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Privatization, Management Education and Entrepreneurship: The Sine Qua Non Conditions for Economic Development in Eastern Europe

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Abstract

The purpose of this paper is to advance the proposition that Eastern Europe countries, in order to make the transition from the "Old" to the "New" order, need to break the sociopolitical grip of management and marketing practices and skills. In order to accomplish this, a business education and learning feedback mechanism needs to be instituted in their evolutionary model. By the same token, each Eastern Europe country needs to cultivate its entrepreneurial venture potential by favorably balancing evaluation criteria of expected Return of Investment, sociopolitical risk and investment incentives offered to attract entrepreneurial ventures.

1. Introduction

With irresistible force the people of Eastern Europe from Poland to the Czech Republic, from Hungary to Bulgaria have toppled their monolithic Communist governments. Geographically, the countries of Central and Eastern Europe comprise over half the European continent and have a combined population greater than the United States. With a combined population of over 400 million people they contain many heavily industrialized centers. These eighteen countries, while not homogeneous, share the history of recent communist governments, and each stand at a different stage in their transition. Since 1989 the area has become a living laboratory in organizational transforma-

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tion within a context of profound institutional change. (Child, 1996). The area has been experiencing economic and political reforms of immense proportions. Yet amid the euphoria of recent years and the enormous strength of the people marching and demanding a new sense of freedom, a larger question is posed. With change coming so fast, how can the nations of Eastern Europe ensure that their metamorphosis toward Western economic philosophy results in a permanent, workable economy? Especially when there is little history of experience with free enterprise management and marketing practices?

It is the contention of the authors that only an irrevocable change of management and marketing practices can lead to the stable economic reform sought in Eastern Europe. The sweeping privatization programs of Russia and the Czech Republic illustrate that forces and conditions that lead governments to botch advantages are the same ones that hinder decent management strategies. (Nellis, 1999) Although the scale of privatization now underway in transition economies of Eastern Europe is unprecedented (Kaufmann, 1997) privatization alone cannot provide the impetus for economic growth and success (Ellman, 1997). Unfortunately, the new perspectives are not satisfying to the majority of the workers and many would prefer to return to the old communist system. (Kuznetsova, 2000) As the economic and political systems undergo a radical transformation, the whole framework of management should be examined. There is increasing literature generalizing the success or failure of various reforms (Fish, 1998), yet there are few suggestions for long-term improvement. Just as perestroika was an irreversible revolutionary process (Cieslik, 1989, Kovacs, 1999), so too is educational reform of management and marketing practices. By the same token, each Eastern European country needs to cultivate its entrepreneurial venture potential (Ash, 1994) by favorably balancing evaluation criteria of expected Return on Investment, sociopolitical risk and investment incentives offered to attract entrepreneurial ventures.

2. Eastern Europe and Privatization

There are two principles involved in the privatization orientation of Eastern European countries:

- a content principle of doing the right things (WHAT); and;
- a process principle of doing things right (HOW).

Even if the content issue is resolved as usual, the process issue is much more difficult to discern. Consequently, Eastern Europe faces two dilemmas: a content dilemma and a process dilemma. The content dilemma deals with the following quandary: In order to do the right things, should the process proceed STEP BY STEP, by creating terms of private competition first with stable prices (Bulgaria) or should the process proceed in a SINK OR SWIM fashion by creating the terms of private competition with **free** prices (Poland)?

The process dilemma deals with the following questions: In order to do things right, since the level of economic knowledge is low and people have no idea what a market economy means, "WHO should be trained in management and marketing education and HOW?" (Stanislav Shatalin, architect of the 500-day plan for Soviet economic reform, and Fey, 2000).

The answer to the content dilemma is a function of such temporal concepts as: the degree of inertia or "wait for instructions syndrome" of workers; degree of confidence and expectations; degree of readiness to compete with the West, how long it would take for individuals to develop an "investor's mentality"; and how systemic the neglect of the economic infrastructure continues to be. (Thach, 1996)

The answer to the process dilemma: "We need material help: equipment, computers, even pocket calculators, but most of all, we need visiting experts and a confrontation of ideas" (Michael Sora, Rumania's Education Minister). There is a need for entrepreneurial and managerial skill development to develop a new order in Eastern Europe. (Puffer, 1992) The successful privatization of medium-sized and larger factories almost always requires new management and physical restructuring and large net investments. (Spechler, 1996) Entrepreneurial education will provide the foundation for change for the first generation of managers/owners, in the short run, while western-financed management training should be directed toward the second and third generation of managers that would encompass the poor and politically unconnected in the long run rather than the existing communist apparatchicks, born-again capitalists retaining their privileged positions. (Mueller, 1998)

There are, therefore, six elements for effectively transforming command economies to market economies:

1. *Monetary Reform*, to ensure control of credit and the money supply.
2. Fiscal Control, to assure budgetary balance and to limit monetization of a budget deficit if one arises.
3. *Price and Wage Deregulation*, to link prices and wages to costs and productivity.
4. *Privatization*, legal protection of property rights and breakup of state monopolies, to provide entrepreneurial and labor incentives that reflect changing market prices.
5. A Social «*Safety Net*» that protects those who may become unemployed as transformation proceeds.
6. *Currency Convertibility*, to link the transforming economy to the world economy and to competition in international markets. (Wolf, 1990)

3. Management Education and Privatization

The field of cross-cultural or comparative management is still at an early stage of development. In a pioneering work, Harbison and Myers (1959) recognized that different people in different cultures view management differently. Some believe that it is merely a series of functions; some regard it as an art; others as a social class or elite representing the intelligentsia. When we cross the borders of a specific society and view management in an international perspective, we find that new economic, social and political dimensions suddenly enter the picture. Harbison and Myers view management from several perspectives: as an economic resource, a system of authority, and as a class of elite. From their analysis, Harbison and Myers conclude that the essential prerequisite of industrialization is high-level human resource development, which must be included as an integral part of planning for general economic growth.

In another seminal work, Farmer and Richman (1965) introduced the significant notion that traditional management theory has drawbacks in terms of both orientation and applicability to different cultures and economies. Farmer and Richman recognized the constant interdependence that ties together managerial effectiveness, productive efficiency, and environmental constraints. These environmental constraints are classified as educational, legal-political, socio-cultural, and economic. These elements have direct impact on the management process, which in turn affect and are affected by the management style and managerial effectiveness. Finally, the latter will determine the firm's efficiency, which will determine the system's efficiency as a whole. Management is therefore, the dependent variable around which the economic environment revolves.

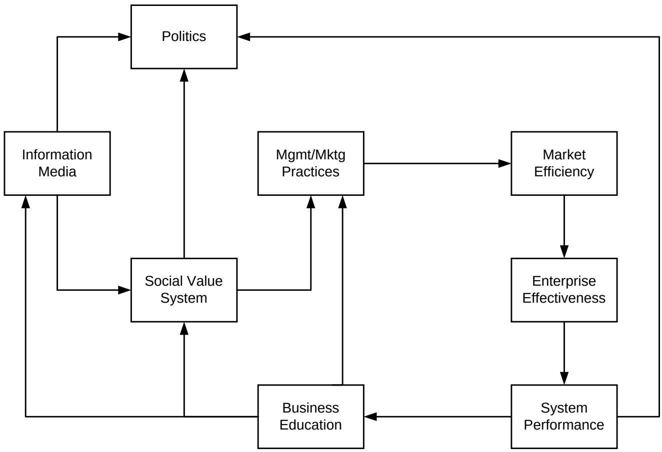
3.1 Business Education and the "New Order" in Eastern Europe

This same type of questions should be raised in Eastern Europe's future Schools of Business Administration as they prepare their graduates for careers in managerial positions. While theoretical prescriptions contribute a great deal in managerial education, managerial skills analysis, can improve the quality of the managerial content and process taught at Eastern Europe's future Schools of Business Administration. And most importantly, they can provide some redirection for the future, by focusing on demonstrably essential managerial skill training and development, instead of textbook recipes from the West with limited face validity. While over eighty percent of entrepreneurs in Russia have a university degree (Kuznetsova, 2000) most are not prepared for the sophisticated managerial skills necessary for analysis of their ventures. However, organizational commitment theories on antecedents such as age, education, job level, correlates, and consequences show that US theories are also relevant to Russian employees. (Buchko, 1998) At the same time workers fear that lowering the school-leaving age to 15 for all but the brightest children will weaken the country's education system. (Monks, 1997; Hewitt, 1997) Reforming higher education in Russia is difficult because it is among the largest and most diversified in the world (Hare, 1999). Nonetheless, the World Bank is still backing for controversial economic reforms targeted at boosting standards in education in order to accelerate the restructuring of businesses. (Thornhill, 1997) Ironically, Russia boasts more than 40 universities in 1997, compared with just two in 1987. The struggle to survive is based on the lack of state funding and the new concept of individual tuition. (Monks, 1997) The purpose of this paper is to initiate thinking and possibly associate managerial skills with worthy performance, rather than the genus manager, as it applies to the specific needs of the "New Order" in Eastern Europe. (Bollag, 2000).

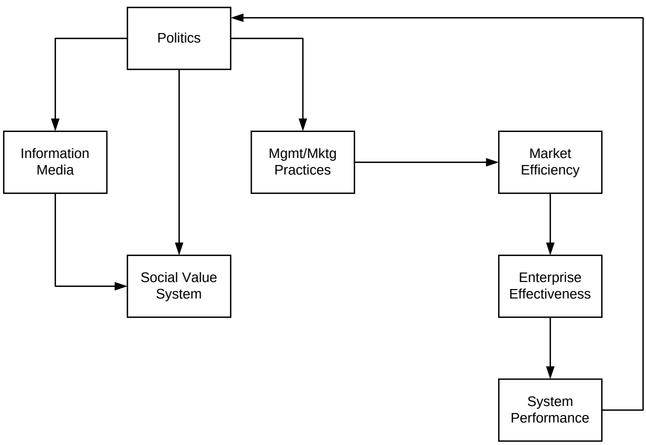
The following models (Exhibit 1), depict a comparison of the management and marketing systems of the: **1)** Private Enterprise Order, **2)** Eastern European "Old Order," and **3)** Eastern European "New Order." A proposition is therefore advanced, that Eastern European countries, in order to make the transition from the "Old" to the "New" order, need to break the socio-political grip of management and marketing practices and skills.

Exhibit 1: *Comparison of management and marketing systems*

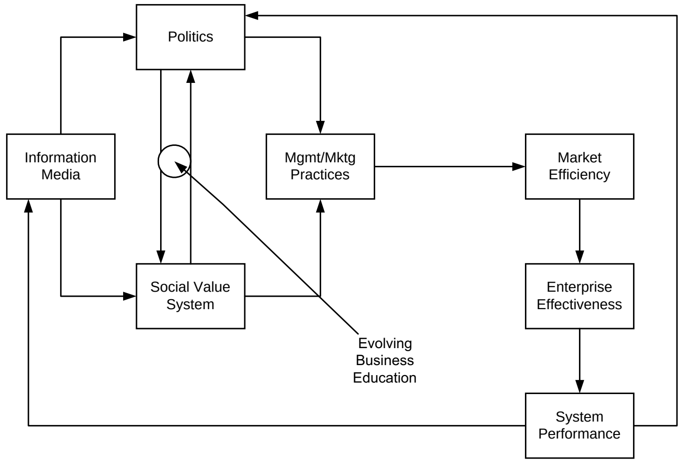
1. Private Enterprise Order



2. Eastern European Old Order



3. Eastern European New Order



In order to accomplish this, a business education and learning feedback mechanism needs to be instituted in their evolutionary model. Business education will initiate changes and unfreeze the assumptions, values, and philosophies of the Old Order, and establish and refreeze new ones. This comparative business education feedback mechanism will in essence link the New Order of influence in the national socio-political system with the consequences of the "good" management and marketing skills and practices in use.

4. Entrepreneurial Venture Potential and Privatization

It is axiomatic from the field of finance that the evaluation of capital investments is based on the expected return and the risk associated therewith. Risk is usually considered to be the variability of the expected return, and is dependent on many factors, including "stability" of the investment environment.

When entrepreneurs consider the potential of a capital investment within the U.S., or any other western-style private enterprise system, the sociopolitical climate is relatively constant and known. When evaluating a potential investment in another country however, this factor may be quite uncertain and the risk-return relationship **different**. On the other hand, the type of special incentives offered to attract capital investment, and the level of these incentives varies widely among countries. While these incentives are certainly considered by entrepreneurs in making investment decisions, it is not certain how these factors are incorporated in the analysis. The profiling becomes more difficult when considering using traditional tools for expected return when transition economies like Russia, many "new" business are simply a reincarnation of off-spring of former state-owned enterprises. (Ash, 1994).

It is our contention that the expected return on a specific investment will be influenced and reconciled by both the nature and level of incentives offered by the host country, and the sociopolitical risk in that country. In making a foreign investment decision the entrepreneur must recognize, evaluate, and reconcile these three factors. It is our purpose herein to investigate the incentives offered by several "classes" of Eastern European countries, and how entrepreneurs should adjust their analysis to account for these incentives and evaluate the venture's potential. It is expected to be shown that the "risk" in the traditional sense, is insufficient to explain the rationale for foreign investment decisions, and that these incentives play an important role in the firms' capital investment choices by reconciling the expected return on investment.

4.1 Country Evaluation Criteria

The three areas assessed in order to determine the entrepreneurial investment potential in an Eastern Europe country are: Risk, Expected Return on Investment (ROI), and the incentives offered by the host countries to attract foreign investment.

Exhibit 2: *Country evaluation criteria*

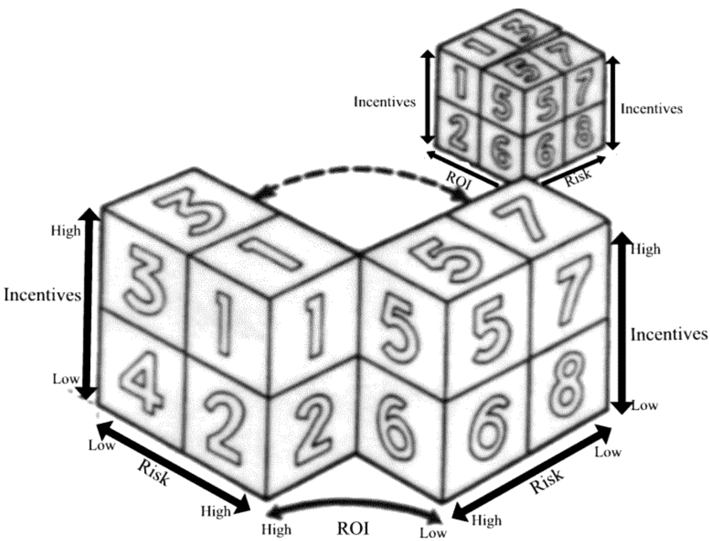
RISK	Social turmoil
	Political turmoil
	Financial risk:
	**External debt*
	*Trends in current account
	Political risk:
	*Consistency of government policy
	*Quality of economic management
	Trade risk:
	*Foreign exchange reserves
INCENTIVES	Liberal direct foreign investment policies
	Liberal financial transfer policies
	Absence of government corruption
	Size and nature of government direct incentives
EXPECT ROI	Export opportunities
	Likelihood of losses from exchange controls
	Likelihood of loan defaults
	Inflation
	Debt service costs

Sources: Economist Intelligence Unit
International Country Risk Guide
Volume XX, Number 6, June 1999
Wall Street Journal, September 20, 1991, p. R4
Political Risk Services
International Business, June 1991, pp. 20-21
July 1991, pp. 36-37
August 1991, pp. 24-25

Our initial expectation had been that direct entrepreneurial investment would be geared to countries with high-expected ROI, low sociopolitical risk, and high degree of government incentives offered by the host country. By incorporating a "high/low" classification of offered incentives, sociopolitical risk, and expected return on investment, a comprehensive three-dimensional matrix of the venture investment alternatives is constructed in Exhibit 2. If the country results in a high classification, it would be over the medium range in the classification approach.

An investment entrepreneur recognizes, evaluates, and attempts to reconcile these variables in the analysis regarding foreign investment. Using the International Country Risk Guide (ICRG) ratings from *The Wall Street Journal*, and the Political Risk Services (PRS) Index from *International Business*, the nine Eastern Europe countries can be classified in their corresponding cells according to whether they score "high" or "low" on risk such as political turmoil, *government incentives* to attract investment, such as liberal direct investment and financial transfer policies, and low financial risk, and *expected return on investment* (ROI), such as export opportunities and low economic risk.

Exhibit 3: *A model for classification of entrepreneurial investment. Alternatives in Eastern Europe*



In general, the factors that contribute to the enhancement of return on foreign investment are:

1. Firm has special **expertise** not readily available in foreign country.

2. There are **gaps** in the market abroad, i.e., there is latent or actual **demand** that is not currently being satisfied within the foreign country. (NOTE: This could lead to an "economic profit", i.e., higher returns than earned at home. The argument here is that there is an imperfect flow of information, skills, and technology).

3. There are potentials for more **efficient** production abroad due to:
– lower labor cost per unit
– a ready source of supply of labor needed
– a ready source of supply of raw materials needed

Further research is needed to confirm or refute our conclusion that risk, incentives, and expected ROI can be reconciled in attempting to explain investment in Eastern Europe. A large sample, a variety of industries, and a historical and longitudinal perspective is currently being compiled by the authors to arrive at more concrete results.

5. Epilogue

Eastern Europe is in a systematic chaos. It faces changes at all levels and across all systems, such as Changes in Government, Changes in the Economy, Changes in the Markets, Changes in the Legal and Political System, Changing Industry Structure, and Changes in Ownership. It is the chaos of opportunity and challenge in terms of attempting to create a free market economy.

Exhibit 4: *Eastern European country entrepreneurship investment classification.*

					Rating			Rating		
					PRS			ICRG		
Cell	**Risk**	**Incent.**	**Expected Roi**	**Eastern European Country**	**Risk**	**Incent.**	**Roi**	**Risk**	**Incent.**	**Roi**
1	HI	LO	MOD	Yugoslavia	HI	C+	B	35	24	23.5
2	LO	HI	HI	Former East. Germany	LO	A-	A	83	50	38.5
3	LO	MOD	MOD	Czechoslovakia	LO	B-	B+	76	36	8
4	LO	MOD	HI	Hungary	LO	B	A	74	32	13
5	LO	LO	LO	Poland	LO			77	29	10
6	MOD	LO	LO	Bulgaria	MOD			71	28	14.5
7	HI	LO	LO	Albania	HI			56	33	17
8	HI	LO	LO	Russian Federation	HI	C-	D+	49	36	26
9	HI	LO	LO	Romania	HI			56	29	19
10	MOD		LO	Kazakstan	HI			67		12
11	HI		LO	Azerbaijan	Hi			56		12

The Eastern European Country Entrepreneurship Investment Classification provides a unique approach toward balancing risk and incentives to estimate expected ROI. This model is advantageous since as a country varies in stability, the rating for the risk will be easily corrected. Certainly Russia will alternate more frequently than Hungary, for example. This model is useful for comparisons across time as these countries receive international funding, banking loans, and continued or additional support for privatization. There may be much to be learned by studying and observing the resolution of this chaos into recognizable and organized systems. Changes of these proportions can invalidate old systems and create opportunities for new systems to develop.

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