

Acquisitions and organisational change: an interview with Professor Gyula Bakacsi

Professor Gyula Bakacsi is a deputy head of the Department of Management and Organisation at the Budapest University of Economic Sciences (BUES). He teaches Organisational Behaviour and Negotiation-Communication. For the first time at BUES, and probably in Central-Eastern Europe, he and his fellow-professors developed and started running a course devoted to issues of Corporate Governance in Spring 1998. Professor Bakacsi was a member of the Board of Directors of a Hungarian Chemical Company (CC herein after) from 1991 to 1995. Furthermore, he chaired the Board of Director of a Hungarian Machinery Company (MC herein after) from 1992 to 1996, where he has been chairing the Supervisory Board since 1996. During his involvement with these companies there was a change of ownership at CC, while ownership of MC has changed even several times. We have interviewed Prof. Bakacsi about his experiences at the companies, and asked him to reflect upon these cases.

Would you please tell us about the major steps of the acquisition process at the two companies?

After the former chemical state enterprise has been corporatised, i.e. transformed into a joint stock company limited by shares, the majority of the stock was owned, and ownership rights were exercised initially by the Hungarian State Property Agency, then the State Privatisation and Asset Management Co., which was handling strategically important assets. Minority shares were held by local councils. A small bundle of shares was held by the company employees. Following the capital increase – essentially a debt-equity swap – the financing bank, one of Hungary's leading commercial bank, became another minority share holder. The first acquisition attempt of the company was by a multinational company operating in the same industry. For unknown reasons the final signing of the deal has been halted in the very last moment. The second tender offer was submitted by another multinational enterprise, following a detailed evaluation of the company's position and due diligence. Eventually, the State Privatisation and Asset Management Co. refused the offer. Only in the third tender offer, again submitted by the same multinational, did ownership in CC change hands successfully.

In the case of the Machinery company, after corporatisation the majority shares in MC went to a consortium of management and employees in a joint MBO-ESOP (Management Buy-Out and Employee Share Ownership Programme). The minority was held by the State Property Agency and the local councils. The SPA transferred its ownership rights to an appointed development bank, which transferred asset management rights to its wholly-owned specialised asset

management company. The bank increased the registered capital of the company and thus obtained majority position, which was balanced out by the owner-managers with a so-called golden share (commanding veto power in some strategic decisions). The last move so far was when – in order to restructure its investment portfolio – the development bank decided to swap its shares in the company for other assets with a venture capital company, which also acquired the MBO-stock (including the golden share), thus obtaining more than 75% of the company shares. Considering the likely objectives of the venture capital company, however, this transfer is probably not the final one in the series of ownership changes.

What are your general observations in the history of the two companies?

These brief stories demonstrate that the events are multi-faceted and of rather different nature at the two companies. In fact, in the case of MC, the process of ownership changes has not concluded yet. Nevertheless, I make an attempt to draw some conclusions.

In both cases the acquisitions happened simultaneously to company privatisation processes, where the state and its representative agencies emerged as owners with special characteristics. The sale of state property in large chunks – without having any previous experiences in doing so – provided a serious challenge and created enormous difficulties.

Another common aspect is that privatisation and acquisition occurred at times of turbulence and complex change management. The nature of changes was unprecedented so far: it was forced, and had an exceptional scope. It was forced because for most companies there was no choice left but to change. They also encountered a completely new environment characterised by:

- a new political system and institutions,
- gradually renewed economic regulations (taxation, company law, accounting rules, employment regulations, banking and security legislation, etc.),
- collapse of the traditional (Soviet/CIS) markets, difficulties of entering into new (Western) markets and shrinking internal purchasing power on most markets,
- no more financing companies by means of central redistribution, general financing difficulties through commercial bank loans due to the poor financial leverages,
- emergence of new money and security markets, banking system, high interest rates,
- high inflation rate,
- restructuring from extensive vertical integration, employee dismissals, outsourcing and de-layering,

- change in key managerial positions at the largest corporations.

The fact that acquisitions and privatisation were strongly intertwined with the process of change management, and the fact that they occurred at the same time posed an enormous challenge to owners, managers and employees.

Several types of owners occurred at the companies: the state as an owner, strategic investors, MBO and ESOP, venture capitalists. To what extent did the different owners follow different strategies, what value did the new owners add to the company?

A comparison of the strategies of different owners during the acquisition process can give us some lessons. As a result of the sometimes highly complicated political interests in the background, it was occasionally possible to observe a peculiar behaviour of the State Asset Managers, which was rather different from what you would expect from owners. The MBO and ESOP owners focused on re-paying the company debts, which resulted in a further depletion of company cash-flow, thus limiting the scope for company development. This was a kind of a survival strategy. The MC initiated a serious internal restructuring, de-layering and cost cutting program. This, however, did not mean a substantially different strategy. Instead, it can be regarded as an effort to make the basic strategy more stable and sound. The commercial bank clearly preferred short term returns on its capital. The development bank took a somewhat longer term approach to the company, as a part of its long term portfolio management. The venture capitalists initiated extremely firm and thoroughly devised measures.

What was the attitude of the management towards the acquisition process?

The attitude of the management towards the acquisition was double-natured. On the one hand, they clearly had their vested interests (particularly with respect to the MBO and ESOP), which were coupled with the momentum of routine management practices. On the other hand, managers demonstrated high learning and adaptation capability. They actively supported, sometimes pre-empted the initiatives of the owners. The top manager of CC described the shock they incurred during a pre-acquisition investigation and due diligence as follows: "In two weeks they figured out all of our slacks, fats, and weaknesses and proposed serious lay-offs and cost cuts in two months. We were stripped and scared. After a while we recognised that their cold-head proposal was correct and if we want to survive, we have to do 95% the same, except the speed of the process – we have to do it in half a year, instead of two months."

Interestingly, the owners often seem to confirm this observation regarding the double-faced attitude – resistance and adaptability combined – of the managers. They complain about certain resistance and cultural barriers. But they also note positively that they could never achieve such large-scale changes at their indigenous companies in such a short period of time. In sum, these change processes certainly entail progress and problems at the same time.