Companies in the transformation process

Companies in the transformation process

- For a development of the Czech economy was very important a development of business sector.
- The position of business sector in the Czech economy was determined by
  - The privatization
  - The development of banking sector
  - The development of capital market

Situation in companies at the beginning of the transformation process

- At the end of the 1980’s in Czech companies were concentrated several problems:
  - Ineffective production supported by government aids
  - Wasting of resources: employees, row materials
    - over-employment about 15%
- The production was
  - uncompetitive in world markets and thus
  - exported only in shallow eastern markets
    - It these markets was considered to be a high quality production
- That all led to decreasing of the labour productivity
  - The Czech industry achieved only 80 % productivity of developed countries because of old-fashioned equipments and weak labour organization.

Situation in companies at the beginning of the transformation process

- Previous negative effects were caused by a negative motivation of subjects
  - Collective proprietorship
- And led to maximalist of imputes and limitation of outputs.
- Whole economy was deformed by
  - orientation in industry (heavy and army industry)
    - Without sufficient technology or natural resources
  - Monopoly structure in all sectors
  - Indebtedness of companies
    - 80% were near bankruptcy

Impact of reforms on companies

- Liberalization of trade
  - Custom duties were limited in 5 % and domestic companies faced foreign competition
- Monetary and fiscal restriction
  - Difficulties in credit granting
  - Stopping of state aids for companies
- In business sector ruled an anarchy
  - State did not control of management in state companies

Support of companies by government

- Postponed bankruptcy law
- The state control of wage growth
- The pressure for banks to grant credits for companies
- With the liberalization of trade came into effect import additional charges
- Liberalization of prices lowered real interest rates in negative value and inflation erased part of debts in companies.
- Government established Consolidation bank that
  - Overtake part of company bad loans from previous regime

Support of companies by government

- Government policy to companies was not neutral.
  - On the one hand
    - Increase of competition
    - The pressure for companies to be effectiveness
  - On the other hand
    - Companies got time to change quality of their production
- Government afraid of misusage of new economic clime by monopoly structure and though that s necessary to companies faced them by a competition.
- Government wanted to companies orient to demand site of the economy
  - The customer demand was in that time satisfied only by foreign importers.

Support of companies by government

- There are no doubts that impact of reform on companies was serious.
- Domestic problems were accompanied by break up of eastern market e.g.
    - CKD Praha finished in 1989 new assembling line with production of 1800 trams per year (1989 there were produced of 950 trams) but after splitting of eastern markets in the 1990's total volume of tram sale was only 13 trams per year.
    - Because of eastern market break up, CKD production collapsed and total volume of trade decreased in 13 trams in 1991.
  - Other example
    - In 1989 in Czechoslovakia was made 73 million pair of shoes.
    - 75% of production was exported.
    - In 1995 shoes production was decreased in 25 million pair of shoes and 80 % export.
  - Other example: the car producer Tatra Koprivnice
    - Collapse of Russian oil industry
    - Debts 4 billion CZK

Shoe industry in the Czech Republic

	1989	**1996**	**1999**	**2001**	**2003**
Shoe production / in million	73,1	25,7	13,5	12,5	7,0
Import / in million	10,9	23,8	30,0	35,9	44,5
Number of employees in the industry / in thousand	36,0	23,0	10,5	9,5	7,8

Support of companies by government

- Because of all troubles the pressure for the government was growing.
  - To grant state aids
- Companies reacted to this new situation with
  - Growing of intercompany debt
  - Had no will to pay supplier loans that the suppliers got in secondary insolvency

Companies debts

	Bank loans / in billion	Intercompany debts / in billion
1989		
12/1989	530,8	6,6
1990		
6/1990	533,5	14,5
12/1990	536,0	46,8
1991		
6/1991	611,3	123,5
12/1991	646,8	170,6
1992		
6/1992	654,0	170,2
12/1992	628,7	

Set up of new companies

- One of the most important modification after 1989 was the liberalization of the business activities.
- In early 1990 was adopted act that legalize
  - Private enterprise
  - Private proprietorship
- This reflected in immediate growth of enterpriser number.
  - In 1990: 157.574 individual enterprisers
  - In 1991: 1.423.000 individual enterprisers

Set up of new companies

- Development of individual enterprisers reflected two factors
  - Small and large privatization
  - Easy conditions for setting up of new companies
    - For a Ltd. Basic capital 100.000 CSK
- During small privatization occurred liberalization of a lot of subjects and similar during large privatization.
  - Privatization projects led to brake up of large monopoly structure and establishing of smaller units.
- Initial purpose was loosen private business
  - At the end of decade condition were getting difficult
    - ↑ Administrative costs
    - ↑ Limitation of a business

Restructuring of companies

- Growing number of companies
- Orientation of foreign trade in western markets
- In modern economy structure dominate services approx. 70 % lower is the share of industry and the lowest is the share of agriculture.
- In the Czech economy decrease the share of agriculture and industry and increase the share of services.
- The Czech economy achieved modern structure in 1991 when the share of services was higher than the share of industry.
  - The reason of this was decline of industry that was strongly effected by the transformation process.
  - At the beginning of transformation process the share of industry was high.
  - Heavy and army industry was replaced by car industry, aircraft industry or electro technical industry.

Restructuring

- Very significant was decline in agriculture
  - Employment decline about 60% in 1990-1999
  - And thus productivity in this sector rose for two times
- The share of services in GDP was growing
  - In the initial phase of the transformation the growth of services absorbed large share of unemployment.

Foreign trade

Situation before 1989

- Foreign trade realized with
  - Export and import plans
- Foreign trade was realized by the companies of foreign trade.
- In 1990 in Czechoslovakia existed only 52 companies traded with foreign countries.
- Main export markets
  - Eastern markets of communism countries (60-80 % of exports)
- In eastern market were exported products with so called “higher added value”
- From western markets were imported also products with “higher added value”
  - Technologies
- From eastern markets were imported row materials
- Czech economy was relative closed, share of exports to GDP was only 19,4 %.

Liberalization of foreign trade

- All important steps for liberalization of foreign trade were realized in first two years of transformation.
- The most important shifts
  - Internal convertibility of Czech currency
  - Decreasing of custom duties in level 5 %
  - Implementation of import additional charges of 20 % to protect Czech market in first years of transformation.
    - This additional charge was applied in all consumer goods
    - In 1992 decreased from 20 to 15 % and later in 1992 was cancelled.

Liberalization of foreign trade

- At the end of 1991 was made a deal with EC (the European Communities) its part was so called asymmetric liberalization
  - EC immediately cancelled 70 % of barriers of Czech imports and the rest was liberalized in next 5-6 years
  - Czechoslovakia cancelled only 20-25 % of all barriers for import from EC countries and the rest was liberalized during next 9 years.
- State aids for exporters were limited because government did not support interventions in market economy.
  - Exception was establishing of EGAP (Export, Guarantee and Insurance company)

EGAP

- The insurance company focused on insurance of export risks related with export of goods and services from the Czech Republic.
- EGAP provided insurance services for all exporters of Czech goods.
- EGAP was established in 1992 and it is fully owned by state.

Changes in foreign trade

- In the 1990's got significant growth of foreign trade
  - From 339 billion CSK in 1990 to 2.800 billion CZK in 2003.
- Nowadays Czech economy is considered to be one of the 12th most open economies in the world.
- The basic change was shift of foreign trade from eastern markets to western markets that occurred in 1990.
- Sectional changes
  - Permanent growing of imports from other countries with transitive economies e.g. China
  - Growing of exports in western countries with share about 80 %

Changes in foreign trade

Country	Export in %	Import in %	Difference in billion CZK
Germany	36,1	40,4	50.360
Slovakia	6,8	7,7	11.340
Austria	5,4	6,0	5.514
Russia	4	1,3	- **65.320**
USA	3,7	2,8	- 23.390

Significant deficit with Russia is because of oil and gas imports

Changes in foreign trade

- In transformation period was changed the commodity structure of the foreign trade.
  - Imports
    - Decline of consumer products and imputes – row materials
    - On the other hand increase of imported machines and traffic facilities. This group represented the most significant share of Czech imports.

  - Exports
    - Decline of machines and equipments – traditional Czech exports in first phase of transformation
      - This products were uncompetitive in developed markets and
      - Decline of this product demand in former central planned countries.
      - Growth of exports of row materials and intermediate products
      - In second half of the 1990's Czech exports returned in their traditional structure of exports with high share of machines and facilities that achieve higher level than before 1989.

Inflow of foreign capital in the Czech Republic

- The inflow of foreign capital was based on economic characteristics of the Czech economy
  - Rapid economic growth
  - Confidence of foreign investors
  - Macroeconomic and political stability
- Direct foreign investments
- Portfolio investments
- Attitude of the Czech government to foreign investments was double-faced.
- On the one hand was evident need of
  - Foreign capital, knowledge and management experiences
- On the other and
  - Representatives afraid about sale of Czech assets in foreign companies
  - Representatives were skeptical to specific business conditions for foreign investors

Direct foreign investments

- As direct foreign investments are considered deposits of foreign investors in Czech companies in the value of at least 10 % of basic capital.
- The main condition is permanent interest of investor about management of company.

Direct investments

- Total value of direct foreign investments in the Czech Republic got 1,2 billion CZK in 2003 (51% of GDP)
- In the Czech Republic existed 55.000 foreign companies with 1.200 subsidiaries
  - Volkswagen, Philip Morris, ABB, Ford, etc

CzechInvest

- In 1992 was established the agency CzechInvest.
- Main aim
  - Promoting of the Czech Republic as an ideal place for foreign investments
  - Administrative support of inflow foreign investments in the Czech republic

Investment Invitation

- Investment invitations were introduced by left oriented government of Milos Zeman in 1998.
- Was opened for Czech as well as foreign subjects.
- Initial subject investment at least 25 million dollars (was decreasing later) limited a lot of domestic subjects.
- Investment Invitations included
  - Tax advantages (till 10 years)
  - State grants for establishing of new working positions
  - Grants for scholarships or requalification
  - Discount for selling of state property
  - Zero consumer duties for import of technologies, etc

Investment Invitation

- Criteria for an acceptation of Investment Invitation
  - Direction of investment in production at least 50 % financed machines had to be on government list of high tech machines
  - Building of a new factory of modernization of an old factory
  - Sufficient share of investor property value to the value of investment as a whole

Investment Invitation

- Direct foreign investments came during the 1990’s especially from Netherlands, Germany and Austria
  - 65 % of all direct investments

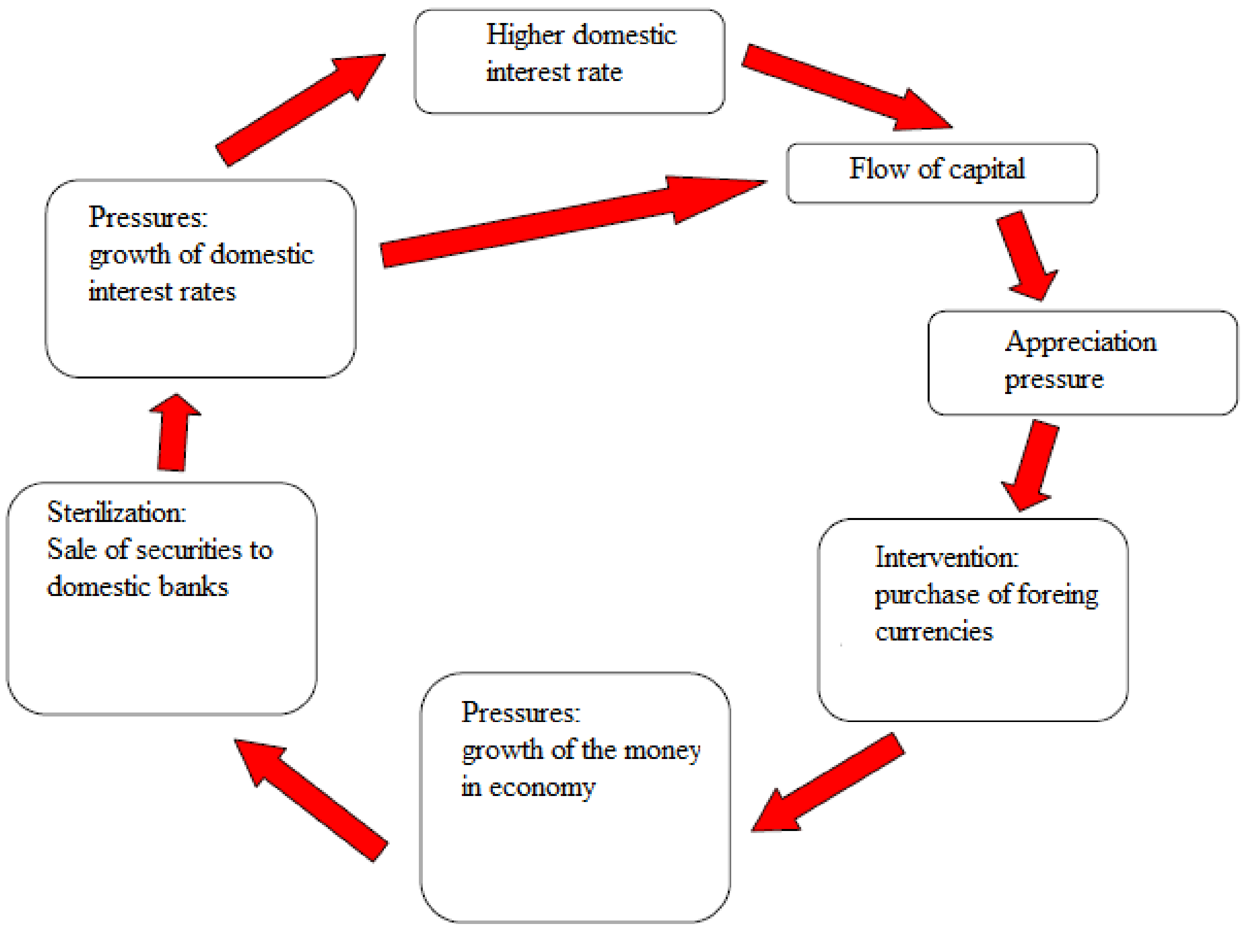
Portfolio investments

- Fluctuation of portfolio investments in Czech republic because of changing of investors interest about Czech securities.
- In 1996 decrease of interest about Czech securities and thus decrease of foreign investments.
- In 1999 and 2000 increase of interest about Czech bonds and growth of portfolio investments.
- Decrease of portfolio investments because of Asia crisis and Crisis in Russia.

Portfolio investments

- Short-time portfolio investment are generally very volatile.
- In the Czech republic were several factors that attracted investors
  - High interest differential because of fixed exchange rate in 1993 and 1995
    - After spreading of Czech currency fluctuation belt decrease of foreign capital in 1996

Short-term foreign capital



Long-term capital

- 1993 -1997 significant growth of foreign long-term capital
  - In the form of bank loans
- Different situation 1998
  - In the time of economic recession
  - Decreasing of demand about investments
  - In bank concentrated free financial resources and was not necessary to invite foreign capital.

Legislative in case of company bankruptcy

- Economic basic of bankruptcy consists in possibility of resources reallocation.
  - If company gets in trouble and gets bankruptcy:
    - The new owner of company property is able to use company resources more effectively.
      - Bankruptcy is a process of cleaning the market structure from ineffective companies.
      - This process is running all the time but in the time of economic crisis the number of bankruptcies is growing.
    - On the other hand bankruptcy offers possibilities for creditors to achieve their rights. The quicker bankruptcy process the higher probability for creditors to get redemption of their costs.

Legislative in case of company bankruptcy

- If in economic environment does not go bankruptcy
  - Company in trouble increase its liabilities and troubles deepen.
- Slow bankruptcy process of Czech companies had negative impact on other sectors
  - Banks
  - Restructuring of companies

Legislative in case of company bankruptcy

- At the beginning of the 1990's majority of the companies were near economic collapse.
  - 80 % in bankruptcy
  - Without possibility to get credit in market oriented economy
- But development of number bankruptcies did not reflected this situation

Legislative in case of company bankruptcy

Year	Number of bankruptcies
1992	1
1993	66
1994	294
1995	727
1996	808
1997	1251
1998	2022
1999	2000
2000	2491
2001	2473
2002	2155

Development of bankruptcy law

- Bankruptcy law was point of view for several times since the beginning of the 1990's.
  - At the first in 1990
    - The law was postponed because of general fear about mass bankruptcy of companies and strong growth of unemployment.
  - Next time was slowed process of companies bankruptcy related with slow process of company restructuring
  - Third time in connection with the mention of cohesion of banking sector and companies after privatization process
  - At last one after crisis in 1997 and whole wrong institutional environment

Development of bankruptcy law

- Bankruptcy law was criticized since the beginning of transformation process.
- Execution of law was postponed form companies designed for privatization process till 1993.

Development of bankruptcy law

- Main reason for careful approach to bankruptcy was fear about
  - interruption of privatization process
  - Cascade effect – one bankruptcy led to bankruptcies of other related companies.
- As a result all bankrupt discussion was the legal regulation that protected debtors.
  - It is a proof that Czech government did not want to company went bankruptcy.
    - In Czech republic bankruptcy law postponed for two times in contrary to situation in Hungary 3.500 bankruptcies in 90 days after adopting of bankruptcy law.

Development of bankruptcy law

- Bankruptcies got in point of view after privatization process.
- Banks keep alive a lot of companies that should have gone bankruptcy
  - Relation between banks, investment funds and companies was considered to be a reason of banks unwillingness to adjudge of adjudicate in companies.
- The main consideration was following
  - If small banks let company go bankruptcy
  - This bank lost assets of this company collected in bank’s investment fund
- Large banks were state and did not initiate bankruptcies because of fear about growth of unemployment.
  - I led to the situation when banks granted credits because bankruptcy process was slow.
  - Market value of securities were more lower than value of liabilities.
- First large company that went bankruptcy was Poldi Kladno in 1998 and then Chemapol in 1998.

Development of bankruptcy law

- Government policy in bankruptcy was very careful.
- The government position was problematic
  - About 80 % of all companies in fact in bankruptcy
  - But government had to cleaned economic environmental from ineffective companies.
- The low number of bankruptcies at the beginning phase of transformation
  - 66 in 1993
  - 294 in 1994
- shows that whole process was long and incorrect.
- The number of bankruptcies should have been higher especially in years of economic growth 1994-1996 to cleaning of economic environment.
- The result was that government kept low level of environment and problems spread in banking sector.

Thank you for attention