THE ISSUES OF ENTERPRISE GROWTH IN TRANSITION AND POST-TRANSITION PERIOD:

THE CASE OF POLISH 'ELEKTRIM'[1]

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Elektrim's final product is shares'

Elektrim ex-CFO Piotr Mroczkowski,

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1. Introduction

Elektrim is the biggest private company in Poland in terms of market capitalisation and the second largest publicly traded company after TPSA, the national telecom company. Before 1989, Elektrim operated as one of the large Polish foreign trade organisations which, during the course of transition, became a conglomerate. Elektrim S.A. manufactures high quality cables, high voltage power cables, telecom and home circuit cables and motor wires. The group also includes a power engineering design firm, a boiler manufacturer, an environmental equipment manufacturer. It provides telecommunication services (fixed and mobile) and is involved in other unrelated businesses. In 1999, the company began a radical restructuring by refocusing on telecommunications and infrastructure, in particular energy.

Elektrim's case has a wider relevance for understanding the growth of enterprises in central and eastern Europe. It illustrates the changing basis of growth of enterprises between the transition and post-transition periods. Elektrim grew primarily through conglomeration in the transition period. After the exhaustion of this mode of growth Elektrim has started to focus on a few core areas (telecoms, cables, energy). The strategic shift to telecommunications has been based on partnerships with foreign firms and it is likely that this will be the pattern in other areas. In this respect, the case of Elektrim shows the importance of internationalisation for growth of enterprises in CEE.

First, we provide a background for the analysis of Elektrim by pointing to factors that led to the transformation of Polish ex–foreign trade organisations (FTOs) into conglomerates of which Elektrim is a good example. Section three of this paper analyses Elektrim's recent history and profile. Section four overviews Elektrim's main areas of activity and strategic changes during the last 10 years, especially the strategic shift towards telecommunication services. Section five highlights several analytical issues that are important for understanding the growth of the CEE enterprises in the light of Elektrim's case.

2. Transformation of foreign trade organisations into conglomerates: temporary 'windows of opportunity' for enterprise growth in transition period

Elektrim is one of seven Polish ex-foreign trade organisations (FTOs) that in the transition period transformed themselves into conglomerates. Out of more than 40 FTOs in 1989, around a dozen have managed to survive and grow in the market context including the'big seven' - Elektrim along with Agros Holding, Animex, Mostostal Export, Universal, Rollimpex, and Stalexport. Although they are all conglomerates they differ in the degree to which they are focused, with Mostostal Export and Universal being the least focused.

During the communist era, FTOs were the main intermediaries between foreign markets and domestic enterprises, which were basically reduced to production units. For example, Elektrim was selling electrical equipment and turnkey power systems produced by Polish enterprises. This led to an accumulation of expertise in foreign trade organisations and knowledge about foreign markets as well as what domestic producers could deliver. These companies have also accumulated diverse engineering skills through the large turnkey projects in COMECON and Third World countries. With the dismantling of trade barriers in 1990, FTOs found themselves in an ambiguous situation. On the one hand, they lost their privileged status of indispensable intermediary, but on the other hand, they had accumulated experience of operating in foreign markets, and also knew the true value of domestic producers.

Three factors played important role in their survival as well as in growth and transformation into conglomerates [*Review*, 1996 #2]. First, when the Polish economy opened in the early 1990s they had accumulated foreign reserves - a huge advantage when compared to cash stripped domestic producers at that time. The value of these reserves was greatly increased through strong zloty depreciation. This enabled them to use accumulated foreign currency reserves to buy up many of the firms they represented, as well as banks.

Second, the seven largest Polish FTOs got themselves listed on the Warsaw Stock Exchange, which was rising in 1993 and 1994. This enabled them to get additional cash and bring into their respective groups their traditional suppliers and other companies that were seriously undervalued. In 1995, their shares accounted for a third of the total value of the Polish stock market, excluding banks [*The Economist*, 1995 #3].

Third, trading groups flourished thanks to large windfall profits either as a result of their being reimbursed overpaid taxes from 1990 or from one-time asset sales.

These three factors explain why certain FTOs have managed to survive and then to grow. However, they do not give a reason for their transformation into conglomerates. It seems that the nature of the business environment, in particular the market uncertainty in the early transition period and the undeveloped market infrastructure, was such that conglomeration was perceived as the optimum strategic option. This led companies to diversify in order to cope with the uncertainty of domestic markets. As Mr Mroczkowski, ex-Chief Finance Officer of Elektrim put it 'diversification gave security' [*Review*, 1996 #2]. In addition to uncertainty, the undeveloped financial system, scarce management skills and the generally undeveloped institutional systems of the market economy made conglomeration not only a viable but also a desirable strategic option. A business analyst, Martin Taylor, from Baring Asset Management, London, put it this way: 'Given the choice, I would always choose a pure producer …. But because of the inefficiencies of the Polish economy, there is a place for conglomerates now' [*Review*, 1996 #2]. This comment suggests that the specific institutional context of the post-socialist economy, especially in transition years, drove the conglomeration.

The issue to be explored then is what are the internal advantages of conglomerates that can sustain their growth? What are the inherited capabilities on which they can build long-term growth? Are the institutional factors that drive conglomeration in CEECs still operating? Undoubtedly, FTOs have accumulated marketing capabilities and have been able to advise their member firms with regard to exports or the creation of domestic brands. Also, ex-FTOs enjoy the advantages of large business groups in terms of easier access to financial capital. Business groups easily gather capital by using corporate holdings as loan collateral to finance more projects and distribute capital within the group. The easy access to finance enables firms, members of a group, to import components more cheaply than independents. These firms are also in a better position to tap the stock market for equity and the banks for credit than independent firms. The sheer size of the groups enables easier access to government through preferential status in receiving licences in areas like telecoms, or in the form of ‘certification requirements’. In short, they have advantages in nurturing so called ‘network capital’.

However, some of these advantages may not come into play for a long time in a fast reforming transition economy as Poland. As transition progresses we may expect that the financial system as well as the marketing infrastructure will also develop. There are signs that in Poland the advantages of business groups in raising capital may be reduced as the availability of capital improves. Moreover, Elektrim considers that some subsidiaries can now raise capital just as easily as it can itself [Economist, 1995 #3]. This suggests that there are factors in the business environment that push enterprises away from conglomeration towards more focused company profiles. Also, internal advantages from a period of market uncertainty, like extreme diversification of lines of businesses, may become a problem when the market environment stabilises. Diversification increases the problems involved in managing many different businesses and highlights the lack of in-depth industry-specific expertise. Also, general management capabilities may be insufficient for running a successfully diversified business in an open and competitive economy.

These issues form the background to how Elektrim grew up to become the largest private company in Poland as well as an appreciation of what were the main issues involved in its growth. In the next section we analyse Elektrim’s history and current restructuring activities.

3. Elektrim: history and profile

Elektrim was established in 1948 as a foreign trade operator. Like other FTOs, until 1989 it had the sole right to trade internationally. The crucial decision for the continuing growth of Elektrim after 1989 was its decision to shift from being a trading organisation into becoming also a production company . This quick grasp of the need to migrate from trading to manufacturing was seen in retrospect as being very important for Elektrim to be 'a step ahead of rest of the game' [Europe, 1994, April 1 #5]. As Elektrim's Chief Finance Officer, Piotr Mroczkowski, explains it 'To stay in business we had to stop being solely an agent. We had to go for vertical integration and get control of producing what we had been selling' [Finance, 1997 #4]. Elektrim entered production mainly by taking over some 25 enterprises in the course of Poland's privatisation process for which it paid around $300m from a strong cash flow in the early 1990s, when assets were inexpensive. It made a profit by selling shares in companies it had bought cheaply from the state, an activity close to investment banking. CS First Boston estimates that Elektrim earned 19m zlotys ($8.37m), about a fifth of its pre-tax profit, from selling financial assets in 1994 [Economist, 1995 #3]. Its assets even included yoghurt factories, milk plants, fruit drinks manufacture, pig farms and chicken feed processing [Dawson, 2000 January #28].

During this (second) period the main feature of Elektrim's growth was conglomeration. Elektrim bought many of the concerns it had been representing, including most of Poland's cable manufacturers, which today are growing due to the expanding domestic market and exports to Germany and elsewhere. At the end of 1993 Elektrim had a stake in 87 companies concentrated in five sectors. Its management saw little choice but to expand. Acquisitions were seen as essential to build market power. As one of its chief executives, Mr Muszynski, explained: 'If you are late on the train foreign capital will buy in'[Europe, 1994, April 1 #5] .

Despite the fact that Elektrim's acquisitions were random they were largely in five main areas: power generation equipment, electrical machinery and apparatus, cables, lightning equipment and telecommunications. However, it also had assets in agriculture and food processing, in cement and construction and in seven different banks (1995). The underlying strategy behind the conglomeration in the 1990s was 'to use privatisation to integrate vertically' and to transform Elektrim into a 'vehicle for acquisitions of core business suppliers' (Piotr Mroczkowski, Elektrim's the then Chief Finance Officer) [Europe, 1994, April 1 #5]. The idea was that the Elektrim should operate as a restructuring agent or a 'network organiser' by pursuing a hands on approach to restructuring new subsidiaries. In the mid-1990s the strategy was to model Elektrim on Japan's Mitsubishi and Sumitomo groups. Like them, Elektrim planned to spin off shares in subsidiaries to suppliers, creating a corporate network bound by commercial ties [Economist, 1994 #6].

However, this strategy was not followed for long. Instead of building diversified business group in 1999 the company entered a new (third) stage, which can be described as consolidation, and focusing. Its new Chief Executive Officer, Barbara Lundberg, set the focus for Elektrim on three core business: telecommunications, power generating equipment and cables, with strong expansion in telecommunications as a starting point[2]. This included take-overs of local operators and acquisitions of shares in telecom companies. This new strategy suggests that the days of frenzied acquisitions are now over and that Elektrim, like other ex-FTOs, faces consolidation. As part of this shift it is currently trying to dispose of 80 of its non-core subsidiaries. Finally, Mrs Lundberg pledged to focus Elektrim on its core line of business, to improve productivity and to dispose of underperforming assets.

Elektrim is concentrating on construction of the telecommunication group, as a competitor to TP SA, the national telecom company, and as an operator delivering a full range of telecommunication services. Elektrim also intends to continue its operation related to the performance of complete energy objects and their refurbishment. In the very near future it aims to raise the effectiveness of cable companies by way of further restructuring but 'without too much investment' [Elektrim, 2000 #7]. Other assets unrelated to the core line of business were transferred to Warsaw Equity Holdings Sp (ibid.). Before the strategic shift towards telecommunications, sales by divisions (1997) were as follows:

Table 1: **Elektrim: sales by divisions, 1997**

Cables	34.9%

[2] Elektrim holding has a staff of roughly 650, that is compensated under one of Poland's first performance based play schemes. The image of company is that it has very capable management. The arrival of a foreign national as CEO has reinforced this image but also changed Elektrim's strategy.

Power engineering	25.7%
Motors	10.6%
Agro	11.8%
Electrical Equipment	5.7%
Telecom/Lightning	6.0%
Other	5.3%

Source: [Merrill Lynch Capital Markets, 1999 #1]

However, by the end of 1998, Elektrim had already achieved 1998 operating revenue with the following structure:

- $460m for its wireless holdings (mobile telecommunications),
- $376m for its power cable holdings, and
- $205m for its power engineering holdings.

Although sales and operating revenues are not comparable the data suggest that in a very short period telecommunications have become Elektrim's the most important activity.

Elektrim was listed on Warsaw Stock Exchange in 1992, with a share price of 0.35 Polish zloty. In 1996, it was valued at around $620m [Times, 1996 #13]. By January 1997 the share price had risen to 31 zloty, bringing Elektrim's market capitalisation to $700m, and making it the largest non-bank market-capital stock on the Warsaw exchange. In 1999, its market value rose to $912.81million. Elektrim shareholders are mainly institutional investors (85%). (See table 2).

Table 2: **Elektrim: shareholders with above 5% of total votes, 1998**

Chemia Polska Sp	29.02%
Emerging Market Growth Fund	22.28%
Elektropol Cantoni & Co	11.47%
Merrill Lynch Development Capital Markets Fund	11.45%
Creditanstalt	8.83%

Source: [Merrill Lynch Capital Markets, 1999 #1]

In central European terms, Elektrim is very large in terms of the value of total assets ($1.2bn) as well as sales ($874m). However, in terms of internationalisation it is a company which is predominantly oriented towards the domestic market (see table 3). As an outward investor it has only 62 employees abroad, mainly in 9 sales/distribution centres (Austria, Germany, UK, Egypt, France, India, USA, Sweden, Turkey). Its transnationality index is very low (2.2%).

Table 3: **Elektrim: total and foreign assets, sales and employment**

(Millions of dollars and number of employees)

	Assets		Sales		Employment		Transnationality index (percent)
	Total	Foreign	Total	Foreign	Total	Foreign	
1997	1090	20	829	38	23445	57	2.2
1998	1228	21	874	42	26475	62	2.2

* The index of trasnationality is calculated as the average of three ratios: foreign assets to total assets, foreign sales to total sales, and foreign employment to total employment.

Source: [UNCTAD, 1999 #10]

4. Elektrim's main areas and strategy

On 1 January 1998 Elektrim began business activity as an industrial commercial holding with four companies: Elektrim Kable Polska Sp, Elektrim Motor SA, Elektrim Volt and Elektrim Energetyka SA. During 1999, a fifth company, Elektrim Telekomunikacja, was added.

4.1. Elektrim Kable Polska SA

Elektrim Kable Polska is one of Elektrim's main subsidiaries. This company was established in March 1999 through a merger of three of Elektrim's cable companies; Bydgoska Fabryka Kabli S.A.[3], Fabryka Kabli Ozarow S.A. and Fabryka Kabli Zalom S.A. Elektrim Kable Polskie produces the highest quality cable in Central Europe and is the only manufacturer of high voltage power cable in Poland. Its management considers it to be in the upper half of the world's best cable firms, Cable and wire production from Elektrim Kable Polskie exceeds 50% of the domestic market share, and 30% of its products are exported to Western markets [Elektrim, 2000 #7]. Company currently has 904 employees. With sales of 409.84 million Polish New Zlotys (US$97.40 million), this equates to sales of US$107,738 per employee. The company has not paid any dividends during the 1996-99 period [www.profiles.wisi.com, #12]. The firm's good prospects have been reflected in its market performance. Elektrim Kable, after being quoted below PLN 6.00 per share until the second part of November 1999, hit a 52-week high at the beginning of 2000 of PLN 9.55 per share (Reuters).

The ownership of Elektrim Kable Polska SA by Elektrim as a telecom service company probably gives it an advantage over its competitors in the telecom market. It can purchase telecom cables from its own company as well as improve its own bargaining position towards other telecom companies. For example, Elektrim Kable signed an agreement with Telekomunikacja Polska SA (TPSA) for the supply of the local telecommunication cables to the value of PLN 19.5mn. However, Elektrim is also dependent on KGHM, a supplier of copper rods and a new entrant into telecoms, and thus a competitor to Elektrim. The two companies signed a long term agreement and contract for the year 2000 worth $120m. Elektrim claims that the contract is profitable and important since raw material expenses amount to 65% of Elektrim's material costs

[3] Bydgoska Fabryka Kabli-BFK S.A. is a manufacturer of power cables, mainly for the domestic market (86%). The company was established in 1923. BFK was awarded the ISO 9001 certificate in 1996. BFK also received other prestigious international awards concerning the company's products and activities. It has a share of 20.18% in the British company Copper Cable Devices and 5% of distribution company Electrim North America. The company exports its produce to Germany, Great Britain and the USA. Bydgoska Fabryka Kabli also managed to expand into new markets such as: Belarus, Lithuania and South Africa. Power cables accounted for 57% of 1997 revenues; cables for permanent installation, 14%;

[Bulletin, 1999 #14]. The contract defines a minimum annual purchase and guarantees increased supplies in case of higher demand.

4.2. Elektrim Motor

Elektrim Group - Motor SA constitute the manufacturing companies Besel SA, Indukta SA, Celma SA, Emit SA i Ema-Elfa. These are companies that Elektrim bought during the 1990s. For example, it paid $2.72m for a 75% share in Emit, a local electrical machinery producer [FT, 1996, Dec 31 #8]. Among these companies is the largest electric motors manufacturer in Poland within the range from 0.04 kW up to 2,000 kW. All manufacturing companies have been awarded ISO 9001 quality assurance certificates. Group products are exported to 35 countries including Italy, the Netherlands, Germany, Sweden, USA, Austria and Spain [Elektrim, 2000 #7]. Elektrim - Motor SA exports and imports electrical engines, equipment for industry and also purchases materials for electric motor manufacturing in Poland and abroad, as well as making manufacturing machinery purchases. In March 1999, Elektrim Motor share capital rose from 3.7m zlotys ($0.9m) to 7.8m zlotys ($1.9m). In addition, Elektrim has pledged to invest 10m zlotys ($2.5m) in the company over the next four years.

4.3. Elektrim Volt

Elektrim Volt exports and imports high and low voltage equipment, transformer stations, transmission lines, electric energy, lightning equipment and many other goods (gas, crude oil). It also offers its services in construction and installation of electric plants, power transmission and distribution, etc. Elektrim Volt is the co-ordinator of a project to construct environmentally friendly buses in Poland [Elektrim, 2000 #7]. In March 1999, its share capital rose from 3m zlotys ($0.8m) to 7.3m zlotys ($1.8m).

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telecommunication cables, 13%; movable devices cables, 9%; and other cables and wires, 7%.[Elektrim, 2000 #7]

4.4. Elektrim Megadex

Since its formation Elektrim has been active in the field of power engineering and environmental protection in Poland and abroad. The first power plants under Elektrim contracts were built in China and India, followed by Turkey and other European countries (Yugoslavia, Czech R, Finland, Bulgaria and Hungary). Elektrim Energetyka and Megadex were merged into Elektrim Megadex. The Elektrim energy group includes over 50 companies, among them large companies such as Rafako, Megadex, Energomontaz Pol, Mostostal Warszawa, Remak, Elwo, Elektrim Energoblok Gdyna. As a result of the merger 200 people were made redundant and a much more decentralised management was introduced. The budget was split between three business centres: power energy, natural environment protection and industry. Elektrim Megadex is involved in the complex execution of investments in the energy and ecology sectors, a feasibility study of investments, design of objects, developer services, organisation of tenders, arrangement of financial structures and individual delivery of plant and installation works, as well as complete turnkey delivery of energy and ecology objects [Elektrim, 2000 #7].

Elektrim continues to expand its energy activities. For example, it is negotiating contracts worth $300m to build power-generating blocks in India. In March 1999, the Elektrim consortium, which consists of three Elektrim controlled construction companies: Megadex, Mostostal Warsaw and Energomontaz Polnoc, bought a 20% stake for $87.9m in the lignite fired 2700MW power generating company Patnow Adamow Konin (PAK). PAK has its own mine. The consortium pledged to raise PAK's equity by $100m increasing its stake to 38%. The take-over was part of a bid by a consortium, which includes also the US CalEnergy. The investor pledged to maintain the present employment level for the time of reconstruction and modernisation of the firm. PAK provides 11% of Poland's electricity and is the second largest Polish power generating company. Analysts estimate that PAK would require up to $2bn in investment over the next decade. Also, estimates are that PAK is worth around $440m. In 1997, PAK's sales reached $320m and after tax profits of $9m. Over 10 years (1999-2008), the consortium will invest more than $1bn in the reconstruction and modernisation of PAK's old power blocks and in reducing environmental pollution. This is a significant amount but still only half of what would be required for full restructuring. Initially, National Power (UK) was poised to take over PAK. However, National Power (UK) required a five-year contract with Polish Power Grid for the immediate electricity delivery at guaranteed electricity prices. Elektrim did not make this a condition for partial take-over. As the Polish market had started to liberalise government rejected UK offer

4.5. Elektrim Telekomunikacja

In the last two years telecommunications have become the most important and the fastest growing of Elektrim's activities. Elektrim has consolidated several of the most important local operators and purchased shares in a few telecommunication companies. The following telecommunication operators are included to different degrees in Elektrim group:

Polska Telefonia Cyfrowa Sp. z o.o. (Era GSM)
Regionalne Sieci Telekomunikacyjne El-Net S.A.
Telefonia Regionalna Sp. z o.o.
Bresnan International Partners
Elektrim Tv-Tel Sp. z o.o.
Zakład Telekomunikacyjny Św. Olaf
Polish Phonesat Sp. z o.o[4].

Elektrim Telekomunikacja was set up on 12 May 1999. Initially its capital was 100% owned by Elektrim. The move was part of the company's strategy to concentrate on developing the telecom sector and on restructuring and consolidating the Elektrim group[5]. Elektrim plans to expand its telecom business to become the second largest in Poland

[4] Phonesat is Elektrim's subsidiary in over 93%. It renders complex telecommunication services utilised best in the banking and fuel sectors; state administration, the army, special forces and trading corporations with a dispersed structure. Phonesat obtained from the Telecommunication Ministry a licence for rendering telecom services and the permission to set up and use telecom network for a period of 15 years [Elektrim, 2000 #7].

[5] CEO of Elektrim Telekomunikacja is Jacek Marek Walczykowski. B. Lindberg, P. Mroczkowski and K. Rzyski, members of Elektrim Management Board, were appointed to the new company's Supervisory Board.

after TP SA, the state controlled operator. In line with this goal, the newly founded Elektrim Telekomunikacja company aims to become the telecommunication operator alternative to TP SA offering the highest technical level and the broadest scope of services. This decisive shift towards telecommunications is mainly due to Elektrim's chief executive, Barbara Lundberg, who took over Elektrim in February 1998 after the shareholders voted to get rid of her predecessor[6]. She immediately embarked on a high-profile billion-dollar acquisition spree designed to focus Elektrim first and foremost on telecoms. Within a few months, Elektrim had bought Bresnan, a local cable TV company, a regional phone operator, and had been awarded a licence to operate fixed-line services in Warsaw. However, the key acquisition was a packet of small stakes in Polska Telefonia Cyfrowa (PTC), Poland's top mobile company, which gave Elektrim a 51% stake - and brought it into negotiation with the minority shareholder, Deutsche Telekom (DT). The Germans, blocked by Polish telecommunications law from owning a majority stake, were in the process of increasing their share of PTC to 45%. They pushed for control of Elektrim's telecoms subsidiary once the law changed. Elektrim resisted and the negotiations fell through[7]. However, within a month, Ms Lundberg announced it had found a new partner, the French telecoms-to-utilities group Vivendi, which agreed to take a third of Elektrim Telekomunikacja, if the subsidiary managed to gain control of PTC. On 17 June 1999 the joint venture Elektrim Telekomunikacja was set up with the French conglomerate Vivendi.

Vivendi is renamed Societe Generals des Eaux, the French water company, the world's largest water company, which employs 193,000 people, with assets of $43.1bn and revenues of $28.6bn, [UNCTAD, 1999 #10]. In the last 20 years Vivendi has

[6] In 1996, Elektrim secretly agreed to sell a 6.5% stake in PTC (Era GSM) to Kulczyk Holding. The price Elektrim agreed was close to its nominal price and the latter has not been made public until the sale was about to take place. This 6.5% was supposed to be compensation to Kulczyk, a Polish tycoon, for the role he played in talks with company's other partners. On the demand of international fund managers the President and Deputy President of Elektrim had to resign. This paved the way for new CEO, Mrs Lundberg. Her arrival changed significantly strategic orientation as well as management style of Elektrim. The extent of changes is described by Mrs. Lundberg's advisor Piotr Czarnowski who states: "This is a completely different organisation. There is no other Polish company that has transformed itself in an eight to ten-month time-frame and invested $1.7bn in one year alone."[Europe, 2000 #15]

[7] In Feb 1999, Elektrim disclosed that it had signed a preliminary agreement with DT in October 1998 whereby DT would acquire a 26% stake in El-Net. On May 19, 1999 Elektrim announced it had broken off talks with DT about the potential purchase by the Germans of 26% of El Net.

diversified into telecommunications, media and several other activities. Its activities include water distribution (Cie Generale des Eaux), thermal energy supply (Blanzy Ouest), building and heavy public construction projects (SGE), waste management (CGEA Onyx), transport (CGEA Transport), electrical energy services (Cie Generale de Travaux et d'Installations Electriques), real estate (Compagnie Generale d'Immobilier et de Services) and telecommunication (Cegetel) and publishing and multimedia (HAVAS) activities. Vivendi is a major shareholder in Cegetel, the number two telecom company behind the incumbent France Telecom, offering fixed and mobile telephony, as well as internet access. Vivendi streamlined its organisation during 1997, disposing of 334 companies in the health, cable television, laundry, restaurant and car parking sectors. The group consisted of 3371 companies in December 1998, of which 1394 were located abroad. Its major business is presented in table below.

Table 4: **Vivendi major businesses, 1998**

- share in revenues -

Construction, building & public works	27%
Water distribution	21%
Waste management	10%
Publishing & multimedia	10%
Communication	9%
Thermal energy	8%
Transportation	6%
Real estate	6%
Independent electricity production,	2%
Other	1%.

Source: Vivendi, 1999

Vivendi partly owns French Canal+, it has 16 Internet services, including joint ownership of the French no 1 – AOL France, it has 40% of the French mobile telephone market (4mn subscribers), over 600,000 connections of fixed line telephony developed since January 1998, i.e. as soon as the state monopoly of France Telecom was lifted. In some respects its experience of challenging France Telecom corresponds to Elektrim's strategy to challenge TPSA. Both companies are conglomerates, and the second most important players in their domestic markets in fights against incumbent national operators, and both have experience in dealing with national administration, which is important in licensing in telecom. In addition, France Telecom has won the right to negotiate for a stake in TPSA, which means that the oligopolistic competition from French market may be soon transferred into Poland. Partnership with Vivendi complements Elektrim's strategy to focus on telecommunications and become a strong competitor to TPSA.

Initially, Vivendi took over a 30% share in Elektrim Telekomununikacja. Agreement was reached for the sale of over 45 mn shares in Elektrim Telekomunikacja for over $1 bn. Under the investment agreement Elektrim Telekomunikacja Sp. z o.o. must involve shares of the cellular telephone operator, Polska Telefonia Cyfrowa Sp. z o.o. (operating under the business name of ERA GSM), cable television and the telephone operator Bresnan Communications Poland, as well as shares of other telecommunication operators in the future. In this way it will be possible to integrate ERA GSM cellular telephone services with stationary telephone services and related services, such as Internet, data transmission and cable television.

However, Deutsche Telekom claimed the right to 3% of the 15.8% PTC shares purchased by Elektrim in August 1999 from minority shareholders. Also, it claimed it had right of first refusal on some of the shares. It blocked the transfer of Elektrim's stake in PTC to its subsidiary and took the case to court. Elektrim maintains that DT's refusal to agree to the transfer of shares is a violation of the Partners Agreement and was damaging to Elektrim as it blocks the restructuring of Elektrim's telecom sector development with Vivendi's support. Elektrim offered a defence to the State Telecom and Postal Inspectors PITIP as to its transfer of shares to PTC, which was challenged in the court in August 1999 by DT. It also announced that it intended to submit a motion against the German firm for regulatory irregularities over PTC.

As a result, Elektrim was forced to begin paying 10% interest on the $650 mn, which Vivendi had invested in the joint venture until such time as the PTC shares were transferred to the telecom group. This stopped the Vivendi investment, blocked debt financing and threatened to force Elektrim into default on its massive short-term debt payments [Europe, 2000 #15]. For a time, it looked as if the Germans would take over. In order to secure the deal Elektrim had to sell a larger stake. Fortunately for Elektrim, Vivendi stepped in, offering to double its investment to $1.2bn, plus $250m in cash, to clean up Elektrim's balance sheet. In exchange, the French got a 49% stake in Elektrim Telekomunikacja and, indirectly, ownership of 25% of PTC.

In the meantime, DT failed to prove legal credibility of its claims to pre-emptive rights to PTC shares. A Warsaw court dismissed the claim by DT, which argued that, as a shareholder in PTC, it had first refusal on any shares that existing partners wanted to sell. DT claimed that it had the right to buy any shares on offer up to a ceiling, which would have maintained the existing proportions between the remaining shareholders. Elektrim stated in court that DT did not have the necessary approvals to make purchase of the additional shares. In response DT submitted a motion to the Court of Arbitration in Vienna. Elektrim has since agreed to abide by the Viennese court's decision. The outcome of the arbitration battle in Vienna, which Vivendi will part-finance, remains to be seen. A positive outcome is vital to Elektrim's plans. Mobile is where the money is, and the PTC stake constitutes as much as 85% of the parent company's valuation [Europe, 2000 #15].

In December 1999, Elektrim transferred 47.99% of shares of PTC to its subsidiary Elektrim Telekomunikacja. Elektrim Telekomunikacja's share capital increased by almost PLN 9 bln ($2.25bn) to PLN 10 bln ($2.5bn) [FT.com, 1999, June 10 #9]. The transfer enabled Vivendi to take over a 49% stake in Elektrim Telekomunikacja, which gave Vivendi insider control over PTC by holding a 50% stake and a 100% share in the Bresnan Aster City Cable TV operator [8] [Bulletin, 1999 #16]. Vivendi guaranteed to increase its investment to over $1.2bn, which constituted an initial immediate payment of $150m and a second payment in the amount of $100m. At the same time Vivendi converted its earlier loan in the amount of $615m into an equity stake in Elektrim Telekomunikacja. These investments made Vivendi one of the biggest foreign investors in Poland.

However, the battle for control over PTC is far from over. DT has increased its 22.5% stake in PTC to 45% by acquiring MediOne International, a subsidiary of the US Media One Group [Dawson, 2000 January #28]. DT paid between $1bn and $1.2bn for the stake in PTC. DT now controls 45% of PTC, but is fighting via the courts for another 3% against its co-shareholder Elektrim [FT.com, 1999 #17][9-10]. Regarding Elektrim's position in this battle it is important to bear in mind that Vivendi agreed to join in the legal fight against DT.

[8] As part of this deal, the Elektrim has sold Vivendi 50% in a Carcom Warsaw SA that holds 1.9% of the PTC. After the capital raising operations and sale of Carcom shares in Elektrim, Elektrim and Vivendi each hold 50% of the nominal capital and voting rights at Carcoms shareholders meeting.

[9] DT is also present in the two Hungarian mobile phone operators Wester Radiotelefon and Westel 900, which at 58% has the largest market share in Hungary.

[10] [Dawson, 2000 January #28] reports that DT effectively controls additional 4% in PTC through Polpager, a foreign registered company which would allow it in effcet to move through the control treshold.

PTC – Era GSM

Era GSM, another Elektrim subsidiary, is Poland's first digital mobile telephony network. In terms of subscribers and users ERA GSM is the biggest GSM operator in Eastern Europe. Its network covers 90.9% of Poland's population and 80.5% of the country's territory. The PTC network services over 2565 cities and villages with a population of over 1000. On April 9, 1999 Era GSM reached over 1million active users and subscribers. It connects 1,068 new customers to its network every day. Morgan Stanley made a valuation of PTC based on an aggregate valuation of all companies included in the Elektrim group. The Polish Cellular Telephony PTC, the operator of the Era GSM network, had the largest value in the group, at $5.8 bn. Morgan Stanley analysts claim that PTC's profits will grow much faster than the profits of those companies in Western Europe.

In 1996, Elektrim, as the leading shareholder in a consortium which included Deutsche Telekom (DT), won the right to operate one of two new mobile telephone licences in Poland [Dawson, 2000 January #28]. PTC's main shareholders are Elektrim which increased its share from 32.5% to 34% and then to 49.9%, DeTeMobile 22.5% and US West Media One 22.5%. Elektrim increased its share in PTC by entering into agreement with smaller shareholders. It paid $679.4m to increase its ownership stake by 15.6% to 49.9%. On 17 May, 1999 Elektrim entered into an agreement with BRE Bank and Kulczyk Holding, which resulted in the acquisition of 15.8% of the votes of PTC. Pursuant to the agreement, Elektrim have acquired from BRE Bank 3% of its share capital, from Kulczyk Holding 4.8% of its share capital, from Drugi Polski Fundusz Rozwoju – BRE 2% of its share capital, and from TUiR Warta 4.1% of its share capital. Elektrim has also acquired 100% of the share capital of 'Carcom Warszawa' which holds 1.9% of the share capital of PTC. Separately, Elektrim's minority affiliate, Elektrim Autoinvest holds 1.1% of PTC which gives Elektrim a total of a 51% share in PTC.

Fixed telephony activities

As part of its strategy to become a main competitor to TP SA, Elektrim has been acquiring and consolidating telecom operators. Elektrim controls three regional fixed line telecom service providers: TV Tel - Plock[11], Telefonia Regionalna - Katowice, and El-Net, the third largest private operator, which hold licences to provide telecom services in six voivodships[12]. Elektrim also acquired Bresnan International Poland, the second largest cable TV operator in the country with total networks serving approximately 360,000 customers and passing nearly 700,00 homes nation-wide. Bresnan also holds licences in 2 voivoidships. Take-over of Bresnan by Elektrim is Poland's largest take-over by a domestic company outside the financial services sector. The use of the infrastructure of the cable operator Bresnan International, which Elektrim acquired for $325 million in 1999, will allow the firm to cut the cost of connecting each user to $700 from over $1000 (Data Base Reuters Business Briefing). Bresnan International's biggest operation, Aster Citycable, serves 290,000 subscribers in Warsaw, and has an agreement with France's Canal Plus SA to develop Polish digital direct to home platform. The cable TV system, AsterCity, is currently offering an internet connection to its clients. Elektrim can also use Bresnan's Warsaw cable TV network for telephony.

Elektrim controls the fixed line telecom operator El-Net, which owns a key licence for the service in the Warsaw region and six other regional licences. El-Net commenced its activity in September 1996 in Bydgoscz, where it has invested almost $41m. It also received licences from the Telecommunication Ministry for building a fixed line telephone network on the territory of 6 former voivodships. In June 1999, it received a licence for Warsaw for which it will pay $325m over the next five years. Elektrim expects business clients to make up 15-20 percent of all of its local clients and generate about 50 percent of all the revenue in Warsaw. The Warsaw licence gives it potential and non-exclusive access to 1.5m people.

[11] Elektrim will have to pay $112m over 5 years for this offer.
[12] This strategy is a response to the Ministry's intention to have one private service provider in each of 49 voivodships, which would compete with state-owned Telekomunikacja Polska. In 1999, Poland changed its administrative system which is now based on 16 voivodships.

In 1998 El-Net won 3 licences in the Koszalin, Slupsk and Suwalki voivodships. For these three licences, El-Net is paying $40m over the next five years. Initially El Net shareholders were Elektrim 40%, the Elektrim controlled Bydgoscz Kable Factory BFK (20%), Centrostal Bydgosczc 33%, Cecom 5%, and Commerzbank BRE Bank 2%. Currently, Elektrim owns 92% of El Net and has transferred its El-Net stake to its telecoms arm, Elektrim Telekomunikacja, which will ultimately manage the company's telecoms operations ranging from cellular phone network PTC to fixed-line services [Ft.com, 2000 #18]. As part of this strategy, Elektrim has taken over 100% of the Polish subsidiary of the Dutch company PenneCom, Pilicka Telefonia, for up to $140m in cash and promissory notes. This will give it access to 2m people through the control of three additional voivodships in central Poland although currently PenneCom has only 10,000 subscribers.

Elektrim expects that the acquisition of regional operators and licences will allow it to roll out capital expenditures, lower operating costs per line and offer a wide range of products. If all these agreements taking over regional companies succeed Elektrim will control almost 60% of Poland’s territory, with access to nearly 50% of the population and business.

Elektrim Internet strategy

Elektrim’s orientation towards telecommunications made it inevitable that company would expand its activities to Internet operations. Given its access to hundreds of thousands of cable television viewers and close to two million mobile phone customers in its PTC subsidiary this has been perceived also as a big business opportunity. As an Elektrim representative put it: "It's the most profitable niche of the telecommunications business. It's impossible not to offer internet services". On 14 April, 2000 Elektrim outlined its strategy for becoming the leading provider of Polish language interactive content and services to both private and institutional clients on the Polish market. It plans to combine the know-how of its newly acquired Internet firms with the company’s strong position in mobile (PTC-Era GSM) and fixed-line telephony (El Net) as well as in broadband cable TV (Aster City Cable) and satellite data transmission (Polish Phonesat) serving over 2.5mn clients.

Elektrim announced that it would introduce its Elektrim.com portal by the end of 2000. The strategy is to offer as broad as possible a package of services[13]. The company will probably cooperate with another internet service provider, since collaboration would cut costs and save time. Bidders for Elektrim's internet plans include Telekomunikacja Polska (TPSA), Computer Land and Optimus [Base, 1999 #20]. These companies are among the "seven or eight potential big bidders" who would likely spend $100 million on the project. Elektrim intends to invest PLN 2 bn ($490 million) in its forthcoming internet activities[14].

As part of its Internet strategy, Elektrim is to acquire Easy Net and AGS New Media, two Polish e-commerce companies. The total value of the share purchase in these two companies is estimated at $52.5mn. Elektrim will purchase 50% of the shares and invest $12.5m in Easy Net, which operates as a business to consumer e-commerce retailer under the brand name empik.com. Easy Net is considered to be the most successful e-tailer in Poland. Elektrim also intends to acquire 50% of the shares of AGS, one of the leading Polish software houses focused on Internet solutions, with an option to increase its holding to 80%. AGS is the leading e-commerce, e-publishing and intranet services provider. The company has existed since 1992 and has a customer portfolio of over 60 leading institutions. AGS is running a team of 44 specialists including project managers, systems analysts, software designers, web and graphic designers, JAVA, XNML and OO programmers and database as well as operating systems experts.

Combining the abilities of both companies creates a powerful mix of content, product assortment and transactional capabilities. The costs of building such capabilities independently would be very high. Elektrim also intends to develop as a content provider. It will build on the teams of over 150 experts coming from newly acquired companies InterPolska, NASK service, CT Creative Team as well as AGS New Media and Easy Net.

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[13] Eelktrim CEO highlights this by saying: "The issue for ourselves is strategically how we want to go about this business”.
approach should be broad." says Lundberg.
[14] Elektrim spokesman clarified that "Elektrim will be active in the Internet and it will be a serious project, but the amount reported is speculation" [Briefing, 2000 #21].

These new members of the Elektrim group bring with them Internet expertise in network development and implementation of content and e-commerce. Elektrim estimates that the current Internet market in Poland represents revenues of some $5.8bn per annum, mainly deriving from hardware sales and network services. Elektrim will offer to:

- Individual clients: access to a full range of content and services such as news, mail, shopping and online chat.
- SMEs: access to services, time critical information services, better supply sourcing and sales opportunities
- Corporate clients: customised connectivity including the establishment of private corporate networks, advisory services for web design and hosting to implementing tailor made business to consumer and business to business solutions, comprehensive on line advertising and marketing [Elektrim, 2000 #7].

4.6. Divesting activities

In accordance with its new strategy of being focused, Elektrim is selling off assets that do not fit its new focus on the telecoms, energy or cable sectors. It has concluded a deal to sell 80 such subsidiaries. In June 1999, jointly with Clifton Consulting, Elektrim set up Warsaw Equity Holdings, a holding company in which it has a 15% share the remainder being with Clifton Consulting which is entitled to 20% of the proceeeds from the sale of any assests [Dawson, 2000 January #28]. Elektrim will obtain $62.7m from the transaction and will be reduced to 28 firms following the deal. [Agency, 1999 #19] Also, the Spanish construction group, Acciona, in June 1999 signed a collaboration agreement with Elektrim under which Elektrim will retain its present 28.4% stake in Mostostal Warsaw for the next two years. Elektrim's share ownership of Chemia Polska has been reduced by 21.16% of the total votes (Feb 1998). The Dutch group, Campina Melkunie, in 1997 acquired the Elektrim Food, a specialist in yoghurt and dairy dessert production, for an undisclosed sum. In its heyday Elektrim had an 8% of share of the Polish dairy market, but has been in the red with regard to production, running at around only half of actual capacity. Interlektra of Luxembourg bought 3 of Elektrim's motor producing subsidiaries for PLN 58 mn ($14.19m). The Luxembourgians are paying PLN 43 mn

($10.52m) for 99.94% of the motor producer Celma, another PLN 9 mn ($2.2mn) for 67.398% of a similar firm, Besel, and a further PLN 6 mln ($ 1.47m) for 100% of the shares of Elektrim Motor (Jan 2000). The acquisition of Celma is contingent on Celma's purchase from Elektrim of the holding's 69% stake in Indukta, another electric machine factory. The envisaged transactions will enrich the firm's budget by zl 58m and allow it to pay off its most urgent debts and develop its priority project, the El-Net local telecom in Warsaw [Gospodarka, 2000 #22].

4.7. Financing growth

In order to grow and restructure, Elektrim needs to raise huge amounts of money. For example, to finance only its recent acquisitions and major licences in telecommunications in 1999 it needs:

- $680m to acquire an additional 15.8% of PTC stock;
- $325m for the purchase of Aster City Cable TV from Bresnan International Poland,
- $140m to pay for the acquisition of Telefonia Pilicka, a fixed line telephone operator,
- $300 m for the licence fee for its El-Net subsidiary to start connecting fixed line telephones in Warsaw and surrounding area.

Elektrim has not paid in full for most of these purchases as payments are often spread -. In addition, approved licences require further investments. Elektrim’s planned capital investments total $1.3bn. This means that the company, already heavily in debt (net debt/net equity 92%), must either take out a loan of at least $1bn[15] or issue convertible bonds. This explains in part why Elektrim entered into the joint venture with Vivendi. Initially, Vivendi offered a loan to Elektrim, which has been converted into an equity stake in Elektrim Telekomunikacja.

In the 1997-99 period Elektrim raised through convertible bonds $1249mn which was used to purchase its new acquisitions[16]. See table below.

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[15] There are reports that a banking consortium including Merrill Lynch, Donaldson Lufkin and &Jenrtee as well as ING Barings is preparing a $1bn credit line for the Elektrim[Voice, 1999 #26].

[16] A recently Elektrim announced that it wants to raise its capital by as much as a half through an issue of up to 45 million shares. Elektrim, which has nearly 83.6 million shares outstanding, said it wanted to earmark half of the proceeds from the issue for financing expansions as well as acquisitions in telecoms and

Table 5: **Elektrim convertible bond issues, 1997-1999**, **based on business press**

Issuing date	***Issuing agent or partner***	***Amount in $***	***Description***
01/02/97	Elektrim	184	Two thirds will be used to reduce Elektrim's bank debts and cut financing costs, and to finance future purchases of power stations in conjunction with local banks and foreign power operators.
20/05/99	Elektrim	350	To fund the first stage of a plan to become the country's second largest telecommunications provider and to be used for an acquisition.
27/05/99	Acciona (Spain)	150	Acciona (Spain) announced that it would buy Elektrim's convertible bonds for $150m and take 10-15% of the company. Cooperation would probably take place in energy and construction sector.
27/05/99	Eastbridge (Holland)	150	Eastbridge (Holland) plans to help Elektrim to develop an Internet shopping system. It is present in Poland, controlling Empik chain of music and book stores and has a stake in Domy Towarowe Centrum SA.
29/06/99	Elektrim	415	To fund its acquisition of Bresnan Communications Poland, because it should pay $325m by the end of June. (result: successfully subscribed by the US and European investors, worth Euro 400m.)
	Total	**1249**	

Internet ventures. The remaining shares will be offered as Global Depositary Receipts (GDRs) (Reuters June 6, 2000).

Source: SSEES Data Base

Also, new strategic partnerships are being created through the issuing of convertible bonds. At a general meeting of shareholders on 28 May, 1999, Elektrim decided that the company would issue convertible bonds, maturing after five years and worth EUR500mn ($415m). These bonds (26.7m bonds) are convertible into common stock in the company, and hence carry an initial conversion premium of 15.3% on the fixed price. The proceeds from this bond issue were used to finance the company's investments in its telecom branch, for instance payment of $325m for Bresnan. The buyers of the bonds were Spain's Accion and Holland's Eastbridge. Eastbridge has a chain of music shops in Poland and plans to help Elektrim develop an Internet shopping system. Acciona plans to cooperate with Elektrim in its telecom, power industry and cable industry operations.

In addition, Elektrim exercised a call option on DEM 294.9 million worth of convertible bonds to encourage their owners to exchange them for equity in the company. In this way Elektrim hopes to boost its equity and reduce its current debt accordingly. Some two-thirds of the debt is convertible to equity, further reducing leverage.

Elektrim's total investments in fixed telecommunications will exceed $2bn. As Elektrim does not have this scale of finance, its expansion is very much dependent on partnerships like its relationship with Vivendi. However, similar moves may follow in other areas. Elektrim's Ms. Lundberg said that her group will seek other partners for the other two core businesses, i.e. cable manufacture and power engineering [Base, 1999 #23].

The trade-off between the need to expand and restructure, and the inability to fund growth from retained earnings leaves no room for generic expansion or independent growth by Elektrim. The domestic banking system and the capital market are far from being sufficiently developed to match the levels of investment needed in areas like telecoms. Domestic loans are used mainly to finance current operations. For example, in 1999 Elektrim signed a 40m zloty ($9.37m) loan agreement with the Handlowy bank to finance its current operations (Ft.com Data base, 06. 1999).

Restructuring and investments led Elektrim into red in 1998 when it lost nearly PLN 330m ($95m). The loss was blamed on the transfer of PLN225m ($64m) of assets to

Warsaw Equity Holdings, a company set up to unload Elektrim's interests in 80 firms that Elektrim regarded as non-core businesses [Bulletin, 1999 #25]. 1999 results show that the Elektrim parent company made a 107.7 million zloty profit ($30m)The company's results were boosted by 1.6 billion zlotys ($400m) in financial revenues in 1999, mainly from the sale of 49 percent of Elektrim Telekomunikacja shares to France's Vivendi whose $1.2 billion cash injection in late 1999 has stabilised the group. Although the company had to pay high taxes from these operation, its balance sheet figures improved dramatically as a consequence. Elektrim's equity rose almost 54% against 1998. These transactions enabled Elektrim to reduce its short-term liabilities and improve liquidity [17] [Rzecpospolita, 2000 #24](p. 3).

The financial data suggest that the problem of the further growth of Elektrim is far from resolved. The trade off between the need to grow in order to capture business opportunities in telecoms and reduce diversified portfolio of business have to be reconciled with huge investment demands, which may threaten the independence of the company. Elektrim has started to enter into equity relationships as a way to facilitate its growth. These are likely to expand in terms of number and depth.

4.8. Business relationships and growth of Elektrim

Annex 1 shows the frequency and types of business relationships or broadly defined alliances of Elektrim. Business relationships are classified as mergers, acquisitions, joint ventures, alliances (international co-operative agreements), subcontracting, major contracts, government-approved licences and divestitures. They are summarised in the tables below.

[17] An analysis by [www.profiles.wisi.com, #12] notes that 'at the end of 1998, Elektrim S.A. had negative working capital, as current liabilities were 2.42 billion Polish New Zlotys while total current assets were only 1.66 billion Polish New Zlotys. The fact that the company has negative working capital could indicate that the company will have problems in expanding. However, negative working capital in and of itself is not necessarily bad, and could indicate that the company is very efficient at turning over inventory, or that the company has large financial subsidiaries'. We would argue that none of this is the case. Elektrim is sitting on assets from which it is not yet able to generate adequate sales. This has caused it great cash flow problems and makes it vulnerable to any disturbances in environment. Hence, the importance of deals like with Vivendi, which can stabilise cash flow and provide breath for putting newly acquired assets into operation.

Table 6: **Summary of types and frequency of business relations of Elektrim as reported in business press, 1990-2000 (mid-year)**

Insert here

Table 7: **Business relations of Elektrim as reported in business press, 19990-2000 (mid year)**

Insert here

The dominant types of relationship are minority and majority acquisitions, which reflect the dominant mode of growth of Elektrim as described in the previous section[18]. The second most frequent type of relationships are licences and major contracts. Licences are indispensable for increasing the company's potential for gaining market share in telecommunications. Major contracts show that Elektrim is building an important position in cables as well as continuing to play a significant role as an engineering company and an organiser of new projects. Also, a number of divestitures that are either divestments of unrelated businesses or a diluting of its control in telecoms, shows that an intensive restructuring is taking place.

Elektrim is growing predominantly in the existing areas of business (horizontal related diversification) primarily in telecommunications where it is endeavouring to build market presence. Vertical diversification is rare, which reflects the still high opportunities for growth in telecoms. Also, a strong, and here under-reported, unrelated diversification in the early 1990s diminished in the late 1990s. The year 1999 stands as quite clearly a very important year in terms of expansion of business linkages in different forms (licences, acquisitions, divestitures). It fully confirms the descriptive picture from the previous section about the shift towards focused strategy, which is accompanied by increasing divestitures, new licences in telecoms and new acquisitions.

[18] The acquisitions are under-reported in the early transition years when Elektrim has acquired around 80 different business. It is now preparing to sell 80 subsidiaries whose operations are not connected with the company's new strategy. The sizes of these businesses are very small and they probably represent a great burden on management.

5. Analytical issues

Elektrim belongs to a group of large domestically controlled CEE enterprises that operated in the socialist period and which have managed not only to survive but also to expand in the transition period. What distinguishes Elektrim within this group is that it operated as a foreign trade organisation during the socialist period, and that it has become a conglomerate in the transition period. Here we highlight several analytical issues that link Elektrim's case to a broader literature on corporate and industrial change, and in CEE in particular. We want to raise several analytical and theoretically relevant questions which are based on the case study of Elektrim.

FIRST ANALYTICAL ISSUE: Elektrim's shift from conglomeration to focusing suggests that the institutional context, which drives firm strategy in post-socialist economies like Poland, is, perhaps, also changing.

During the 1990s the management of Elektrim tried to model itself along the lines of companies like Mitsubishi, Sumitomo and Mitsui, Japanese industrial groups led by trading companies (former zaibatsu). However, the business history of Elektrim suggests that it has not been able to operate as a network organiser or the core of a new industrial group where individual diversified firms would find significant advantages in exploiting intra-group externalities in cheaper finance, secure demand and supply, etc. In many respects the frenzy of acquisitions from the early-1990s suggest that Elektrim behaved like the CEE tycoons who put the opportunity to 'build empires' over the profitability of individual operations or over exploitation of synergies among intra-group firms. While this assessment may have been correct for the very early years of transition, Elektrim has started to develop a more coherent group profile in the late 1990s. Moreover, with the appointment of the new CEO, in 1999 it shifted very strongly in this direction.

This situation raises several general issues. First, does Elektrim's shift from conglomeration to focusing reflect a change in general conditions in the Polish economy or merely the inability of the company to develop into a diversified industry group?

Alternatively, is the shift towards focused strategy the result of the personal vision of a new CEO or is it partly determined by the difficulties of growing through conglomeration?

There is a literature that suggests that in emerging markets or economies with undeveloped market institutions, business groups like Elektrim have significant advantages over focused enterprises ([Khanna, 1997 #30][Palepu, 1999 #31]. The advantages of industrial groups have been analysed also in economies with developed market institutions [Kester, #32][Jacquemin, 1982 #33]. The underlying factors behind the growth of diversified business groups are in multimarket power, related resources, informational imperfections, entrepreneurial scarcity and policy distortions in the emerging market environment [Khanna, 1998 #34][Palepu, 1997 #35]. These factors have played an important part in explaining Russian industrial financial groups [Petkoski, 1997 #36]. The case of Elektrim suggests that some of the factors that work in favour of such groups are relevant in explaining its growth. The grouping of unrelated businesses has helped Elektrim to gain market power and improve access to outside capital. Moreover, in the early years of transition to help finance its growth Elektrim moved into banking. It founded a medium sized commercial bank and owned stakes of up to 11% in four others. However, most of these were too small to be of much use.

Elektrim's knowledge as an ex-FTO of the Polish manufacturing companies that it worked with helped it to circumvent informational problems associated with the efficiency of take-overs. Also, the management of Elektrim encompassed general management expertise and capabilities that were relatively scarce in the transition years in Poland. Finally, its preferential access to bureaucracy and policy makers, especially important in telecom, gave it great advantages over independent firms.

The shift from conglomeration to focusing may suggest that many of these advantages do not operate any more in the Polish economy. If companies can access capital under similar terms as a large business group, if markets for management skills have developed and the market environment becomes more stable, then the advantages of conglomeration may not be as strong as in the transition years. This externalist explanation for Elektrim's strategic shift may suggest that the market infrastructure required for the growth of independent firms (effective intermediaries, sound regulations, enforceable contracts) are already in place in Poland. On the other hand, one could argue that Elektrim's shift towards focusing is a premature move which does not take into account that the institutional context (product, capital, and labour markets, regulatory system, and contracting enforcement) have not changed much from the early years of transition. Within this framework the focussing is doomed to failure and conglomeration can still add value given the particular institutional context of post-socialist economy.

SECOND ANALYTICAL ISSUE: In order to grow Elektrim is forced to enter into equity relationships and partnerships like that with Vivendi. This suggests that the possibilities for firm growth in post-socialist economies, like Poland, through generic expansion are still fewer when compared to growth based on mergers & acquisitions or different forms of alliances.

The institutional framework features strongly determine the modes of growth of enterprises. Within this perspective it is useful to distinguish between three basic modes of growth in any enterprise: generic expansion; mergers & acquisitions; and networks (alliances) (see Peng and Heath, 1996). Undercapitalised enterprises with limited management capabilities have difficulty in growing through generic expansion. Among the top companies in CEE, there are only a few new private firms. Mergers and acquisitions are limited to foreign investors who have the funds for take-overs, and to domestic companies like Elektrim. Elektrim has succeeded in its transformation largely because it has maintained what many Polish enterprises lost: *cash flow* [Europe, 1994, April 1 #5]. However, with the focus towards telecom Elektrim's growth is highly dependent on how good it is at raising sufficient amounts of cash to invest in order to exploit newly acquired operating licences in mobile and fixed telephony. Analysts question Elektrim's ability to finance its long list of projects, mainly those in telecoms and the power industry. The difficulties that Elektrim has to overcome to grow further independently have been confirmed through its initial link with Deutsche Telecom and later on with Vivendi as well as in new partnerships which it has to enter into if is to play any important role in the Internet area. Also, its growth in energy and cables is dependent on building similar partnerships in these areas as well.

What makes its position in this process relatively more favourable when compared to other domestic firms in general, is that its licences give it an access to the telecom market which it can then trade for access to finance and technology. An analyst at Warburg Dillon put it this way: ‘Elektrim holds the biggest interest in the largest mobile operator in Poland – with a 42% market share – it has a local fixed line licence covering 22% of the population and it owns the second largest cable TV network in Poland. Who else can compete with that?’ [Dawson, 2000 January #28]. Indeed, this is the biggest bargaining chip that Elektrim can employ to raise capital for growth. The joint venture with Vivendi gave Elektrim access to much needed capital and expertise in the telecommunication sector. However, the price paid for this is the possible loss of control as soon as government restriction on 49% of ownership in telecommunications is lifted with the approaching liberalisation of telecom services.

Similar to the cases of alliances in CEECs (Radosevic, 1999) Elektrim’s situation suggests that the balance between generic expansion, alliances (networks), and M&A as modes of growth, reflects differences in firms’ abilities to control technology, access to market and finance. Elektrim’s access to the domestic market enables it to trade for access to capital. However, although it is large company by central European standards Elektrim is not able to raise external finance solely through convertible bonds and loans but must also enter into joint ventures. This risky strategy is unavoidable once a strategy of focusing has been decided upon. Although growth through joint ventures and other forms of partnerships has provided it with greater opportunities it has also exposed it to the risk of loss of independence.

THIRD ANALYTICAL ISSUE: Elektrim’s relationship with government is complex and refutes simplified dichotomy markets vs. governments. This raises the issue of to what extent post-socialist governments operate as a ‘compensatory mechanism’ on which firms like Elektrim can rely to grow.

From a competition policy perspective large business groups are most often seen as rent seekers that prefer to control markets rather than to compete. Large diversified firms are seen mainly as rent seekers that thrive on government support and stifle competition. Based on this logic, privatisations in CEE have been designed in the belief that the break up of large diversified firms is beneficial to the economy. In the development economics literature the role of large business groups is seen in a more complex light. For example, [Chang, 1994 #29] finds that the role of business groups can be productive provided that the state can force business groups to export and compete. Within this logic, governments can operate as 'compensatory mechanisms' or providers of productive rents. The case of Elektrim shows that its relationships with government is ambiguous and cannot be accommodated into a simplified picture of state – large firms relationships.

The history of Elektrim during the early 1990s suggests that it might have had a favourable position in privatisation, especially when government was making choices between domestic and foreign investors. For example, Elektrim took over the country's third biggest cable producer. It edged out Siemens, a big German group. *The Economist* described it as 'the most spectacular case of giving privilege to a Polish bidder' [Economist, 1994 #6]. At that time Elektrim already owned the biggest cable producer and was planning to buy another. So, Elektrim bought all three, which raised its share of the domestic market to 80%. Also, Elektrim has been very successful in getting telecom licences, which may be due to its sheer financial power and developed 'network capital'.

On the other hand, when Elektrim's subsidiary, the cellular telecom Polska Telefonia Cyfrowa PTC, offered its cellular clients international connections via the Internet it brought Elektrim into conflict with the TPSA, the state operator[19]. Also,

[19] Era GSM, market name for PTC, through Zephyr Polska, offered its subscribers international connections on non-state telecom lines just before Christmas 1999. The connection was much cheaper than that offered by TP SA who, in line with communications law, has a monopoly on the international connection service until the end of 2002. The new service consists in converting the voice signal from a digital voice transmission into data transmission, which is further, transmitted via Internet. In the opinion of regulator, PTC has violated the Polish Communication Law, which grants TPSA the sole right to international services. The position of PTC is different: pursuant to the law an international telecom services encompasses only telephone and cable transmission, and does not include data transmission. Minister of Telecommunications ordered PTC's Era to halt its international connection service, which considered that

Elektrim won the fixed telephony concession for Warsaw on the understanding that it would be the sole competitor to TPSA. Its subsidary, El Net, was bidding for the licence in the conviction that for at least 3 years it would be the only alternative to the mammoth TPSA in the metropolitan area until the market was completely liberalised. However, government has issued a third licence to the rival operator Netia. Elektrim asked the Communications Ministry to block the execution of operating licences for the Warsaw region won by its rivals Netia and Telefonia Lokalna. Since fixed-line telecoms means huge up-front costs and no quick profits on the horizon this regulatory shift does not fit into picture of a cosy relationship between the state and Elektrim [Europe, 2000 #15].[20]

The case of Elektrim suggests that the relationship with government is important for its growth. However, this relationship cannot be clearly described as a situation of 'reciprocal subsidies' as in the case of Korean *chaebols* (Kim, 1997) or as a situation where the state is confined to a regulatory and neutral position. The government restriction of 49% for foreign investors in telecommunications suggests that the government aims to ensure market share for domestic operators. However, the issue of the government-business relationship in CEECs is evolving and reflects the changing political economy whereby governments have their constraints in following institutional reforms to meet EU accession criteria as well as in ensuring trade and capital openness to meet WTO and OECD criteria. This has effects on their relationships with domestically controlled groups and probably reduces their opportunities to provide 'productive rents' to domestic groups. Moreover, it exposes them to being captured not only by domestic but also by foreign firms, which they try to attract.

FOURTH ANALYTICAL ISSUE: The opening of the CEECs has led to relocations of EU and other MNCs into this region whereby they are also transferring the

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its offer was in line with international data transmission law, which treats voice transmission via traditional telecommunication networks differently from Internet transmission.

[20] This was the third time that the Minister of Communications has made decision, which is a surprise for Elektrim. First he has delayed the issuing of the Warsaw licence for months (El Net was selected as winner of the relevant tender at the end of 1998) and it got it in June 1999. Second, then he announced that he could award a second Warsaw fixed line licence to another operator. Third, El Net hoped the Ministry would agree to divide the licence fee into five yearly instalments but it is likely that the payment will be divided into just two parts, both due in one year (Polish New Bulletin, 02. June 1999)

oligopolistic competition from EU into new markets. The case of Elektrim shows how CEE companies and goverment regulations become factors in the oligopolistic competition between big EU companies. CEE companies and governments may use this competition to their advantage but also their limited bargaining powers may lead to outcomes unfavourable to them.

The process of 'East – West' production integration is not only a process of relocation of production facilities and control but also a process of relocation of competition from 'West' to 'East'. This is the competition between EU and local companies like Elektrim as well as the competition between EU companies in CEE markets.

Elektrim is one of a few CEE companies that have so far succesfully coped with foreign competitors for shares in the domestic market. Its fight against Deutsche Telekom for control over PTC has been greatly helped by the government restriction of 49% on foreign ownership in the telecommunication industry. Being a much weaker player when compared to EU telecom operators, Elektrim can grow only in alliance with foreign partners. Its joint venture with Vivendi was to escape from the possible takeover of PTC - its most profitable acivity- by DT. Without Vivendi's increased involvement, Elektrim might have had to sell some of its stake in PTC or risk getting into more difficulty in its relationship with DT [Brewis, 2000 #27]. However, the battle is not yet over as it seems that DT could effectively control above 50% of PTC through a 4% of share of Polpager, registered in the Netherlands, which transferred its holdings to Holdco, a Polish registered vehicle [Dawson, 2000 January #28].

Beside direct competition between domestic and foreign firms there is the transfer of competition from the EU to CEE markets. In the case of Elektrim this operates in the following way. France Telecom has won the right to negotiate for a stake in TPSA, a major competitor of Elektrim, which means that the oligopolistic competition from the French market between Vivendi and France Telecom may soon be transferred to Poland. Hence, the competition in CEE markets increasingly can be understood only if we take into account the oligopolistic competition on Western markets. The American Vodafone is a shareholder in PTC’s rival Polkomtel. There is a danger that Vodafone may buy Vivendi, which would have important effects on the control of PTC and on Elektrim. However, it seems that Vodafone does not intend to take over Vivendi within the next three years. This seems fairly certain given the recent Vodafone acquisition of the UK licence for a third generation of mobiles and its sale of Orange to France Telecom. This suggests that Elektrim's shareholders need not worry in the short-term. However, it does not exclude this possibility in the medium term, even before Poland joins the EU. The effect of this may be, as a business analyst put it, that ‘Elektrim, a small domestic operator, will not be around in two years’ time in its current form. PTC is an extraordinarily valuable asset. How long the market will let Elektrim pour cash into PTC is an academic question. All that matters is who will bid, and whether management can extract the best price’ [Dawson, 2000 January #28]. The management of Elektrim should welcome such amove as it is basically in line with its general philosophy. As Elektrim’s ex-CFO Piotr Mroczkowski, put it ‘Elektrim’s final product is shares’.

Such a move, however, would further lead to the deepening of ‘East – West’ ownership linkages through mergers& acqusitions. Moreover, if FranceTelecom’s partial takeover succeeds it will also lead to the full foreign-led control of telecommunications in Poland. This will further limit the ability of the Polish government to control the pace of modernisation in telecoms. In addition, the possible takeover of Vivendi Telecoms by Vodafone, which already controls Polkomtel, will make it increasingly difficult or even reduce government’s ability to regulate competition and anti-monopoly practices. Paradoxically, the only way to enhance its regulatory role in the future may be by delegating some of its regulatory functions to the EU level. As ‘East – West’ industry integration progresses there seems to be more need for mergers and acqusitions to be harmonised, probably even before full accession.

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Table 5: Elektrim: Summary of types and frequency of business relationship- as reported by business presss -

									Related diversification		
Starting Date	***Merger***	***Acquisition***	***JV***	***Alliance /ICA***	***Subcontracting***	***Maj. contracts***	***Licence***	***Divestiture***	**Horizontal relationship**	**Vertical relationship**	**Unrelated diversifcation**
10-Oct-90			X							X	
March 92								X	X		
15-Jun-93		X									X
21-Sep-93		X							X		
01-Dec-93		X							X		
10-Oct-94		X									X
05-Aug-95		X									X
Sept 1995		X									X
05-Feb-96							X		X		
08-Mar-96							X		X		
24-Mar-96						X			X		
17-Jun-96						X				X	
31-Dec-96		X							X		
03-Feb-97						X					X
01-Apr-97								X			X
01-May-97			X								X
14-Aug-97								X	X		
26-Jan-98						X			X		
01-Sep-98							3X		X		
31-Oct-98								X			X
March 99		X							X		
March 99			X						X		
March 99			X						X		
15-Mar-99								X			X
24-Mar-99		X							X		
24-Mar-99							2X		X		
8-Apr-99		X							X		
8-Apr-99							3X		X		
17-May-99		X							X		

19-May-99						X			X		
31-May-99		X							X		
05-Jul-99								X			X
08-Jun-99			X						X		
09-Jun-99							X		X		
17-Jul-99						X				X	
03-Dec-99				X						X	
08-Dec-99								X	X		
08-Dec-99								X	X		
10-Dec-99								X	X		
14-Dec-99						X				X	
17-Dec-99						X				X	
20-Dec-99							X		X		
22-Dec-99								X	X		
25-Jan-00								X			X
18-Apr-00		X							X		
18-Apr-00		X							X		
18-Apr-00		X							X		
18-Apr-00						X					X
18-Apr-00						X					X
Total	**0**	**15**	**5**	**1**	**0**	**10**	**12**	**11**	**30**	**6**	**13**

Source: Annex 1, SSEES Data base

* For 1990-1994 period business press has greatly under-reported Elektrim's acqusitions

Table 6: Business relationship of Elektrim as reported in business press, 1990-200 (mid year)

	Merger	*Acquisition*	*J-V*	*Alliance/ICA*	*Sub-contracting*	*Major Contracts*	*Licence*	*Divestiture*	**Total**
1990			1						**1**
1991									**0**
1992								1	**1**
1993		3							**3**
1994		1							**1**
1995		2							**2**
1996		1				2	2		**5**
1997			1			1		2	**4**
1998						1	3	1	**3**
1999		5	3	1		5	7	6	**26**
2000		3				2		1	**6**
Total	**0**	**15**	**5**	**1**	**0**	**10**	**12**	**11**	

Source: Annex 1, SSEES Data base

* For 1990-1994 period business press has greatly under-reported Elektrim's acqusitions