZ has close contacts with the various departments of the state privatization (holding) organization, primarily through the employee delegate on the Executive Board of SPA. ETOSZ found the appropriate company size (i.e. a workforce of approximately 300 people, and equity of HUF500 to 600 million) that makes a company most suitable for an employee buy-out.

ETOSZ also sees a future for another scenario, namely where employees become entrepreneurs as a consequence of job loss. Many people have become entrepreneurs involuntarily. Their bosses tell them "you have received the final compensation for lay-off, now establish your enterprise, buy the appropriate tools, you can rent the workshop, etc." ETOSZ also assists these involuntary entrepreneurs.

2.4 National Association of ESOP and MBO

Organizations and their companies

The involvement of employees' organizations in privatization is regulated under section 65 of the Labour Code and various articles of the privatization laws: right to receive information, right to express views, right to approve a decision, etc.

In practice, however, these rights are not fully or consistently exercised. This is partly because of the position in which trade union officials have been placed.

In large companies, for instance in public utility firms and their subsidiaries, where privatization is under way, independent, full-time trade union staff from outside the plant can represent employees' rights more effectively because they can take more risks.

But with the decrease in union membership, the number of independent trade union staff also declined.

In smaller enterprises where only in-plant works councils operate, employees -- and trade union activists -- fear for their jobs and therefore do not insist too loudly that the legal provisions on information rights be duly respected.

Another reason is that management can cover privatization costs, i.e. the fees of external experts, with company resources. Trade unionists cannot do so, unless management is in favour of an employees' buy-out. It is in this situation that the ESOP association can help out.

The association was founded in 1992 when the first ESOP law took effect. It represents 60 member ESOP organizations (30 per cent of all ESOPs) and 31 employee-owned companies.

Its main objective is to represent employee-owners' interests as efficiently as possible in the field of legislation, privatization and other spheres of the economy.

The association offers employee-owners, their ownership organizations and societies both representation and technical assistance.

In this respect the association monitors legislation, participates in the drafting of employment-related laws and initiates amendments to laws that are disadvantageous for employee-owners.

The association provides technical assistance free of charge to its members in legal, accounting, management, taxation and other matters and regularly organizes an *exchange of experience*.

The association offers *training* at a 50 per cent discount to members (outsiders have to pay the full price) in the following topics:

-- requirements and the implementation modalities of privatization;

-- tender application and preparation of an offer;

-- legal, accounting, management and taxation for the representatives of ESOP organizations.

Since the establishment of ESOP organizations in Hungary, the association has been regularly organizing training programmes. For beginners (for people from companies in which employee buy-out is at the planning stage) the association holds sessions about the work preparatory to submitting a tender application. For advanced groups (for people from companies having concluded successful buy-outs), it offers seminars in which the participants find out how to carry out the financial, accounting and administrative tasks of an ESOP.

The association helps members with the feasibility calculations according to a model drawn up in accordance with general legal and financial standards.

With few new ESOPs expected, the association is concentrating on advising existing ESOPs. However, the costs of this activity can no longer be financed from membership fees. This is why the association is seeking additional financial resources to broaden its interest representation, training and consultancy activities.

2.5 The Share Participation Foundation

The Share Participation Foundation (SPF) was founded in 1989 to promote the potential of companies and the democratization of the Hungarian economy **through employee ownership and participatory management**. To this end, the Foundation is involved in creating the appropriate legal and organizational environment; it also assists companies in becoming employee-owned and offers technical support and information concerning organization development, training and participatory management. SPF organizes seminars and group training sessions for employee-owners, so as to enhance their economic and business knowledge. SPF engages in research in the field of employee-ownership in Hungary, shares and exchanges experience with experts, company managers and employee co-owners, collects domestic and international literature and disseminates information about it. SPF regularly publishes its ESOP Newsletter and other information materials ("Piece of the Action" -- video

film, "100 Questions and 100 Answers about ESOP", "How to be an Owner", etc.) for the ESOP community.

IV. National Commerce and Credit Bank

(Department for Privatization Credits)

The National Commerce and Credit Bank (OKHB) is the third largest Hungarian commercial bank, which also ranks third in privatization finance. Out of the 202 ESOP transactions, 40 were financed by OKHB.

Privatization loans ("E-loans") for private Hungarian investors, ESOP organizations or for their consortia have attractive conditions with minimal (2-5 per cent) own-capital requirement, interest rates of 3 per cent (plus 4 per cent bank fee), compared to market interest rates at times between 30-35 per cent. E-loans have a grace period of three years and a redemption time of ten years. Commercial banks are refinanced by the National Bank, but they bear their own risk in the transactions.

Commercial banks have a key role in preferential privatization, thus in employee management buy-outs as well. Their loan commitments are essential preconditions for participation in a privatization tender.

To protect against the risk, banks require their client firms to provide real estate as collateral, and in many cases shares in equity and board membership as well. This means privatized debtor firms have mortgages on their real estate, which may reduce the chances for further credits for investment and working capital requirements.

The bank's interest is to gain new clients, provided the company keeps its accounts with OKHB.

Bank experts take an active part in the elaboration of the privatization bids and especially of business plans.

The bank prefers loan applications where the management has a decisive role (which is usually the case) and, if possible, it also likes to see an outside investor in an ESOP-led consortium. Depending on the equity provided and repayment schedule, a profitability of 10-15 per cent is needed to make an ESOP feasible.

Experience shows that initially (1993), business plans were mostly prepared by the ESOP organizations themselves, but in the last two years the role of consultancy firms has increased. Without exception ESOP organizations are coalitions of employees and management.

The bank's negotiating partners are usually the managing director and the economic director. In the last year, the role of consortia with the participation of outside (financial) investors has grown.

The bank sees the basic problem of employee buy-out as being the dual role of the employee as both wage-earner and owner. The main motivation of employees in obtaining equity is to keep their workplaces. On the other hand, their interest in maximum wages clashes with their

role as owner. The bank watches carefully to see whether ESOP management drains the firms' resources in the form of wages.

V. Conclusions

Employees' representatives discovered only slowly the opportunities offered by the new legislation on privatization. Trades unions and the associated consultancy services, non-profit organizations and professional associations have been active in disseminating information about employee ownership, often with the support of the State Property Agency. However, the information provided is not sufficient to enable employees to implement a successful property acquisition.

The preparation of a good feasibility study is essential for the credit application and tender bid. Top managers, given their position, are better informed about the enterprise's financial situation, market conditions and in many cases their company's future. They are, therefore, better placed to assess whether a feasibility study makes sense or not.

Middle managers get only a partial view, but at least they can find ways to gather business-related information.

How frequently and in what detail shop-floor employees get information about the operation of their company depends on how good the working relationships are. In general, and especially in state-owned companies, top managers give works councils only the information which the Privatization Law and Labour Code specifically requires them to provide. Even if employees are informed, for lack of basic legal or financial knowledge, they cannot really understand and interpret the information. This explains why workers have adopted a rather passive attitude to privatization. Their first concern is to keep their jobs and maintain the purchasing power of wages. Still, employees are able to consider the possibilities and conditions of participation in the privatization process. They can decide who can best represent their interests in the buy-out.

As the privatization process is almost over in Hungary, the focus of attention is shifting as a matter of course to those enterprises that have already undergone an EBO, MEBO or ESOP. The formal completion of the ESOP does not mean that all ownership and performance-related problems have been solved. The ownership organizations still need advisory support on how to operate efficiently, how to cooperate and how to improve corporate performance within the framework of their specific ownership structure.

At the present stage of privatization in Hungary, basically two types of assistance appear to be needed in support of employee ownership.

1. Consultancy services for acquiring state property

Drawing up a tender application, organizing workforce participation, launching the ESOP organization, reviewing legal and regulatory issues, preparing statutes and feasibility studies, negotiating with the privatization agency, banks, outside investors, etc., concluding consortium contracts, concluding contracts on share acquisition or the buying of business shares, training in legal, accounting, management and taxation matters.

2. Organizational development to help ESOP companies

-- Development of internal communication systems.

-- Education covering employee ownership, business literacy courses, finance, skill formation in group problem-solving, and cooperation.

-- Participatory management, and incentive-based personnel management.

Existing organizations (e.g. Interest Defence Consultancy Service, ESOP National Association, etc.) operating in this field should be supported to widen, deepen and upgrade their assistance to more ESOP enterprises.

An ILO workshop may be useful to define in greater detail the potential role, constraints and contributions of the ESOP support agencies in Hungary.

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