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Strategy, Structure and Spontaneous Privatization

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Abstract

Managers and workers in many parts of the former Soviet Union are now able to acquire significant property rights without payment and on their own initiative. This paper reviews the legal changes which initiated this process of "spontaneous privatization," as well as recent proposals which are designed to bring it under control. The authors also report the results of an empirical project in Kiev, Ukraine, which show that spontaneous privatization is not one phenomenon but several. Each version of spontaneous privatization is the result of different managerial strategy. This finding indicates managers are learning to cope with the unstable economic environment, but it also suggests difficulties ahead for government privatization plans in both Russia and Ukraine.
I. Introduction

Over the past several years, new laws have enabled managers and workers in the former Soviet Union to acquire significant property rights in their enterprises on their own initiative and often without payment. This process, known as "spontaneous privatization," remains extremely controversial. There are accusations it is simply theft (Boulton 1992), but also suggestions that it is the only way forward for state enterprises (Uchitelle 1991). What is the evidence about spontaneous privatization, and how should we interpret it?

We first require a clear definition of spontaneous privatization. Using the approach of Grossman and Hart (1986) we consider a firm to be a set of assets and ownership to consist of residual rights of control over those assets. These control rights are residual because any firm also must fulfill its contractual obligations. Spontaneous privatization occurs when managers acquire residual rights of control over their firm on their own initiative.¹ If property rights are considered in this way, it is evident that a change in the legal form of an enterprise -- de jure privatization -- is neither necessary nor sufficient for spontaneous privatization.

We also need to define two further concepts which help us distinguish among the simultaneous decisions being made by managers. We adopt Chandler's (1962) definition of managerial strategy as "... the determination of the basic long-term goals and objectives of an enterprise, and the adoption of courses of action and allocation of resources necessary for carrying out these goals" (p. 13). Chandler also defined structure
as "the design of organization through which the enterprise is administered" (p.14), and we also use this concept although in the context of the former Soviet Union it needs to be significantly modified. "Structure" in this paper will be considered to include both the internal organization of the firm and the way in which the firm is related to other entities, such as various government bodies.

These definitions are extremely useful, because they enable us to examine how the existing structure of a firm conditions the strategy pursued by managers, but also what strategy implies for the firm's structure. Residual rights of control, contractual arrangements and property form are all essential parts of a firm's structure.

When viewed in this way, spontaneous privatization becomes a rather complicated phenomenon. Legal reforms instituted after 1987 initiated changes in the structure of firms, which previously had remained relatively stable for a long time. Confusion was created about precisely who had residual control rights over firms, at the same time as there was a weakening of the state's control over firms -- which had always been enforced through tight centralized control over supplies. Very rapidly managers found they needed new strategies in order to sustain their enterprises. But in order to be viable new strategies required further changes in structure which went far beyond the original intentions of reformers and which further weakened the remaining mechanisms of central control.

In order to gain more insight into this process we have begun a project to interview managers of state firms, and this paper provides an interim report of our main results. Because there is scant information on the population of state firms in the former
Soviet Union, we decided it was not possible to select a representative sample of firms from across the whole country -- there would be many sample selection biases of which we were not sufficiently aware. Therefore we are in the process of interviewing all the state enterprises in one city -- Kiev, capital of newly independent Ukraine. The appendix provides details about the 198 non-military enterprises in Kiev, and the distribution by sector of the 68 interviews which we have conducted so far.2

Of course, each city in the former Soviet Union has its own characteristics and composition of industry, so we do not seek to generalize even to the level of Ukraine as a whole.3 Kiev was selected before we had detailed knowledge of how spontaneous privatization was proceeding, and it is certainly our impression that firms in Kiev are not on the leading edge of privatization in comparison with either Russia or western Ukraine. At the same time, Kiev is very interesting, not least because although it is now the capital of a largely independent country, it remains very much affected by what happens in Moscow.

Although this research project is still ongoing, we do have several important preliminary results. First, almost all the enterprises we have interviewed are now subject to the same set of new external pressures, and most of the structures within which they used to exist have simply disintegrated. Second, the responses of enterprises to this new situation are radically different -- managers have devised a variety of response strategies.

Third, we can discern some systematic variation in these strategies by type of enterprise, where type is determined by the level of government which the enterprise was under up to mid-1991. Enterprises in the Ukraine were previously under three different
type of ministries or ministerial-type organizations: USSR ministries, republican ministries, and local government organizations. The all-Union ministries usually controlled the bigger enterprises in heavy industry, defense and machine building. The Ukrainian Ministries usually controlled light industry and producers of consumer goods, and local government controlled construction, some food processing and service related enterprises. We find some former all-Union enterprises have quite different strategies from former republican enterprises or local enterprises.

Fourth, many of these strategies involve spontaneous privatization, but the role played by changes in residual control rights varies greatly between different strategies. Specifically, we can identify three roles for spontaneous privatization: to reconstruct former hierarchies, to build new hierarchies, or to make the firm more independent.4

The paper begins with an explanation of the new operating environment for state firms. Section II provides a brief summary of how new organizational forms emerged, and section III reviews the latest government privatization plans. Section IV provides evidence from our interviews with managers. Section V concludes with an overall assessment.

II. The Organizational Basis of Spontaneous Privatization

A major catalyst for the process of spontaneous privatization in the former Soviet Union was the emergence since 1987 of a variety of new property and business forms alongside traditional state enterprises. A partial list includes cooperatives, leasing, small enterprises, joint ventures, joint-stock companies, concerns, associations, state
corporations and holding companies. The diversity of forms is misleading, however, since in practice there is no discernible difference between some of the forms, and indeed they are often used interchangeably. The new organizational forms have served as the basis for several basic types of spontaneous privatization.5

The earliest form of spontaneous privatization was the establishment of cooperatives, small enterprises and other types of subsidiary firms under and around existing state enterprises, usually as a means of circumventing the production plans (state orders), wage and price controls, tax obligations and other restrictions applicable to state enterprises. Gorbachev's initial enterprise reforms fueled this movement by keeping state enterprises under a tighter regulatory leash than the cooperatives, while authorizing the establishment of cooperatives that would be attached to state enterprises. Over 80 percent of the 260,000 cooperatives operating at the end of 1990 were attached to state enterprises. The boom in cooperatives was facilitated by laws enabling groups of workers to lease equipment and premises from the sponsoring enterprise for a fixed term.

The small enterprise (maloe predpriyatie, or MP) emerged in 1989 as an alternative to state-sponsored cooperatives, which were tainted by speculation and price-gauging. In lieu of establishing cooperatives, state enterprises were allowed to hive off shops, subdivisions and other structural units as substantially independent, albeit nominally state-owned, enterprises. Legislation passed in 1990 permitted private ownership of MPs, fixed ceilings on the number of their employees, and bestowed them with a host of special tax concessions to promote their development. The number of
MPs mushroomed in 1991 as many existing cooperatives as well as subunits of state enterprises took advantage of the opportunity to reduce their tax liabilities by converting themselves into small enterprises. Notwithstanding the de facto legalization of hired labor within permitted limits, formal ownership of the vast majority of MPs remained vested in the state.\(^6\)

The next stage of spontaneous privatization was the establishment of shareholding corporations as a vehicle for management-employee buyouts of enterprises. Such takeovers usually have been accomplished by converting state enterprises into joint-stock companies (aktsionernye obshchestva, or AO) of the closed type, in which shares are not tradable outside the firm. By freeing enterprises from the direct administrative control of ministries without establishing a system of corporate governance by shareholders, this arrangement results in the complete entrenchment of managers.

Above the enterprise level, there has also been a widespread transformation of the ministries and intermediate-level main directorates (glavki) into a variety of commercial forms.\(^7\) The "corporatization" of the ministries began when groups of enterprises separated themselves from their ministries on their own initiative and organized "from below" three interbranch state associations (mezhotraslevye gosudarstvennye ob'edineniya, or MGOs), which were also sometimes called concerns (kontserny). In the wake of a major cutback in the ministerial apparatus in 1989, corporatization was appropriated as a survival strategy by ministries that were targeted for liquidation. The "liquidated" ministries were reincarnated as state concerns and associations (assotsiatsii). This process accelerated after the failed coup of August 1991.
One-by-one, former all-Union ministries were abolished and replaced by state concerns, associations, corporations and holding companies.

The progressive disintegration of the centralized distribution of supply also led to spontaneous changes in the way enterprises acquire inputs. The wave of corporatization and mergers described above played an important role in this process. Enterprises protected their supply channels by joining concerns and associations and by distributing shares to their suppliers. There has also been an increased reliance on barter. Most striking was the rapid development of a network of commodity exchanges (birzhi), which mushroomed to over 200 by summer 1991. Most exchanges were founded by large industrial enterprises and by commercial centers and territorial administrations of Gosnab, the former state supply organization. Thus, as in the case of other new business forms, the rapid growth of exchanges largely reflects the transformation of existing state structures rather than the initiative of independent entrepreneurs.

Two general problems with the forms of spontaneous privatization described above are noteworthy. First, because the new business and property forms allow managers and workers to gain control of enterprises without giving them clear legal title to the assets, they tend to create incentives to siphon off income and assets from enterprises rather than to increase their value. Second, the corporatization of the ministries preserves and entrenches their monopoly position, and to some extent allows them to maintain control over "their" enterprises. As a subsequent section shows, however, evidence from Ukraine suggests that the role of concerns and associations varies according to which authority -- union, republic or local -- the enterprise was
previously under.

III. From Spontaneous to Managed Privatization?

In 1991, a leading study of the problems of transition in the Soviet economy expressed adamant opposition to spontaneous privatization on grounds of both equity and efficiency (Peck and Richardson, 1991, p. 160). By transferring ownership of firms to managers and workers, the study suggested, spontaneous privatization would create arbitrary inequalities in the distribution of income and wealth, encourage firms to allocate income to wages and salaries at the expense of investment, and fuel a political backlash. This opposition to management and workers becoming dominant owners, combined with a recommendation favoring the sale of shares over free distribution, by implication supported a strategy of privatizing by selling firms to outsiders, through both public offerings of shares and sales to foreign investors.

Recently this view of spontaneous privatization has been challenged by a growing number of economists and practitioners who espouse a more benign view. The "revisionist" view emphasizes that spontaneous privatization, once in progress, cannot easily be halted or reversed, and that it has positive properties that can be usefully harnessed in the service of rapid privatization. This view draws a lesson from the Hungarian and Polish experience with strategies that initially favored "outsider" privatizations. The pace of privatization under this strategy proved much slower than expected or desired, in part because of resistance by insiders to proposed sales, but also because of the scarcity of acceptable buyers. In contrast, spontaneous privatization
proceeds rapidly because it is initiated by the managers themselves.

The revisionist prescription is not to prohibit spontaneous privatization, but rather to regularize it by establishing a clear legal framework designed to place the process under supervision by competent authorities and to make it fairer, more efficient and politically acceptable. For some proponents, this means that the privatization strategy should recognize the ownership claims of managers and workers by granting them concessions that are structured both to clarify the ownership rights of insiders and to persuade them (and possibly other claimants) to cooperate with and actively support privatization. Proposals to grant workers a substantial block of shares in their firms at the moment of their conversion into joint-stock companies (corporatization or commercialization) are an example of this type of policy.10

The basic legal framework of privatization in Russia has been elaborated in stages, beginning in July 1991 with a law on the privatization of state enterprises (O privatizatsii, 1991), and continuing from December 1991 with the "Basic Provisions of the Privatization Program" (Osnovy, 1992) and supplementary guidelines on various elements of the program.11 The stated intent of the privatization program was to stop the process of "nomenklatura privatization" by putting into place uniform and transparent procedures designed to ensure that state enterprises are sold only through competitive processes, such as auctions.12 Further, the program has been attacked by advocates of employee ownership for slighting the interests of workers.13 Nevertheless, the program is largely consistent with the policy implications of the benign view of insider privatizations.
For small enterprises to be privatized by local governments, the program paves the way for management-employee buyouts by establishing procedures that favor insiders. First, local governments are allowed to sell enterprises not only by means of transparent auctions, but also through competitions, in which non-price criteria are considered. Second, groups of workers are entitled to purchase small enterprises at a 30-percent discount off the sale price with a 1-year deferment of payment. Third, enterprises are permitted to set up privatization funds out of net profits and incentive funds for the purpose of buying enterprises.

For large enterprises to be privatized through corporatization, the program seeks to prevent the complete entrenchment of managers by specifying that they may be converted only into open joint-stock companies with outside shareholders and boards of directors. Under a planned Mass Privatization Program, large enterprises in key sectors would be offered for sale to foreign investors, and shares in thousands of other enterprises would be offered to the public, along with workers and managers, through a system of individual vouchers and investment trusts. There are, however, concessions to the claims of insiders. Workers will be given free of charge 25 percent of the shares, up to a limit of 20 times the minimum monthly wage per worker. While the shares are immediately tradable, they are preferred, or initially non-voting, so as to prevent workers from gaining control of companies before they are privatized. In addition, workers have the option to purchase another 10 percent of shares at a 30-percent discount off their face value, and they are entitled to receive 10 percent of the proceeds from any future sale of shares. Managers have the option of purchasing up to 5 percent of the shares at
face value. The idea is to give workers and managers incentives to cooperate with and support the privatization process.

Privatization in Russia is further complicated by conflicts between different levels of government (city, oblast, central) over control of state enterprises and by the existence of ethnic republics that have asserted ownership claims over enterprises located on their territories. The privatization program assigns to local governments the right to privatize small enterprises, and they could use their ownership rights to derail privatization. A full discussion of this issue is beyond the scope of this paper. It is worth noting, however, that the Russian program attempts to induce the various levels of government to carry out privatization by buying them out with a large share of the privatization proceeds.

Economic reform in Ukraine has tended to follow developments in Russia with a lag. Laws on the privatization of state enterprises were passed by the Ukrainian parliament in March 1992 (Law of Ukraine "On the privatization "). The Ukrainian legal framework for privatization differs significantly in details from its Russian counterpart, but like the Russian program it is nevertheless broadly consistent with the view that spontaneous privatization should be regulated by legal norms rather than prohibited altogether. For small enterprises to be privatized by auction or contest, the law favors insiders by allowing groups of workers to buy their enterprises on favorable payment terms, and also by granting them a priority right to purchase enterprises before outside buyers on equal terms of sale. The procedures regulating the privatization of large enterprises grant concessions to insiders in the form of preferential rights to
purchase shares on price and payment terms that are more favorable than the market terms available to outsiders.

By examining the Russian and Ukrainian privatization plans in light of the debate over spontaneous privatization, the foregoing discussion glosses over the gaps and flaws in both plans, and oversimplifies what is in reality a complicated and confusing process. The Russian privatization program in particular has been criticized for taking an excessively detailed, centralized and complicated approach to privatization that is bound to prove difficult to implement. As a result, privatization in both Russia and Ukraine may well continue to be more spontaneous than managed for the foreseeable future.

IV. Structure and Strategy

Operating conditions for state enterprises in Kiev have changed dramatically over the past two years. By early spring 1992, all Kiev managers had to deal with the three new problems mentioned in the previous sections: the devolution of decision-making to the enterprise-level, the disruption of previously established economic ties between enterprises, and the imminent prospect of government-sponsored privatization.

Yet although managers face similar problems, our interviews have revealed significant differences between managers in their responses. This section shows interesting and significant differences between managerial strategies and the meaning of spontaneous privatization at three levels: in former all-Union enterprises, in republican enterprises, and in local government enterprises.
1. Former All-Union Enterprises

Before perestroika, most all Union enterprises operated at the bottom of a hierarchical structure with four tiers: ministry, main directorate (glavk), ob"edinenie, enterprise. The ministry controlled all enterprises in its general area, the glavk was responsible for a group of related enterprises under the ministry, and an ob"edinenie consisted of a main enterprise and several subsidiaries. All enterprises in an ob"edinenie were usually involved in the same production process.

Most all-Union managers report that between 1989 and 1991 their ministries had been either abolished or fused with other ministries, and by the spring of 1991 they were under the control not of a ministry but of an all-Union concern, association or ob"edinenie. These all-Union organizations were as a rule composed of all the enterprises that once belonged to a particular glavk, although some were created from enterprises in different glavki, and even different ministries. As a rule, managers report that while in principle they were supposed to join these concerns "voluntarily", in fact they were not really given a choice -- the responsible authorities in Moscow simply declared concerns to be in control.

From our interviews, we know these inter-republican organizations still operated up to November 1991, but after that month links between enterprises in Ukraine and controlling organizations in Moscow have all been broken. Previous all-Union enterprises have had to re-register with a committee (the new name for a ministry) of the Ukrainian Government.

However, the Ukrainian bureaucracies established to take over many of the
ministerial functions are simply not capable of performing the required tasks, particularly the provision of inputs, machinery and hard currency. Although it is evident the new Ukrainian committees would like to be influential, they are still very inexperienced and under-staffed, and simply can not perform effectively. As a result managers in former all-Union enterprises have both enormous freedom and complete responsibility for their enterprises.

In this context we have found two quite separate managerial strategies: to reintegrate the firm in some form of hierarchy, and to achieve full independence for the firm. Within each strategy there are several variations, each of which involves a different role for spontaneous privatization. We consider each in turn below.

a. Hierarchy

Some managers have reacted to the collapse of all-Union ministries by attempting to rebuild hierarchical structures from below. These new structures can involve vertical or horizontal integration of production. According to the precise goals of managers for this new structure, an appropriate form of spontaneous privatization can be selected.

Several companies we interviewed are trying to vertically integrate -- both upstream and downstream -- the entire productive chain of a good within one firm or association. Such integration is not usually attempted for the whole range of an enterprise's products, but rather for a particularly profitable product or subgroup of products.21

These new organizations are not merely forms of contracts signed by firms. In
order to monitor all participants in these deals, some residual control rights are assigned to the new organization. Although these organizations are often not new de jure property forms, they represent a de facto repackaging of the control rights in the participating enterprises. They therefore fit exactly our definition of spontaneous privatization.

The second type of hierarchical strategy involves the creation of new organizations which horizontally integrate firms producing the same goods or related goods. These new horizontal organizations come in three main forms. The first unites enterprises that produce complementary goods and enables them to increase their combined product range.  

An example of a second type of horizontal reorganization is the electronics sector in Ukraine, where 145 enterprises have agreed to form a holding company with the aim of duplicating some of the tasks previously done by the ministry. As a manager in one participating firm put it, "we are uniting to survive". The holding company will attempt to coordinate the distribution of supplies which are hard to obtain, coordinate some parts of the production chain and lobby the Ukrainian government.

A third type of new horizontal organization unites enterprises producing the same type of goods to form a cartel. These cartels usually involve a small number of firms which together account for most of a particular good's production in Ukraine. In Ukraine, for example, most of the larger enterprises that produce printing presses and book-binding machinery have formed such an organization. Their aim is to have a small staff that will coordinate their production, handle negotiations with suppliers and
represent their interests to the government. The future of such organizations will depend on the effectiveness of Ukrainian government anti-monopoly policy. An antimonopoly law already exists and there is a minister responsible for "destatization and antimonopoly," but we have yet to see any concrete results.

b. Independence

The strategy of independence is completely different from any version of the hierarchical strategy. Managers who want independence seek to retain all residual control rights at the level of their firm. Their interaction with the outside world will be through contracts and market transactions, rather than by participating in an organization which has any kind of hierarchical structure.

As a rule, three conditions must exist for an enterprise's management to choose an independent strategy. The first is that the top manager (director) must want to free himself from bureaucratic interference. If the enterprise director is afraid of operating by himself, he will instead choose some form of hierarchical strategy. Second, workers and managers (the "work collective") must agree with the strategy. The legal arrangements through which a firm can gain independence are actually agreements between the state and the work collective. Interestingly, in our interviews so far we have not encountered a single case where managers were unable to convince workers to support their strategy. The third condition for an independent strategy is that the enterprise produce a good which is in high demand and for which the supplies are secure.
Former all-Union enterprises seeking independence can be grouped in three different categories, according to their progress so far towards this goal. The first and smallest group includes enterprises that have already been privatized -- they already have complete independence. These enterprise usually started an active dismantling of their ties to the state in 1989 or 1990, and thus were able to avoid or receive an exemption from the November 1990 decree which forbade Ukrainian enterprises from changing their property form.

In Kiev a leading example is a factory that produces agricultural machinery. The enterprise was leased with the right to buy from its all-Union ministry by the "workers' collective" in September of 1990. According to our interviewee, this company was the first enterprise within this ministry to go on lease, a step which was made easier by the fact that Moscow felt the enterprise to be "far away" in the provinces. Within three months of signing the lease agreement, the enterprises' managers had manoeuvered to buy the firm from the ministry, and received special permission from the Ukrainian government to do so despite the moratorium on property change. Managers of this enterprise stated that when they first leased the enterprise they did not tell their ministry that they ultimately intended to purchase the firm because they feared the ministry would not cooperate.

The main incentive for this firm to become independent is the strong demand for its machinery, both from state firms and from new private farmers. High demand has put the firm in a position of strength vis-a-vis its customers, as reflected by the high proportion of barter in this firm's transactions. In addition, this firm has an established
export market, which enables it to purchase inputs and technology for hard currency from supplies both inside and outside the former Soviet Union. Undoubtedly relations with its suppliers -- most of whom are located in Russia -- are becoming more complicated, but the firm is now beginning to diversify away from Soviet suppliers, and is planning two joint ventures for the assembly of foreign-designed excavators that will have a relatively high percentage of foreign-made components. This firm simply does not need to cooperate on a non-market basis with any other Russian or Ukrainian firms.

The second group of firms seeking independence consists of enterprises that are already leased from the state by the workers' collective. Many enterprises now rented by their workers' collective actually signed a lease agreement which gave them the right to buy the enterprise. However, the 1990 Ukrainian moratorium on property change has prevented most outright purchases, so the majority of leased enterprises are still formally owned by the state.

Even though immediate purchase is not possible, these lease agreements do allow gradual transfer of ownership to the workers' collective. According to the provisions of the all-Union law on leased enterprises, after signing the lease agreement any new assets belong to the workers' collective -- even if they are financed from retained earnings. Therefore in most leased enterprises a significant percentage of the assets are already property of the workers, and in some cases the workers' collective now owns as much as fifty percent.25

The third group of independence-seeking enterprises includes firms that have neither privatized nor gone on lease, but have simply found themselves with very weak
control from above and have not attempted to strengthen hierarchical links with other firms. Most directors of former all-Union enterprises that remain 100 percent state property report that the Ukrainian bodies set up to control them are inexperienced and undermanned, and are simply not capable of helping them. This is now the default strategy of most managers. If they cannot think of any new ideas, their firms drift alone.26

In summary, looking at the evidence from all-Union enterprises we see quite different strategies may lie behind similar forms of spontaneous privatization. The most important distinction is between forms of spontaneous privatization which are used to build new hierarchical structures, and those which are used to free firms from the remnants of hierarchies. Seen in terms of alternative overall managerial strategy, different forms of spontaneous privatization begin to make sense.

3. Former Republican Enterprises

Republican enterprises, which were always under Ukrainian ministries, are now in a similar situation to that experienced by all-Union enterprises in 1990-91. Ukrainian ministries are beginning to lose control, but the bureaucracy still retains more power over enterprises in Kiev than do all-Union ministries. Almost all Ukrainian ministries have become State Committees or concerns, and are trying to find ways to remain viable even after the full privatization promised by the government.

This creates the possibility for an additional managerial strategy -- some managers choose to rebuild the previous hierarchies above their firms. Other managers pursue the
independent strategies discussed above in the context of all-Union enterprises, but we have not encountered any republican enterprises trying to build new hierarchies for themselves.

The first strategy involves a hierarchy which is basically a renamed glavk, in which previous ties are maintained, and cross subsidies are still very evident. The ministry in these cases has been able to keep people together by delivering inputs. An excellent example is that of the Ukrainian River Fleet which is a new organization of enterprises that were previously under one ministry. Legally, this new organization is a mezhotraslevoe gosudarstvennoe ob'edinenie, or MGO.\textsuperscript{27} This MGO controls the most important products -- cargo transport and fleet maintenance -- and leaves decisions about other products to each enterprise, all of whom are allowed to keep a much larger share of their profits than previously under the ministry. The MGO has access to hard currency, is able to find machinery and joint venture partners for its members, and still has subsidiary organizations that supply raw materials, consumer goods, and imported machinery, and which can find customers and sell abroad. In this case, the entire previous system of output coordination seems to have held, with the exception of breaking ties with a few Moscow enterprises.\textsuperscript{28}

Other hierarchies have been forcibly created from above, but the cases we have encountered are not as successful. For example, a factory joined the concern Uksotzhilmash, which was formed from the ministry of the same name. The enterprise pays dues, and the concern has promised to provide contacts with both suppliers and customers, yet the management of the firm reports that these promises are not being
fulfilled. These managers believe they do not need the concern, but they are afraid to leave it for fear of reprisals. This is a case of a ministerial strategy being forced on a firm, rather than managers choosing a particular strategy.29

Particularly since the beginning of 1992, many enterprises have started to realize that ministries, even at the republican level, are no longer capable of providing inputs. Therefore many enterprises, even those that have joined some of the new hierarchies led by the former ministries, are questioning whether working closely with former ministries is necessary. Some of these enterprises are thinking about the second strategy -- choosing to build their own new hierarchies -- but in April 1992 managers of republican enterprises are just beginning to feel the collapse of ministerial authority, and have not yet had enough time to form new hierarchies for themselves.

However, a significant number of enterprises are already trying to follow a more independent strategy.30 A large subset of such enterprises are subsidiary enterprises that have broken their ties with the head enterprise of their former ob"edinenie.31 There is really no longer any reason for individual enterprises to allow residual control rights to be exercise by the head enterprise. In the recent past the head enterprise had access to state orders (goszakaz) and state supplies, but this is no longer the case.32

As ministerial power continues to disintegrate, we would expect previous republican firms to develop strategies similar to those of the previous all-Union enterprises. There are already signs of changes in residual control rights of republican firms -- managers gain rights while ministries lose rights. Once again, beneath the surface of spontaneous privatization lie significant differences in managerial strategies
and in the ultimate structure for firms.

3. Local Enterprises

We have also conducted five interviews with enterprises controlled by the Kiev City Council and involved in a range of activities. For these enterprises, the changes in hierarchy up to spring 1992 have been minimal and they are still directly funded by the City Council. Most of these firms have no managerial strategy other than trying to maintain the previous structure.33

For example, managers in several construction materials firms report almost no change in the substance of their supervisory organizations in recent years, although some names have been altered. They all have relatively few suppliers and still receive production orders and supplies via the city council. As a result they are now in a very difficult situation -- there was no money in the local government budget for construction between January and March 1992, and this brought these firms to a near standstill. None of the managers we interviewed reported that their firms were trying to find other customers.

Of the firms we interviewed, none of those controlled by the city council had changed their property form. In these enterprises managers are simply panicking because they have never done anything themselves, and now the city has no money. They are already complaining that the glavk takes money but gives nothing. Yet they all want to stay and seem more scared of being independent than the breakdown of the hierarchical structure. In essence, the disruption of their orderly life seems to have
become evident only in the last months, and they do not know what to do -- they have not really had a preparatory period of testing the limits of freedom, unlike enterprises which were under all-Union or republican control.

Managers in these firms have not had time to develop a strategy, and they have no idea how spontaneous privatization could help them to survive. These are smaller enterprises, still very dependent on state orders, and now facing serious problems. Unless they are lucky enough to be in a sector which continues to receive large subsidies, these firms will struggle.

V. Conclusion

Over the past three years, almost all state firms in Kiev have seen their operating conditions change dramatically, usually for the worse. These changes were in large part the result of centrally-ordered reforms which had unintended effects, particularly in the way they allowed managers to gain control of property rights in their firm. Spontaneous privatization helped to undermine the old economic system.

But spontaneous privatization is a complicated phenomenon with several distinct features. There is certainly an element of theft, although it is not clear who -- other than bureaucrats -- is losing effective residual control rights. We also find pervasive evidence that spontaneous privatization is as much a means to achieve a reorganization of the firm's structure as it is an end in itself. Specifically, we find cases in which spontaneous privatization is used to establish a more independent firm, but also instances in which it helps build new hierarchical interdependence between firms. Spontaneous privatization
is an important element of managerial strategies, and the priority goal of these strategies is simply survival.

Although our evidence is not yet complete, we do find strong indications that managerial strategies differ systematically across firms. Managers in local government controlled firms seem to have no new ideas and no strategy beyond rebuilding previous relationships. Managers in republican enterprises are frequently involved in establishing new hierarchical relationships. Managers in former all-Union enterprises seem more likely to pursue independent strategies. These differences in strategies can be explained as due to enterprises' different experiences and current operating conditions.

Previous all-Union enterprises encountered new operating conditions earlier, and have used their experience to devise new strategies. These enterprises also tend to be bigger and to be better endowed with a wide variety of resources. "Ukrainian" enterprises -- those which were under the authority of the republican government prior to August 1991 -- have advantages because they produce consumer goods and they are less dependent on trade with Russia. Enterprises under local government authority are probably in the worst position -- they are relatively small, with few resources, and they have little experience in dealing with the new economic conditions.

On the whole our evidence offers a positive message. Despite the continued instability of the macroeconomy and the lack of a clear legal framework for state firms, managers are finding ways to cope and to alter the structure of their firms appropriately. Given time, many of the managers we have interviewed will probably be able to adapt for survival in a market economy. The relative lack of independent thinking in
republican and local enterprises may be due more to a lack of experience, than to a lack of ability.

The danger in this situation is as follows. The new Russian and Ukrainian privatization laws may restrict or prohibit forms of spontaneous privatization, without replacing it with anything else. To the extent that new property forms are an essential part of managerial survival strategies, such legislation would seriously weaken the ability of firms to cope with continued instability in their operating environment.

Furthermore, merely imposing an uniform privatization plan from above may not be enough. If these plans do not fit with managerial strategies, they will likely be opposed. Given the already very entrenched positions of "insiders" in firms, the most probably outcome would be a stand-off in which neither managers nor the government can take positive action. In that situation, the future of the state sector would be bleak.
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procedure for using the incentive funds and profits of state and municipal enterprises for

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kraev, oblastei, avtonomnoi oblasti, avtonomykh okrugov, gorodov Moskvy i
Sankt-Peterburga i munitsipal'nyuyu sobstvennost' (On the delineation of state property in
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1. In most cases these rights are acquired also in the name of workers. But as we have not yet encountered any cases of open conflict between managers and workers over spontaneous privatization, we use only the term "managers." It really seems that managers are the moving force behind spontaneous privatization.

2. We have also conducted interviews with managers from other places, and a great deal of our understanding is based on conversations with local privatization consultants. However, the examples used in this paper are all from our interview work in Kiev.

3. The next stage in our project will expand outside of Kiev. Pilot interviews are now being conducted in several other Ukrainian cities.

4. Our research also finds spontaneous privatization can be a way to achieve changes within firms. We have reported at length on this aspect of the process elsewhere (Johnson and Kroll 1991). We should note that in spring 1992 in Ukraine the only real path for de jure transfer of assets to private hands is through small enterprises -- but only in those state firms where managers decide to follow this path of internal decentralization.


6. Over 86 percent of the 10,696 small enterprises established in the Russian Federation by October 1991 were owned by the state, almost 13 percent were based on some form of collective ownership, and only 39, or less than 1 percent, were owned by private citizens (Ekonomika i zhizn', no. 49, December 1991, p. 1 of supplement).


9. See, for example, Sachs (1991), Kornai (1991, p. 20), and Shleifer and Vishny (1992). In a seminar presented at Harvard in 1992, Leszek Balcerowicz, former Finance Minister of Poland, endorsed insider privatizations as a means of speeding up privatization in Poland, although he acknowledged that this approach was not politically feasible in the early stage of the Polish reform process.

10. Unlike Sachs (1991, p. 320) or Shleifer and Vishny (1992) Kornai (1991, p. 22) does not advocate partial employee ownership as a strategy for regularizing spontaneous privatization, but neither does he have any particular objection to a moderate form of it.
11. The elements include, for example, methods of valuation of enterprises (Vremennye, 1992, pp. 18-19). Other elements are cited below where appropriate.

12. Chairman of the state property committee Anatolii Chubais stated bluntly that the government intends "to change the nature of the process and to move away from the theft of state owned property" (Bohlen, 1992). Deputy Prime Minister Yegor Gaidar likewise characterized the spontaneous process already taking place as "privatization by robbery" (Moscow TASS International Service, 1100 GMT, December 30, 1991, translated in Foreign Broadcast Information Service, Daily Report: Soviet Union, December 30, 1991, p. 36). See also Boulton (1992, p. 3).

13. In an article published in the newspaper Izvestiya in February 1992, a group of prominent economists criticized the government program and proposed as an alternative the idea of giving away state enterprises to their workers free of charge up to a certain limit, and supplying them with credit to purchase the rest (Piyasheva, et. al., 1992, p. 3). Chairman of the state property committee Anatolii Chubais responded to the attack in a subsequent interview (Chubais, 1992, p. 2).

14. Temporary statutes regulate auctions (O privatizatsii ... na auktsione, 1992) and sales by competition (O privatizatsii ... po konkursu, 1992).

15. The use of enterprise profits and incentive funds for privatization is regulated by a temporary statute (O poryadke, 1992, p. 17).


17. According to economist Jeffrey Sachs, one of President Yeltsin's foreign advisers, the Russian government was finalizing details of the mass privatization program in March 1992 (Financial Times, March 19, 1992). The July 1991 privatization law called for a voucher scheme in the form of personal privatization accounts and deposits that citizens can use to purchase shares (Ob imennykh, 1991, p. 15). The scheme was postponed until the end of 1992, however, because it is costly and administratively difficult to prepare and implement.

18. The division of state property among different levels of government is regulated by a decree of December 1991 (O razgranichenii, 1992, 5).


20. For example, 50 percent of the proceeds from the sale of municipal property goes to local budgets (Velikii, 1992, p. 1).

21. For example, a factory which manufactures agricultural machinery has entered an association with several producers and consumers of potato harvesting equipment. Its managers goal is to insure a steady flow of both inputs and orders. Likewise, a factory that
manufactures machine tools has joined with its suppliers and customers to develop a laminating technology that was previously manufactured only in enterprises outside Ukraine.

22. For example, a large military enterprise in Kiev that produces voltage measuring equipment has been pursuing an aggressive policy of diversification into kitchen appliances. The management now wants to expand into an entire range of domestic appliances, including the production of goods for which it simply does not have the technological know-how or the productive capacity. For this purpose in January 1992 it was negotiating with other firms that already produce electric appliances. The intention is to sell the newly produced equipment under the same brand name.

23. The exact future role of these industry-wide organizations is rather unclear. The ability of any hierarchy to secure supplies and orders is rapidly waning, and will probably continue to decline if the economic reform succeeds and market clearing prices emerge for most types of inputs. It is probable that unless these broad intra-sector alliances of the "unite-to-survive" type find a new role for themselves, they will prove to be only a passing phenomenon.

24. A similar organization has been formed by enterprises that produce electrical cable in Ukraine. This organization was formed when the Ukrainian factories were forced to disengage from a similar all-Union association headquartered in Moscow. The aim — as stated to us in interviews — is to coordinate production and to present a united front to the government when asking for resources.

25. Furthermore, some leased enterprises have been able effectively to avoid making lease payments, by getting their rent included as part of the taxes while paying the same level of taxes as firms which are still state property. In these cases, the enterprise gets the benefits of being leased for zero cost.

26. A large firm that produces consumer electronic equipment is a good example. Formerly under one of the nine central military ministries, this factory joined an inter-republican concern in 1990. However, its relations with this concern, which included all enterprises that had previously been under one main directorate, were much looser than with the ministry. The concern did not give as many orders or decrees as the ministry, but also was unable to give as much help in procurement of inputs. After the August coup the directors of this firm were simply not sure of what steps to take. Their membership in the concern was quickly made illegal, but they were unable to find anyone within the Ukrainian bureaucracy who was responsible for them. Independence for this enterprise was more by default than by choice.

27. This choice of legal form is a little strange, because a MGO was supposed to be for interbranch organizations. However, given the current legal confusion in Ukraine, this represents only a minor curiosity.
28. How did this MGO succeed? Each enterprise director is a member of its board, and everything is decided by voting on this board. As a result, a real consensus has been built among managers. Most importantly, together these enterprises are a powerful monopoly, controlling cargo transport — an essential service which has a large number of customer base. They are also distinctive because of their access to hard currency. Obviously, there is some support at the highest political levels for this monopoly, and at present it appears likely the Parliament will give special permission to allow this MGO to be privatized as a whole.

29. The concern Ukrmestprom is a similar case. Several interviewees said that they are still being helped by this concern and there is no need to leave the organization. However, other factories which belong to this concern, even ones that are near total bankruptcy, complain that they were forced to join the concern against their wishes, and since the concern has not been able to fulfill any of its commitments, they do not quite understand why it should receive money from them. Another firm confirmed this view and argued that nothing can be achieved. Overall Ukrmestprom seems to have promised a great deal, and delivered very little.

30. Interestingly, in some cases the ministry itself pushes its enterprises towards independence. The best example is the Ministry of Timber, where the Ministry actively encouraged entire ob'edineniya to go on lease, and within each obyedinenye, pressured for each enterprise to lease itself from the head enterprise. This only happened where there management was willing. This ministry is trying to change its entire world view, giving away some power which it can probably not enforce, in hopes of having a better chance at establishing a good commercial relationship with this enterprises. In some cases this ministry has helped subsidiary enterprises leave their obyedinenye, usually against the wishes of the head enterprise. In other cases it seems to have forced, or helped force, an enterprise to rent itself out. However, this is still an exceptional ministry — reflected in the fact that in March 1992 the Deputy Minister of Timber was made Ukrainian Minister for Destatization and Demonopolization.

31. We interviewed several managers in different parts of one large ob'edineniye. In spring 1992 all its "daughter" enterprises are breaking away. Managers of the head enterprise cannot do anything to stop them, and are very angry because they feel they supported the daughters for a long time. Now they will be left alone, and forced to survive using only its old capital equipment.

32. A similar point is relevant for a meat processing factory which still gets goszakaz for all of its output. The enterprise, like other large meat enterprises, refused to join the newly created Meat Concern, because the state orders come directly from the government. This firm simply does not need superior hierarchical organizations any more.

33. We did interview a city council controlled meat factory which has decided to pursue a more independent strategy. But this is because the factory has a local monopoly and is virtually guaranteed "state orders," which mean an implicit subsidy in the form of cheap
inputs. For this reason the factory's managers decided to deal directly with the state, and cut out the previous intermediary organization. At the same time, because this is such a politically sensitive sector, it does not appear possible for this firm to privatize itself.
### Appendix

**Distribution of firms in Kiev by sector and number of employees**

<table>
<thead>
<tr>
<th>Sector</th>
<th>250-1000</th>
<th>1000-5000</th>
<th>5000+</th>
<th>Total firms</th>
<th>Interviewed so far</th>
</tr>
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<tbody>
<tr>
<td>Energy</td>
<td>3</td>
<td>1</td>
<td>-</td>
<td>4</td>
<td>0</td>
</tr>
<tr>
<td>Non-Ferrous Metallurgy</td>
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<td>-</td>
<td>-</td>
<td>2</td>
<td>0</td>
</tr>
<tr>
<td>Chemical and Petrochemical</td>
<td>9</td>
<td>3</td>
<td>1</td>
<td>13</td>
<td>0</td>
</tr>
<tr>
<td>Machinebuilding and Metalworking</td>
<td>37</td>
<td>17</td>
<td>5</td>
<td>59</td>
<td>18</td>
</tr>
<tr>
<td>Glass and porcelain</td>
<td>2</td>
<td>1</td>
<td>-</td>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td>Construction Materials</td>
<td>23</td>
<td>4</td>
<td>-</td>
<td>27</td>
<td>11</td>
</tr>
<tr>
<td>Wood, Wood-Working &amp; Paper</td>
<td>9</td>
<td>1</td>
<td>-</td>
<td>10</td>
<td>3</td>
</tr>
<tr>
<td>Light Industry</td>
<td>17</td>
<td>12</td>
<td>-</td>
<td>29</td>
<td>11</td>
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<tr>
<td>Food Processing</td>
<td>16</td>
<td>3</td>
<td>-</td>
<td>19</td>
<td>3</td>
</tr>
<tr>
<td>Pharmaceuticals</td>
<td>-</td>
<td>3</td>
<td>-</td>
<td>3</td>
<td>0</td>
</tr>
<tr>
<td>Flour, Groats and Animal Feed</td>
<td>2</td>
<td>-</td>
<td>-</td>
<td>2</td>
<td>0</td>
</tr>
<tr>
<td>Microbiology</td>
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<td>-</td>
<td>-</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>Printing</td>
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<td>-</td>
<td>4</td>
<td>3</td>
</tr>
<tr>
<td>Other</td>
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<td>-</td>
<td>21</td>
<td>0</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>138</td>
<td>53</td>
<td>6</td>
<td>197</td>
<td>50</td>
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