Introduction

The Management Buy-out (MBO) became a popular mechanism for corporate restructuring and business recovery in the UK during the late 1970s and early 1980s. The majority of UK MBOs in value terms have been small and medium sized enterprises (Chiplin et al 1993). Investigation of the UK post-buy-out experience has indicated that much MBO activity has been driven by the entrepreneurial process to achieve improved business performance (Weir 1996, Wright et al 1994).

While MBOs vary greatly in their scale and method of setting up, there are a number of common aspects that have been identified. Essentially, an MBO entails management taking over some or all of the parent company assets for which they were formerly responsible and utilising various sources of finance such as bank loans, various forms of venture capital or in rare cases loans negotiated by the parent company. In the restructuring process, highly-geared MBOs are often accompanied by a shedding of labour and a drive for higher productivity.

Management buy-outs compete with other methods of divesting parts or all of the company to competitors or other interested parties. Abbot and Johnston (1993) suggest that MBOs generally provide higher returns to parent company shareholders than in selling off to outside companies, although some commentators take a contrary view, while Smart and Waldfogel (1994) argue that MBOs improve the overall corporate performance of the parent company.

The present paper reports on recent case study research of three Polish MBOs which, now as SMEs, are engaged in industrial manufacturing. In the context of the contingent factors affecting their activities, the case studies investigate the patterns of managerial decision-making which have been evident of their period as MBOs. The case studies are based on on-site contact with the managers of the subject firms. Relevant features of the organisational adaptation made within these three businesses are examined using the model derived from the literature concerning the MBO development process experienced in the UK. The paper concludes by exploring the issue of MBO business performance under transition conditions.

The Development of MBOs in the UK

Corporate restructuring has been a significant feature of the 1980s and early 1990s on both sides of the Atlantic. Peel (1995) argues that such restructuring occurred as a response to such economy-wide variables as the de-regulation of markets and increasing global competition.

MBOs in the UK have been the subject of much academic interest and the literature is relatively extensive. Studies have been carried out on issues such as setting up the MBO (Wright et al 1990), their relationship with the parent company and the avoidance of conflicts of interest (Easterwood et al 1994), financing buy-outs and MBO control and performance issues (Wright et al 1994); Smart and Waldfogel 1994, Smith 1990) management motivation and MBO cultures (Green 1992), Smart and Waldfogel (1994) examined the MBO as a privatisation mechanism., whilst Wright et al (1995 and 1996; McKibben (1990) and Pearson (1990)) addressed factors contributing to the success or failure of MBOs. Finally researchers such as Seth and Easterwood (1993) have investigated aspects of strategic change in MBOs. Assembling the results of such studies provides a model of MBOs that can be utilised for comparative purposes.

The early 1980s saw an upsurge of management buy-outs (Anslow et al 1994), although of late the trend has diminished (Beresford 1994; Robbie and Wright 1992). Many MBOs were created as a result of the owner's retiral or the disposal of unwanted parts of larger groups (Chiplin et al 1993). Wright et al (1988) noted that divestments by UK-based parent companies accounted for at least 60% of buyout opportunities and in addition sales to UK-based management by foreign groups contributed another 12% of buyout activity.

A significant number of MBOs evolved as a result of the privatisation of industrial and transport sectors of the UK economy in the 1980s and the early 1990s (Chiplin et al 1993; Wright et al 1994), (Miller 1994). Employees were often encouraged to take a stake in the newly-privatised companies.

Wright et al (1993) argue that MBOs often became more efficient in this form compared with their earlier existence as part of a larger group or as part of the public sector, providing for wider industrial and societal economic benefits. However, debt-bearing MBOs are suspect to changes in the wider economic climate (Singh 1993), the number of new MBOs declined in the recession of the early 1990s in the UK for example. Such economic changes can place additional pressures of new MBOs, a factor discussed below.

Few managers involved in MBOs were involved in the buying and selling of companies before, so clearly it was important that good practice existed in negotiating and setting up management buy-outs and this aspect was the subject of much research activity.

Wright et al 1991 argue that three separate constituencies have to be satisfied before an MBO is created: management, institutions and the company itself.

Of the fundamentally important features of the MBO, three can be readily identified (Ward 1992). Firstly, the management team itself in terms of inherent enterprise and managerial competences, secondly, profit potential and finance, and thirdly, negotiating the MBO. To these can be added issues concerning the positioning and the political economic environment in which the MBO emerges.

Management Competencies

The preliminaries associated with MBOs - assessing the suitability of the business for a buy-out, approaching the potential seller and considering the level of investment (Pearson 1990) are the first test of management abilities. The potential MBO does not have to be profitable at the time of acquisition to be a viable proposition but clearly it should be demonstrable that profitability can be achieved under the new order. Other management competences necessary include constructing a business plan, negotiating with interested parties and subsequently running a business (substantially different from managing it for others).

Considerable attention is also required in assessing issues such as industrial sectors, management and financial controls, the nature of the market and the firm's position within that market (Wright et al 1994). Motivation and leadership are also important as is the ability to take tough strategic decisions such as downsizing. Management team motivation is treated as important in several studies. Green (1988) discussed the benefits of management ownership such as an increased commitment to innovation, potential increase in profitability and discussed four motivating factors, self-interest mutuality, responsibility and control. In a later paper, Green (1992) suggests that organisational decision-making processes and the implementation of cost-reduction strategies had negative effects on motivation.

Managerial skills in the normal functional areas are important (Ward 1992) but so is developing further management skills for the new company. Management and staff development strategies will necessarily be tailored to the business policy of the management team and should not be overlooked.

Finance

A number of crucial issues have to be dealt with when considering the financing of an MBO. Aspects such as the value and expected price of the acquisition (not necessarily the same) and choosing the best advice, arranging appropriate levels of finance and financing mechanisms are important. Selecting financial institutions in terms of what deal they can offer the management team and conditions of support require evaluation.

MBOs are usually financed by a mixture of equity and debt (Wright et al 1992). Whilst, as Wright et al, (1988) noted that the US buyout market was characterised by significantly higher levels of debt than in the UK, MBOs in

this country have carried an extensive debt level. Faced with many financial institutions to choose from, ranging from the clearing banks and venture capitalist through to specialist debt and equity fund providers (Robbie et al 1992) and with different investment requirements, potential MBOs have to strike a balance between equity and loans. Pearson (1990) suggests that expert advice is necessary as financial and legal matters involved may be well beyond the experience of the management team members. More than one advisor is the norm although Wright et al (1988) found that 3.8% of MBOs appeared not to use an advisor.

Other important issues include the transfer of pension fund assets and liabilities and dealing with restrictions imposed by financial institutions including warranties and indemnities.

Negotiations

Negotiations for the setting up of the MBO can be lengthy and at times frustrating. An important additional point is that the management team is in a relatively vulnerable position; effectively the management team is negotiating with its employers and, if the MBO proposition is unsuccessful, they may have a desire to retain their current positions. Professional advisers have an important role to ensure that negotiations do not prejudice the positions of the managers involved and on occasion may seek an undertaking that the parent company will not enter into negotiations with an outside organisation until the MBO proposition has been resolved.

A number of parties will be involved in the negotiation process, the management team, the parent company, providers of finance and professional representatives of all the parties concerned. Essentially the management team should be ascertaining as far as possible that the resulting buy-out will be a fair reflection of the value and selling price of the company to them and that they possess the assets with which to operate the company. The rights to any trademarks or other intellectual property rights, goodwill, etc., should be included together with a survey of the tangible assets of the potential MBO (Pearson 1990).

Wright et al (1994) warn that controls against management opportunism have to exist in privatization MBOs, for example to ensure that managers pay a fair price for the purchase of public assets but that such controls should not stifle management motivation to undertake the risk of buy-outs and thereby lose opportunities for efficiency gains. Wright et al also argue that the sustainability of former public sector MBOs depends greatly on their ability to meet the increased competitiveness or product and product life-cycle restrictions.

MBO Performance

The literature regarding the prediction of MBO performance suggests that both financial and non-financial variables are important (Keasey and Watson

1991). Non-financial variables will include management competence and pro-action, the timely implementation of restructuring and organisational change, downsizing, process and systems re-engineering, product-market development and the extent of monitoring duly undertaken. Houlden (1990), Singh (1990) and Wright et al (1995) found that buyout companies performed better than industrial averages over the medium term of about 3 years but after this performance varied widely between MBOs. Singh takes the view that motivation is a significant contributory factor in improved performance but re-sizing and restructuring may also be important. Otek (1994) also argues that MBOs have the potential to improve performance related to organisational change and improved operating performance.
Many factors affect the success or otherwise of the new MBO. Wright et al (1996) suggest that early restructuring of the organisation is an important aspect of subsequent success. Others argue that appropriate performance measures are an essential initial step. Ronstadt (1986) suggests that entrepreneurial perspectives have an important bearing on the future of the MBO.

However, not all factors are within the control of the management team. Wright et al (1996) argue that changes in the economy and the market can put pressure on new MBOs and affect the MBO life-cycle. Although they suggest that there is little systematic research into MBO failure, the changing of economic and allied market conditions may seriously affect the financial stability of the organisation and bring about a loss of confidence on the part of financial backers.

MBOs which did not increase operational performance within a short term after formation were more likely to be unsuccessful (Kaplan 1989). Wright et al (1994) find that early exits from MBOs are associated with financial institutions being in a relatively stronger position in management and with rapidly changing market conditions. Weir (1996) discussed entrepreneurial issues relating to MBOs and argues that, if MBOs are based on entrepreneurial drivers, MBO performance will be superior to pre-MBO performance. He concludes that MBO activities generally contain a high content of entrepreneurial behaviour.

Wright et al (1995; 1996) suggest that MBOs, as a means of corporate reconstruction and new organisational form, has a longer-term future than predicted in the 1980s although it is true that some MBOs change dramatically in the short term. Wright et al (1995) further support Kaplan’s heterogenity view derived from his study of US MBOs (Kaplan 1989). Wright et al suggest that the survival of MBOs is related to factors such as the scale of the buyout, institutional control and the number of buy-out team members. On the other hand, Oftek (1994) argues that MBOs have the potential to improve performance related to organisational change and improved operating performance and argues that performance is an essential aspect of successful MBOs.

A particular challenge for the new company will be in the retention of suppliers and customers. The buy-out may give rise to uncertainty on the part of these

stakeholders, suppliers in terms of the commercial risk of supply and customers in the ability of the new company to maintain product features such as quality and product attractiveness.

Finally, Wright et al suggest that mechanisms for exiting the MBO should be considered, either as a way of minimising losses or in terms of selling the operation as a profitable concern. The eventual form of exit is important because of taxation, legal, financial and performance issues. Exiting the current MBO format is not necessarily a signal of failure or internal change such as the breakup of the management team, it can be a positive move, for example to float the company or to provide staff with a greater shareholding.

Fig 1. Illustrates the important activities and factors associated with the setting up and operation of a management buy-out, based on UK practice.

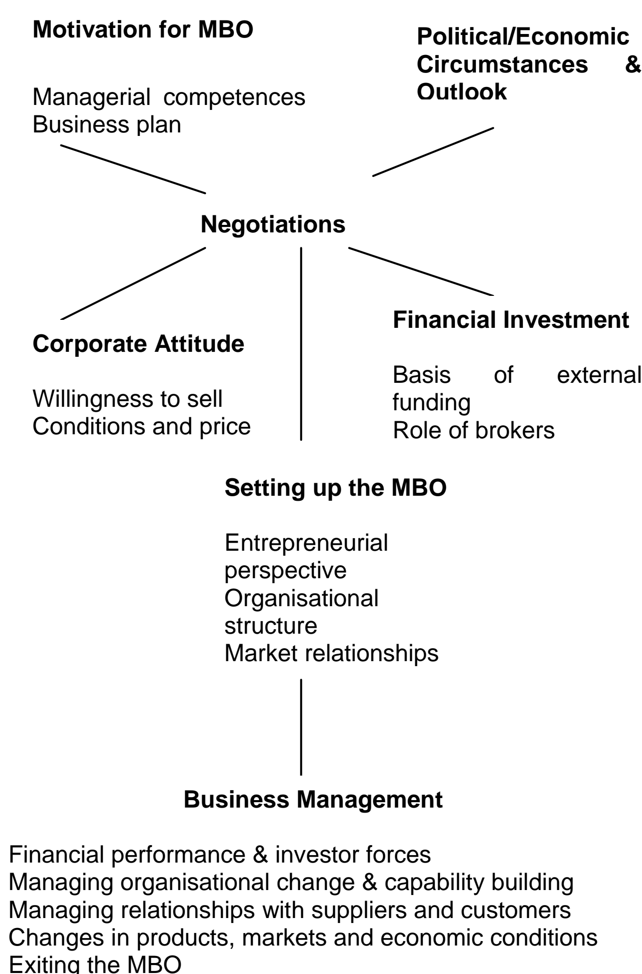

Fig. 1: Important factors in setting up and operating a MBO in the UK

The preceding review of the emergence of MBOs in the UK suggests that success or failure in MBO performance is contingent upon the conditions affecting and the business decisions made at three successive phases of development of the MBO:

Phase 1: the Negotiations Phase; when the basis of ownership, start-up resourcing and control is established in the wider context of the political/economic conditions and forecast opportunities for the business.

Phase 2: the Setting Up Phase; when external market relationships are consolidated and decisions are made regarding the organisation and direction of the business.

Phase 3: the Business Management Phase; when strategies to improve the efficiency and effectiveness of the business are implemented and financial performance is closely monitored.

This model of MBO development is used to review the experience of three Polish companies which were privatised in 1991.

Case Methodology

In 1996, the authors, as a part of a tutor training programme with four Polish technical universities, had the opportunity to be involved in making a set of business audits on-site of a number of Polish firms. Three of these were manufacturing firms that had been privatised in 1991. Information about the progress made by these firms was obtained from interviews with senior management and supplemented by company annual reports. For reasons of market sensitivity the names of the companies reviewed in this paper are withheld.

MBOs Development in Poland

The three Polish MBOs were each firms of long-standing. Each was unlike the other in terms of their products and the industries they served. The period of their operations reviewed covered the years 1991 to 1996. This was a period of transition in Poland when the political and environmental factors active in these years strongly influenced the process of development pursued by these companies.

The Negotiations Phase

The circumstances of the prevailing macro-environment in Poland at the start of the 1990's conditioned all aspects of the negotiations phase founding these MBOs.

Poland's 'shock therapy' transition to a market system, by way of Balcerowicz's reforms of 1989 - 1991 and culminating in the re-negotiation of Poland's crippling foreign debt in the early 1990's, created a national psychology of optimism that the renewal of links with the West would result in economic growth. The Polish Government encouraged a process of so-called

"small privatisation" of shops, small businesses and small factories as a means of giving quick effect to fostering the market mentality.

The enthusiasm for the free market was also founded in a realistic appreciation of the precarious position of Poland's economy at the end of the 1990's. Servicing the foreign debt of over $40 billion threatened economic collapse. The break-up of the Soviet Union, the dissolution of the CMEA and the re-unification of Germany had broken established foreign trade links. Exports to the former Soviet Union countries suffered a permanent collapse. Unlike the strategic and politically powerful industries, for example, coal and ship-building, which would continue to expect public subsidy, the small firms sector had to become self-reliant.

The Ministry of Privatisation and the State Treasury as the corporate managers of the Polish privatisation process and the managers of the small firms shared this appreciation of the then economic situation and had a common interest in divesting control to company level.

The privatisation process was underway by mid-1990. Polish regulation allowed a number of methods of privatisation: public offering, the selling of a whole company to an individual or group of investors, the liquidation and sale of company assets, the leasing of a state company, and, as of 1995, "Mass Privatisation" by the creation of the National Investment Funds (Karziewicz,1995). The companies investigated by the authors were manufacturing concerns which were acquired as whole companies by their existing managers and employees. To facilitate the transfer of control, lacking sufficient capital, the boards of the new companies had negotiated long-term deferred asset acquisition provisions with the fixed assets being retained by the State Treasury as collateral.

The three privatised firms, on entering the emerging market system of the early 1990's, were unchanged in terms of their managerial and operational capabilities; although they had the safety net of the long term purchase agreements from the State, they were under-capitalised; and with their markets in the former Soviet Union lost, they were reliant on the then uncertain prospects of the Polish domestic markets.

The Setting Up Phase

The profiles of the three companies were as follows:
Case 1 specialised in the manufacture of marine ship control systems. Its main customers were the Polish shipyards. It had a total of 18 internal shareholders. It employed in excess of 120 and, although not the dominant Polish producer, it held around 25% of the Polish market.

Case 2 manufactured marine pumps, overhead industrial cranes and bronze castings. Its customers for the pumps and the cranes were the Polish shipbuilding and the Polish coal and energy industries respectively. It had a total of 320 shareholders, all within the company. It employed in excess of 450 employees. The firm was one of a small number of Polish suppliers of pumps and cranes.

Case 3 manufactured arc welding equipment. Its customers were a diverse range of Polish industries. It had a total of 360 shareholders at the time all internal to the company. It employed in excess of 500 employees.

Operational control in the three companies was managed by senior management teams involving a managing director and key functional directors. They were accountable to small supervisory boards and periodically reported to shareholder assemblies.

In the setting up period in 1991-92, the companies had concentrated on retaining their existing suppliers and customers and on maintaining their employee levels. In effect then the MBO process achieved pursued a "little change”, "business as usual" outcome.

Business Management Phase

In the early years to 1994, in the immediate difficult trading conditions following the "shock therapy" reform process, the three companies defended their trading positions. Existing relationships formed over the years mattered but sales also depended on price.

The re-organisation of the companies was achieved only slowly. All the case companies designated a sales and marketing director and team during 1992. Financial management procedures were revised within each of the companies over the full period in part by the introduction of standard financial accounting IT and also reflecting the requirements of changes in Polish Accounting regulations. The companies also early embarked on the process of achieving ISO9001 quality accreditation.

These adaptations reflected trends common to the industries in which the companies were engaged as suppliers.

During the period each of the companies pursued a cost-reduction objective principally by reducing the employee count through natural wastage. By 1996, the total employee count in cases 1, 2 and 3 was 95, 395 and 330 respectively. As a result of this process by 1996 small percentages of the original shareholders were retired but retained their stake in the companies.

The improving circumstances of the Polish economy were reflected in improved sales in the three companies from 1993. During 1995 each of the companies had restructured, largely along functional lines and the limited introduction of new 'blood' at middle and senior manager levels had been made.

The pace of change at the three companies differed. One company, case 1, made use of an external consultant during 1995 to advise on systems improvements. This resulted in the introduction of an IT based project management system which greatly increased efficiency and materials management. However, although the company recognised a need to diversify into the markets for on-shore control systems it had made little effective progress in this regard.

Company case 2 had the greatest complexity of production processes and product variety. It was progressing towards a restructuring of the company along a business unit basis serving its distinctive product markets; pumps, cranes, fabrication, castings.

Company case 3 had made greatest strides with regard to embedding a quality culture within the business and, as required for the distribution of its welding product, had established an extensive dealer network.

None of the companies had successfully entered the Western European markets. They saw the Zloty as overvalued and could not afford the cost of establishing agents in these markets. They were apprehensive about the growing impact of Western producers in their own markets but were held back by the high cost of loan capital from making substantial investments in new plant or in product development.

Although each of the companies had substantial "bought in" component purchases they each maintained extended internal production capacities and had concerns for the security of their supply chains.

In short, none had taken a radical route in defining its business strategy. Product-market specialisation remained essentially unchanged. What organisational development was evident lay in the improvement of capabilities as evident in the marketing function, financial management and quality systems. The profit performance of the companies was improving but they remained unattractive to external investors; indeed there was no indication amongst the management teams that they wished to exit from control of their companies.

Discussion

The MBO mechanism has been widely adopted in the privatisation programmes of Central and Eastern European countries as a means to improving business performance (Filatotchev et al 1994; Wright et al 1994). The premise held has been that by providing managers with the opportunity to hold a financial stake in their business, they will have an incentive to improve business efficiency and exploit new market opportunities. In the Polish cases reviewed in this paper there is evidence in particular to confirm that there have been significant efficiency gains but that market innovation has not occurred.

The transition economies have undergone more fundamental and unpredictable change processes that was the recent situation in the UK. On account of these contingent circumstances, the business recovery and growth strategies which have been effective in MBOs in the UK, in large measure based upon the availability of investment capital and more readily forecast markets, have not been readily applicable.

Studies such as Wright et al (1994) and Filatotchev et al (1994) have considered the use of MBOs in the transformation process from both an ethical and return on investment perspective. Viewed as an instrument of transition, MBOs are a factor of industrial restructuring but management may be buying from a state system that is not set up to realistically value the MBO, therefore opportunities exist for asset profits to be made by managers at the expense of the state. In the cases examined in this paper there is no evidence that the shareholders in the MBOs have gained an excessive benefit. Indeed the Polish Government appears to have achieved a solution in the public interest in its handling of the "small privatisation" process.

The privatisation process in Poland has been the subject of extensive debate over the past eight years. The evidence of the three Polish MBO cases reported upon in this paper suggests that for small firms, at least, privatisation has been worthwhile. The success of entrepreneurship within the MBO in the transition economy cannot be judged simply by the evidence of profitability as this may be the result of short-term strategies (Filatotchev et al 1994). Moreover Polish managers themselves are more likely than their UK counterparts to be inexperienced in buying companies let alone in setting strategic and business plans for the buyout. How such organisational learning can be measured is no less relevant. The issue of appropriate indictors for predicting the performance of MBOs is important given the need for the monitoring of business effectiveness to improve the direction of industrial investment and control of commercial debt in Central and Eastern Europe.

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