

## Squeeze play: a case from the Hungarian privatisation\*

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*Privatisation of a state-owned enterprise is an acquisition by private investors from the state. In this article we present a case history from the Hungarian privatisation. For an adequate understanding of what privatisation is about, one needs to look at behavioural issues arising at the level of organisations undergoing privatisation. This should also be informative to any case of acquisitions, economic system regardless. We have found that in this case, chiefly due to the superior bargaining power of the acquirer, the privatisation process went relatively smoothly. In return, the firm could enter its post-privatisation era without those handicaps that typically resulted from intense external and internal politics in several other cases we studied.*

*Die Privatisierung von Unternehmen kann als eine Akquisition durch einen privaten Investor angesehen werden. Dieser Artikel präsentiert hierzu eine Fallstudie aus Ungarn. Um den Privatisierungsprozeß zu verstehen ist es notwendig, die verhaltensbeeinflussenden Faktoren auf Organisationsebene zu betrachten. Dies dürfte für jede Form der Akquisition, unabhängig vom jeweiligen ökonomischen System aufschlußreich sein. Im vorliegenden Fall sorgte vor allem die Verhandlungsmacht des Investors für einen 'sanften' Ablauf des Privatisierungsprozesses. Das Unternehmen erreichte seine heutige Position ohne die typischen Behinderungen durch externe und interne politische Auseinandersetzungen, wie sie von vielen anderen Fällen bekannt sind.*

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## Introducing “Saturn”<sup>4</sup>

“Saturn”, as we shall refer to the subject of the case throughout this paper, became independent of an industry-wide trust in the late eighties. It was engaged in a consumer product industry, produced its own products, but also carried out commissioned business for other firms. It made modest profits on sales of more than a billion forints (US\$ 13m) in 1991. Saturn had one site only, and employed several hundred people.

The firm exported about half of its production, mainly to Western countries. On the Hungarian market it had about 15 per cent market share in its main product line. More than 80 per cent of its products had been produced for more than 20 years. From the early nineties, Saturn had to face decreasing domestic demand and growing competition. A sensitive point of the operations was the commissioned business, a highly profitable but volatile trade. The firm was run by a General Director, appointed in 1985 in his late thirties and confirmed in his position since then several times. He chose the other members of the management team.

## The management’s initiative

The management started preparatory discussions with the Ministry, the SPA, domestic business partners and foreign potential investors in 1990, but only in October 1991 did it submit a Transformation Plan with an (updated, then revised) asset valuation to the SPA. They planned to convert the firm into a joint stock company with shareholders including the SPA and the firm’s business partners. “There were examples that served as a pattern, but the Ministry profoundly objected to cross-ownership”, explained the General Director. Transformation was planned to take place at the beginning of the next year, to be followed by a sale of shares to and an increase of the registered capital subscribed by foreigners, who would eventually hold a 30–40 per cent interest. Financial investors were preferred to “strategic” ones, admittedly because they were thought to have no intention “to influence the company’s economic

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<sup>4</sup> Quotes throughout this case are taken from a wide range of interviews (with state officials, company managers etc.) and documents (including Information Memorandum, bids, minutes taken at various meetings; advisor's reports, briefs and proposals, internal memoranda, contracts and agreements, financial reports, correspondence between parties involved).

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activity". The management held firm views as to what they wanted to do with the new finance. The General Director stated at a workers assembly that "we shall use the capital provided by the foreigners to pay back short term loans, to modernise and enlarge storage facilities, and to improve technology". He also argued that "When most of the country's enterprises are becoming joint ventures of mixed [domestic and foreign] ownership..., if we stay out of this process, that would necessarily lead to loss of markets".

Further discussions with the SPA and the Ministry followed, and went on until February 1992, turning the original Transformation Plan upside down in a period that the General Director described as "rhapsodic [i.e. erratic]". It appeared that state agents intended to put recommendations of corporate governance textbooks to practice. Evaluating Saturn's Transformation Plan in March 1992, the Ministry could already refer to "reconciliation in the meantime" which had resulted in giving up the "debatable cross-ownership solution". Instead, the SPA would have 96.3 per cent interest and a municipality 3.7 per cent. At the same time the SPA determined that there should be only a three-strong Board, with two outsiders one of whom being the Chairman, as opposed to the management's proposal of six board members that would have included the top management.

On the issue of "real privatisation" in the second step, the ministry supported 40 per cent foreign interest "only if the rest of the state-owned shares can indeed be sold to domestic owners. Besides employee ownership this can be achieved by shares-compensation notes swaps, and farmers' ownership". The Ministry also suggested that a high proportion of the shares should be sold in return for compensation notes and that maximum legally possible discount should be granted to the employees in order to create an indigenous "owners class", and that "in order to strengthen [export] market positions ... strategic investors should be preferred to financial ones, contrary to the firm's proposal".

The SPA passed a resolution on Saturn's transformation a few months later, prescribing that employee shares could be issued subsequent to the privatisation, and that 20 per cent of the SPA-shares should be reserved for later sale in exchange for compensation notes (as specified by the provisions of the Compensation Act). The rest were to be offered for sale. When Saturn transformed into a joint stock company, its equity was divided between registered capital and capital reserve in a ratio of about 3:1 ratio.

At the time there already seemed to be interest in the firm. The Hungarian subsidiary of a foreign bank claimed that it could introduce a strategic investor, and requested the SPA to suspend proceedings of Saturn's privatisation for three months while they prepared an offer, and urged the SPA to declare its position because "our commissioner is becoming downhearted". They also asked the SPA to help in obtaining information from the management. Two weeks later the foreign bank again urged the SPA to postpone the privatisation, this time at

top level of the hierarchy, and repeated the complaint that the management was not co-operative. The General Director suspected that the prospective buyers were after only information about Saturn because they had already made an acquisition in Hungary and were competitors. The foreign bank's request was refused on the ground that the SPA certainly could not delay the process for months and grant exclusive rights to the bank for mediating between the SPA and a potential investor.

### **First tender with no success**

A tender for consultants attracted 10 offers that Saturn's top management and its Board of Directors evaluated. The General Director argued that the offers were quite similar, and the decision could only be made on the basis of trust. It must have certainly helped that one bidder had been working with the company on the introduction of the TQM (total quality management) concept. It was also considered an important factor that the consultant should "be able to carry out the privatisation by considering the management's concept", and "the other important factor was the readiness to co-operate". More than two months later the SPA approved the management's choice of a consultant. The Consultant prepared a draft call for investment tender but had to revise it, since the SPA wished to emphasise in the tender announcement that bids from employees enjoying discount opportunities would be treated as equal to bids of "external, or capital-strong investors". It insisted on keeping the opportunity for a two-step tender procedure.

In a review of Saturn's situation at the time of the tender, the company's financial position was said to be "balanced", with no delays in payments. In the second and third quarters of the year, however, some losses were made, casting doubt on the possibility of achieving planned level of pre-tax profits. The management regarded the accomplishment of the profit target as top priority, not only because of the bank's judgement but also because of the forthcoming privatisation. They had introduced measures to improve the situation by restricting purchasing ("only if approved by top management"), monitoring revenues and costs item by item every week, and preparing weekly cash flow reports. Co-operation between marketing and production functions was improved. Yet, the decline of the industry whose products Saturn stored had caused severe problems. In terms of volume, this highly profitable business reduced to a fraction of what it had been in the previous year. In terms of profits, the effect was alarming. "We must prepare for survival", the management declared. In addition, the Western export markets for Saturn's own products had posed larger than expected difficulties. This situation was certainly mirrored in the increased stock of finished products. To alleviate the difficulties, the management had launched sales promotion and cost cutting programmes which previously had not been common practice. Buyers were monitored by making

use of a computer programme, and they were not serviced until outstanding payments had been settled. The proportion of cash sales in total sales increased; a successful campaign helped to clear stock at reduced prices. Maintenance works were delayed. The management also attempted to reduce social benefits. These measures brought some results, and the firm could record profits at the end of the year, although these were less than planned.

The call for bids was advertised towards the end of 1992. An ESOP Organising Committee had been established by then and was interested in acquiring a stake of 52 per cent. They calculated that the company would be profitable even after meeting obligations for the ESOP. They promised to prepare the ESOP Feasibility Study and submit a bid by the end of March 1993, and asked the SPA to consider their intent to bid later when evaluating submitted tenders.

There was no officially submitted tender; only the ESOP's announced, but informal interest could be entered in the minutes of the tender opening, although the Consultant had directly invited several firms. The foreign bank that had earlier seemed interested did not reply to the Consultant's inquiry. The SPA approved a second call for tenders but asked the Consultant to prepare a detailed report of the causes of lack of interest. The Consultant pointed out that the time period available to prepare bids had probably been too short, general considerations of country risk might have played a role, and investors who already knew the firm might have been deterred from bidding by the need to make large investments to update the company's technology to modern Western standards. In an interview, the General Director implied there was an additional reason, namely that the management had some discretion in how to present the firm to potential investors, and it could be done in a way that they would not want to make an acquisition. A foreign company that appeared to be planning substantial downsizing at Saturn was given such a discouraging impression.

On the eve of the second call for tender, the General Director informed the Board that the SPA supported the ESOP-concept. They had asked four consulting firms to submit offers to assist in preparing the ESOP's bid. At this time they wished to acquire 51 per cent of the shares but also wanted to have a 30 per cent foreign interest in the company.

## **Second tender fails**

Soon after the tender announcement the SPA and leaders of all the firms in Saturn's industry discussed how to speed up privatisation. The Ministry encouraged employee ownership through an ESOP but, at least in Saturn's case, the SPA firmly rejected it. It applied different principles to different companies in the industry. Specifically, "Saturn was threatened, not in writing of course, that they would sell it to the Social Security Fund", recalled the General Director; this was the option which he was against since the firm needed "a

future-oriented”, resourceful owner. For the same reason, the General Director personally did not particularly support the ESOP. Repaying the ESOP’s debts and financing necessary developments seemed too demanding a pair of tasks to accomplish in parallel. Pondering on why other firms had, nevertheless, chosen this path to privatisation, he suspected personal factors, such as the number of years until retirement – implying that one can gain a lot before retirement and then leave the firm to its fate – and the possibility of a clandestine acquirer to which the ESOP could pass on the shares it acquired at discount.

As for Saturn’s ESOP, its plans for the size of interest to be acquired changed several times. Only a few weeks after it intended to acquire the majority position, the business plan for 1993 envisaged only minority. The management’s letter to the SPA also asserted that they favoured a foreign strategic investor’s majority and capital increase, with additional employee ownership through an ESOP and other means. These changes in the ESOP’s aspiration level admittedly resulted from bargaining with the SPA, whose position appeared to change depending on how it regarded the chance to sell Saturn for cash to a resourceful buyer. In effect, the ESOP would be allowed to get what would be left after a – hopefully successful – tender.

There was no bid submitted. However, two firms had indicated their interest to the Consultant. If nothing else, this could be entered in the minutes. A foreign company had announced a non-binding interest and required one or two months to prepare a bid. It intended to establish a store chain in Hungary, of which Saturn could be a supplier. They gave up their acquisition intent soon afterwards.

The other interested company was “Mighty Multinational”. It first indicated interest in late March after a visit to Saturn, and asked the SPA to keep the tender for Saturn open for an additional eight weeks to give it the opportunity to investigate other factories in the industry. In another fax, sent only 20 minutes before the opening of tenders, Mighty Multinational announced that on the basis of its investigations Saturn seemed the best acquisition target in this industry, and asked the SPA again to extend the deadline to allow it submit a formal bid within two months. It also indicated its objective to acquire all the shares in the firm, requesting the SPA to convince the minority owner municipality to sell its shares. No possible employee ownership was considered.

## **Offers and negotiations off-tender**

Saturn at this time appeared to be a target exhibiting relatively better performance in a drastically worsened business environment. According to a report to the Board, owing to new, active marketing methods, domestic sales had increased, but the commissioned business continued to decline drastically, causing serious damage to Saturn’s return on sales. The devaluation of the

pound had also hit the company. In export markets competition had intensified owing to low cost producers. Saturn had been working on launching new products. The management had succeeded in reducing interest payments with a better credit policy, but the firm's indebtedness, partly inherited from the time when Saturn became an independent firm, remained a serious burden. Had the commissioned business brought in results such as those in 1991, profits would have risen, which indicates the management's success in its efforts to compensate for this lost opportunity. The firm's cash flow was said to have been very well managed. Organisational changes had also been made. Personnel of a whole department, dealing with suppliers, had been replaced. A new export department had been established. The ISO 9000 quality standards were being introduced at that time and their audit was scheduled for early June. All this was done by mutual agreement. "It was not that I decided", explained the General Director. They had meetings and debates, then "once we decided, everyone acted on that". The members of the Supervisory Board and the Board of Directors were said to be "people who did not go for personal gains but for the firm's interest". The Supervisory Board stated at its first meeting that it intended to assist the management, and then it regularly reviewed the firm's situation and provided feedback to the management.

Mighty Multinational paid a visit to Saturn and again requested that the deadline be extended, now until the end of May. Just as in earlier correspondence with the SPA and the Consultant, its letter started by emphasising how important company the potential acquirer was. It was not only one of the largest worldwide companies in consumer goods with leading positions providing very strong financial resources but it was also a strong presence in Hungary already. It intended to invest a large amount in Saturn, which would be managed as a division of Mighty Multinational Hungary, in order to upgrade it to its own requirements. Ambitious plans were outlined for quality improvements, exports, technology and know-how in the technical and marketing areas. Making an offer was subject to satisfactory due diligence and the possibility of the acquisition of all the shares, amongst other conditions. The SPA wanted Mighty Multinational to make a binding offer. Until the issue of ownership was resolved, the management saw their main objectives as "to ensure the viability of the company and to facilitate privatisation" in a very unfavourable environment.

The Annual General Meeting of the shareholders affirmed that the company had made achievements: it was still profitable and financially stable, although short of resources to invest. No dividend were distributed, but profits were to be spent on new equipment.

The SPA at this time considered the possibility of a new tender for Saturn. Alternatively, it could just wait for Mighty Multinational's offer. The law permitted the privatisation of state-owned assets by leasing after two unsuccessful tendering processes. This possibility was also contemplated, and

the management had earlier expressed its interest in it in case there was no other solution, but the SPA expected that Mighty Multinational would submit a binding offer even before the alternative of privatisation by leasing was fully examined.

Not knowing what would eventually happen, the employees' representatives must have felt it important to secure the benefits they were entitled to under the law. The local Union Leader's letter to the SPA simply confirmed that they wanted to take the opportunity of acquiring some shares at a 90 per cent discount, as stated in one of the SPA's earlier decisions.

Instead of a binding offer, Mighty Multinational again requested an extension of the deadline. Then it did submit an offer for 100 per cent of the shares, but explicitly stated that it was a non-binding one. It did not wish to share ownership with either the employees or any third party. In case shares had later to be sold to employees, the difference between the price of their shares and the value of their shares was of course required to be met by the SPA. The prospective acquirer again introduced itself in considerable length, emphasising not only its mighty size and resourcefulness but also its already considerable importance in foreign direct investment and employment in Hungary. It placed a value of several hundred million forints on Saturn, but more than half of this was to be deducted because of debts. Thus, the cash price offered was only a couple of hundred millions, and even that was to be reduced by any losses that might have occurred in the working capital value between 31 December 1992 and the date of transfer. On the other hand, planned investment was substantial. The transfer of know-how and the use of Mighty Multinational Trade Marks were to be the subject of separate service agreements. Mighty Multinational would source locally and intended to boost Saturn's existing exports. It did not fail to emphasise how beneficial this would be to the country's trade balance. Saturn was planned to be run mainly with local management, supported by a few expatriates to transfer know-how and management skills. Substantial retraining of the workforce was considered necessary.

Mighty Multinational was thorough in devising reasons that might reduce the effective share purchase price. Among the conditions, it was specified that the SPA had to guarantee the transfer of the local municipalities' stock to Mighty Multinational. Obsolete stocks, stocks sold at less than inventory price, and uncollected debts were to be further deducted from the price. No major decisions concerning Saturn's business was to be taken without the prior consent of Mighty Multinational as from the date of the non-binding offer. All guarantees given by Saturn to third parties were required to be withdrawn, or undertaken by the SPA. Payments to non working employees covered by a legal obligation (e.g. for maternity leave), bonuses to be paid to employees of Saturn in relation to the achievement of the privatisation of the company, as well as bonuses related to the achievement of the planned profit target, and costs and investments arising

from an environmental audit were to be covered by the SPA. It was also required to guarantee that no penalties and/or increase of levies would be charged to Saturn for environmental matters within the following five years. Because of its foreign ownership exceeded the limit of 30 per cent specified by the law, Saturn was also to be granted a full tax holiday for a period of 5 years, and a partial tax holiday for the following 5 years. Mighty Multinational also laid claim to export subsidies at a rate of 25 per cent of export revenues for a period of at least 5 years. Finally, a part of the purchase price would be retained as further security for the performance of the obligations of the SPA.

Although some at the SPA objected several of the conditions, there was a firm intent to negotiate and, eventually, sell Saturn to Mighty Multinational.

In the next few months, negotiations resulted in “final offers” and their revision a couple of times. In the first version of its “final” offer, Mighty Multinational increased the value placed on Saturn as well as the amount of debts to be deducted. It also specified some of its claims, naming especially Saturn’s guarantee for an International Bank as an example of liabilities to be withdrawn or undertaken by the SPA. The part of the purchase price to be retained until the SPA fulfilled its guarantees was given as 10 per cent of the price, and the maximum length of the review period was shortened from two to half a year.

It was now the SPA’s turn, first, to evaluate the offer and, second, to lay claims for the buyer’s guarantees for the investment, increase in exports, the maintenance of current levels of employment and the provision of necessary retraining, and that Saturn would not revoke its contracts with its current suppliers for at least a year. Certain conditions required by the acquirer were rejected, partly because the SPA had no authority to grant them and partly because they were considered exaggerated. So that the SPA could better argue, the General Director was asked to provide information on Saturn’s current status. He updated the SPA on the amount of the firm’s debts and specified the amount of Saturn’s guarantee for a loan that had been taken by a Foreign Trade Company from an International Bank. Saturn inherited this liability from the times when it had been part of an industry-wide trust. The General Director could, by now, also inform the SPA that the municipality seemed willing to sell its shares at the purchase price as negotiated with Mighty Multinational.

Towards the end of the Summer, Mighty Multinational acknowledged some of the SPA’s proposals, mostly those that arose from the SPA’s lack of authority to decide, such as subsidies and tax holidays. These were granted by law in any case. It also confirmed that it would stick to the prescriptions of the laws prevailing in Hungary with respect to employee ownership. This would not mean any support for an ESOP scheme, of course, but only the acceptance of issuing new employee shares from the sale proceeds. The SPA also wished to sell some shares to producers in return of compensation notes, but the acquirer

was not in favour of the idea. On the basis of negotiations, Mighty Multinational prepared a draft share purchase agreement.

The SPA officials working on the Saturn-case were aware of Mighty Multinationals' strong position. They pointed out that the bidder had excellent information, and had formulated its terms and conditions after the failure of two tendering processes. The SPA considered two options: either accept the offer but with conditions more favourable to the SPA (for example, requiring the buyer to pay at least 80 per cent of the nominal value of the shares; 25 per cent + 1 vote to be sold to producers in exchange for compensation notes), or reject it (and offer the shares to small investors and producers). A draft proposal to the decision-makers elaborated the first alternative; in its final form, it was suggested that after concluding a contract with Mighty Multinational a press release should be made in which the SPA would state how much it was in the national interest to attract a major multinational company to the industry.

The Ministry objected to the sale to Mighty Multinational and wanted to see a more lucrative deal. Considering all the claims that could lead to a reduction of the purchase price, it concluded that "then it may happen that the SPA will have to make a financial sacrifice in order to strike a deal". It insisted that, as required by the provisions of the Property Policy Guidelines, shares representing 25 per cent+1 vote be warranted to producers, and some shares be sold at a discount to employees—both in line with the government privatisation policy that, since 1992, had put emphasis on these forms of indigenous ownership. The Ministry also made the criticism that the draft agreement as drawn up by Mighty Multinational "requested guarantees for everything but provided no guarantee for the buyer's undertaking". In sum, whatever advantage it might bring in the future to have Mighty Multinational in this Hungarian industry, the "one-sidedly dictated" terms and conditions attached to the offer were regarded as unacceptable even from the internationally respected Mighty Multinational, particularly when good long term market prospects for Saturn's products were envisaged. Finally, the Ministry suggested that in case negotiations with Mighty Multinational failed, a new call for tender should be announced. According to the General Director, the reason behind the Ministry's objection was twofold: it was probably afraid of a monopoly situation, and it wanted to protect the producers. However, this position had to change later, under pressure from the exchequer.

In this situation the SPA made a decision which, while accepting the offer in principle, required further negotiations. It wanted to achieve about 70 per cent of the registered capital being sold for at least 80 per cent of the nominal value, employee shares with discount being issued, capital investment being carried out within two years, and a stock of 25 per cent+1 vote being sold to producers in exchange for compensation notes (with Mighty Multinational's option on the shares not subscribed to). It was also decided that these target conditions could

only be modified by the SPA's Board. As proposed, the Board's resolution prescribed a press release to be issued after the conclusion of the contract, which was to emphasise that "it is in the national interest" to draw a multinational into this industry.

The SPA made its decision in the absence of the Ministry's representative, although he had personally requested that the case not be discussed when scheduled because he would not be able to attend. His request was disregarded and a decision was made which he saw as being contrary to the Ministry's position. In a new tender he wished to see that only 50 per cent+1 vote should be offered for sale, and the SPA's earlier decision on the possible extent of employee ownership should be enforced. He insisted the Ministry's expressed objection should be entered in the minutes, which was duly done afterwards. The SPA management was then instructed to conduct negotiations with Mighty Multinational in accordance to the Ministry's position and bring back the issue before the decision-makers in the event that the negotiations failed to result in an agreement. At the company the Ministry's efforts were regarded futile: "If Mighty Multinational says it wants 100 per cent, it is in vain that the Ministry" held different ideas. "It wasn't serious", commented the General Director.

The ongoing negotiations had resulted in Mighty Multinational's revised, "final and definitive" offer in September 1993 for more than 80 per cent of the shares (instead of some 70 per cent as prescribed by the SPA resolution), so that it could have full control with at least 75 per cent+1 vote after sales of shares to employees and producers. It also required right of first refusal on all shares not purchased by them, and on shares sold by any other shareholders (municipality, employees) at any time. The offered price represented 60 per cent of par. Accepting the SPA's request, it undertook to issue new shares to be subscribed by employees, but also wanted to be compensated by the SPA for any price discount on these shares given to the employees.

Clearly, this was not exactly what the SPA had hoped for. The offered price was only two thirds of the claimed one. Yet, it was proposed that the offer should be accepted since the SPA official evaluating the offer believed that it was "in our interest to attract them into the industry". He also noted that in the case of two other firms in the same industry the SPA could only achieve price levels of 50 per cent and 85 per cent of the nominal value of the shares which made Mighty Multinational's offer of 60 per cent in cash look acceptable.

According to a marginal note, there was a view within the SPA that the Ministry was just "thwarting it [dragging its feet]". Assuring its "fellow state-agent" that the SPA did not wish, nor it was in its interest, to take a position against the Ministry, the SPA asked the Ministry for its opinion on the revised offer. Anticipating that it would want to reject the offer, and in an attempt to try and involve the Ministry in devising a mutually acceptable solution, the SPA also wanted to hear the Ministry's view on "how then should Saturn's privatisation

happen” while keeping it viable and safeguarding the value of the state’s shareholding.

The Ministry was still unhappy with the likely outcome of this privatisation, and kept fighting for more influential stakes for producers. It also spotted that Mighty Multinational had now indicated larger employee ownership than originally prescribed by an SPA resolution. This would also mean higher compensation from the SPA to the acquirer, resulting in an effective share purchase price of less than 50 per cent. If a price of 60 per cent was regarded as too low by the Ministry, this new figure was seen as simply “beyond reality”. In fact, because of further price adjustments, even this amount might decrease. The offer was unacceptable: at such a price “we do not recommend the sale”, concluded the Ministry.

An SPA official reviewed the situation by comparing the offer to the SPA’s expectations, particularly those that had formally appeared in earlier SPA resolutions. The latest offer was made for more shares than the SPA wanted to sell, reducing the size of the stock that could be offered to producers below the limit prescribed earlier. Striking a deal on these terms would yield less than hoped for proceeds to the SPA, although somewhat more than offered formerly. It was also considered that the investor had made it clear: this was the last and definitive offer – no more major changes, please.

Apparently, the main obstacle to striking a deal was that the SPA, as it was also required to by law, had once acknowledged the right of producers to have an opportunity to acquire stock. This would prevent Mighty Multinational from acquiring absolute majority once the employee shares were issued. The negotiations had now been going on for about six months in the context of the potential acquirer’s apparent superior bargaining position, and it was important to conclude a deal before the end of the year so that Saturn could be eligible for an automatic tax holiday. The SPA reviewed the situation and decided that the shares originally intended for sale to producers could now be offered for sale to Mighty Multinational. It argued later that the producers could have submitted bids in the first two tenders but they had failed to do so. On the other hand, if this stock were sold to Mighty Multinational, the producers could count on a solvent owner of Saturn, and buyer of their products. The wording of the resolution makes it possible to speculate that the SPA’s reasoning actually meant the following: since Mighty Multinational’s offer left only about half of the stock originally intended to be offered to farmers (who would pay with compensation notes), we might as well sell this stock to Mighty Multinational (who pays in cash). The investor was asked to revise its offer accordingly.

Mighty Multinational submitted its once again revised offer for all the SPA shares in Saturn. It also exerted pressure at high level for the deal to be struck quickly. It urged the conclusion of the agreement on a meeting with and in a letter to a Responsible Politician. Its intent was conveyed clearly: “We want to

acquire Saturn”. That such an acquisition would be very beneficial to the firm and the national economy was also elaborately presented. Timing was critical; the deal had to be struck before the end of the year. To that end, the Responsible Politician was asked to help in concluding an agreement.

The SPA accepted the offer, again with conditions. Further negotiations followed. Now all the SPA shareholding could be sold to Mighty Multinational at 60 per cent of par, and employee ownership was to be ensured to the extent of 10 per cent of the enlarged registered capital. The SPA wanted a guarantee that a substantial capital investment would be carried out within two years. The Ministry apparently agreed, but it was noted that “Mighty Multinational took unfair advantage of its favourable bargaining [position]”. According to standard SPA procedures, the final agreement was to be concluded within 30 days of the decision.

Upon the SPA’s request, Mighty Multinational submitted its draft of the agreement. It specified some previous conditions, but also included new elements. Indemnification was to be limited to 25 per cent of the purchase price, instead of to a smaller extent as the SPA had wanted. Capital investment was to be undertaken by Saturn itself and not Mighty Multinational, allowing it to finance new machinery and fixed assets partly from Saturn’s profits instead of new finance as the SPA had hoped for. The acquirer wanted Saturn’s release from a guarantee given to International Bank for Foreign Trade Company and the guarantee to be assumed by the SPA – a claim which Mighty Multinational had already made but which seemed to be a new demand to some SPA officials, as we shall see later. Finally, it wanted English to be the language of the contract.

### **Closing with debate**

Only a few weeks from the end of the year, an all-day-long meeting, supposedly the last before the signing ceremony, was held to finalise the agreement. Some issues were still being debated. An SPA-report prepared at about this time noted that the buyer had enjoyed the benefit of knowing that there was no bidder in the tendering, and it would “get Saturn in one way or another in any case”. It was feared that the acquirer would oblige the SPA in various ways to pay indemnification to a considerable extent. In addition, the SPA believed that the employee shares – subsidised by the SPA up to 90 per cent of the nominal value – would be bought up by Mighty Multinational eventually. As an SPA staff member calculated, the worst possible scenario (if Mighty Multinational claimed all guarantees, price adjustments and indemnification) would provide an income to the SPA which would be only slightly more than 10 per cent of the nominal value.

Mighty Multinational requested one more meeting, but with a higher ranking SPA executive, while urging the SPA administrator assigned to the Saturn-case to settle the issue of the Bank-guarantee as soon as possible. Tension and possible misunderstanding of previous communication between the parties were indicated by a marginal note, which viewed this request as “once again a provocation”. In his reply, the SPA administrator expressed his surprise at a request which seemed new to him, believed that the acquirer was hindering the conclusion of the contract, and shifted “responsibility for your unusual action and all its detrimental consequences onto you personally”. He immediately prepared a report to his superiors on this matter. In a few hours the misunderstanding was cleared up, when Mighty Multinational’s counsel, assuming a “fatal misunderstanding”, explained that Mighty Multinational had only tried to ask for the administrator’s assistance in solving the problem of the guarantee, but had no intention of delaying the conclusion of the contract.

Had the administrator waited only a few hours with sending Mighty Multinational his excited reaction and preparing a brief for his superiors on the problems, as perceived by him, jeopardising the scheduled Closing Date, he could have saved himself some work. Now he had to prepare an addendum on the most recent developments, since Saturn was released just in time from the much debated bank guarantee (assumed by the SPA).

On the eve of the signing ceremony some further objections were raised by legal counsel of the SPA. He criticised the buyer’s one-sidedly favourable position and the lack of some formalities that he regarded as indispensable for the SPA to sign the contract responsibly. These minor problems disregarded, the parties signed the contract, although on somewhat different terms that had been formerly approved by the SPA Board. Mighty Multinational as the Purchaser thus acquired all the SPA-shares, the price being subject to adjustments. It was to be compensated for discounted employee shares in such a way that the allowance given to employees when acquiring these newly issued shares would be repaid by the SPA to the Purchaser within 60 days of the issue. The Purchaser withheld 10 per cent of the purchase price to cover subsequent adjustments. A ceiling of 20 per cent of the purchase price was applied to indemnification. Regarding investments, Mighty Multinational guaranteed that within two years capital investment “will be made” at Saturn “up to” a specified amount. The transfer of know-how and the use of trade marks were subject to a separate agreement. Before the end of the year, the acquirer paid for the stock, and the shares were endorsed.

Saturn’s new Boards were elected in early 1994 at an extraordinary shareholders’ meeting, which also increased the company’s registered capital by issuing employee shares against capital reserve. About two months later Mighty Multinational informed the SPA that employee shares had been issued as contracted, and this had been recorded with the Registration Court. Therefore it

claimed its money from the SPA, namely 90 per cent of the nominal value of the employee shares. In its reply the SPA could “not construe this request”, and asked for evidence that the Purchaser had met its contractual obligations. When Mighty Multinational again urged the SPA for compensation, it was rejected again and was told that employee shares could be issued only after an increase of the capital had been registered with the Court; thus, in order to lay claims to compensation, the acquirer should first provide evidence of that act. In fact, Mighty Multinational had already done so, but the SPA did not repay the employee allowance for months.

As this issue was kept in suspense until the middle of the summer, the acquirer found one more reason to submit a claim to the SPA. An International Auditor prepared a report on Saturn’s balance sheet at 31 December 1993 and the company’s asset value was considerably less than a year earlier, giving rise to a possible price adjustment of the same amount. Along with its claim, Mighty Multinational informed the SPA that the employee shares scheme had already been finalised “to the full satisfaction of the employees”. Other developments included quality improvement programmes in co-operation with the producers the relationship with whom was said to be excellent. Investments had already started, and the company was preparing to launch a new high quality product.

After the SPA paid the acquirer compensation for the employees’ allowance, a report on Saturn’s privatisation believed that the employees shares had been bought up by Mighty Multinational, “contrary to the spirit of the agreement”. This was confirmed by the General Director; in fact, these shares “were not actually issued [i.e. printed]”. The employees received cash amounts equal to net wages of six months. He also added that the acquirer bought up the municipality’s shares, too, resulting in the accomplishment of its original plan, the ownership of the whole stock. Although the said report also raised concerns with respect to Mighty Multinational’s obligation to carry out a capital expenditure programme, the General Director spoke about an investment program far exceeding the acquirer’s contractual obligations, although with some delay. Benefiting from this, Saturn could then decrease its dependence on the commissioned business and concentrate on its core business.

At the time of closing this case history, some outstanding issues were still being debated. The case is ended here with a review of these issues, and the General Director’s reflection of this privatisation.

Following the 1990 elections and changes in the SPA’s management, the SPA attempted to close all outstanding issues with Mighty Multinational in early Autumn. After paying tribute to the Auditor’s well-attested competence and impartiality, it pointed out some errors and missing formalities in the report, and asked Mighty Multinational to specify its claims and reveal its position on whether in its understanding the 20 per cent ceiling upon indemnification

included both price adjustment and various guarantees, since the recently submitted claim alone exceeded this ceiling.

The General Director regarded Saturn's privatisation a success, something that "we can be proud of". At the national level, Mighty Multinational's investment in Hungary was said to be "barometric, an acknowledgement", that is it indicates that the country is a safe place in which to invest. Its investment also provides market opportunities for Hungarian producers. The acquirer developed a good relationship with them, including financial support. Its business culture and long-term commitment have also been noted. The price it paid for the acquisition was subject to negotiation, but for Saturn, this was a matter of indifference. Employment was important, and it decreased somewhat, but the General Director viewed it as necessary short term sacrifice for better long term prospects. He believed Saturn would soon advertise vacancies again and "will be doing very well" as market opportunities improve and the business, on a healthier foundation, starts expanding. In reply to a specific question about politics surrounding privatisation, he remarked: "No, there was no politics. There are charismatic party leaders in [the region where Saturn is located] but regional politics could be kept out".

Reflecting upon his personal involvement, he pondered, "I acted upon conviction; my colleagues sometimes said I was too virtuous; I think I facilitated a good privatisation".

Less than two years after the agreement between Mighty Multinational and the SPA, the General Director left Saturn, apparently because he saw no future career opportunities in running a unit which was under tight control and "needed only a shopfloor manager".

## Conclusion

In this final section, Saturn's case is briefly analysed in terms intensity of politics, features of strategy making and strategy content during the privatisation process. The performance level of the firm regarding its financial and market position, and the outcome of this privatisation are also considered.

Saturn's privatisation process appears to have been influenced by political considerations, but these seem to have had only limited effect on the final outcome. In the early stage of the process, the overall plan for transformation and privatisation "changed several times ... often according to political interests." However, cross-ownership and management-employee majority (the latter never seriously considered by the management) had been ruled out relatively early. The Ministry's attempts to secure a larger stake for the employees and the farmers were probably driven in part by political objectives (note the Ministry's reference to an indigenous owners' class), but these attempts eventually failed. The Ministry's objection may have made the

negotiation process a little longer than it would have been otherwise, but without initiating a turning point in the flow of events; the process still remained an economic bargaining between a resourceful and determined acquirer (“We want to acquire Saturn”) and a seller with low bargaining power. Similarly, although Responsible Politician was involved in the process towards its end, his involvement served the quick conclusion of the agreement and not any discernible political objective (other than an economically successful privatisation, that is). Interestingly, the SPA Board’s decision to emphasise in a press release that “it is in the national interest” to draw a multinational into this industry seems to reflect a political consideration in that the Board felt it necessary to explain its decision. In addition, Saturn’s privatisation process seems to have been devoid of ‘party politics’.

Regarding another side of politics, namely internal organisational politicking, Saturn’s privatisation scores low on this dimension, too. This firm avoided raging conflicts, unlike some other firms we studied. The management and the boards of the company were apparently working in tandem. Saturn did not become the subject of oversized ambitions. We have seen no example of any party attempting to have its own way through the use of political means. Indeed, there was no need for using political tactics; sheer economic bargaining power and its use to the full appear to have determined this privatisation.

Saturn is an example of focused strategy-making and – at least attempted – recovery. Facing growing competition and decreasing domestic demand, and being hit particularly by the shrinking commissioned warehousing business, Saturn was rapidly losing profitability. The management considered it a top priority to keep the firm viable. Once the main objectives had been defined, various measures were introduced to achieve them. Tough cost-cutting measures were taken, sales campaigns were launched, organisational changes were introduced, and all the difficult decisions were implemented by mutual agreement among management ranks, including a supportive and responsible Board of Directors and a Supervisory Board. Despite all the efforts, the firm’s position certainly deteriorated, owing to severe shocks. Yet, good cash flow management was acknowledged by the Supervisory Board, the General Director was in a position to state at the 1993 General Meeting of Shareholders that “we have accomplished our main objectives, the company is profitable and financially stable in a difficult economic environment”, and eventually, by the end of the privatisation process the firm was still in business in a relatively healthy financial position, and ready to reap the benefits of the resources provided by the acquirer.

Saturn was acquired by a resourceful foreign company. Both effective governance and a high level of resource replenishment were in place, as applied under the acquirer’s corporate strategy. However, being subordinated to MM’s

global corporate strategy meant not only access to substantial resources, but also being downgraded to the status of a production unit.

On the basis of available information, a successful turnaround of Saturn seems granted in the long-run. Note General Director's comment: "As soon as market opportunities improve – you see, this market is very much dependent on the general standard of living – the firm will be doing very well." With the resources provided by MM, the company can now prepare for better market opportunities.