GÁBOR HOVÁNYI

"Low Flame Management": New Challenge to Management Theory and Practice in Eastern Europe

There are typical crisis situations and already well known crisis management techniques. But a new type of crisis emerged in the economic transition of East-European countries: companies had to shut large production capacities because of the collapse of their traditional markets - but the remaining parts of the firms could operate without an imminent threat of bankruptcy. The management of a company possessing unused assets required a new technique: the "low flame management technique". This management practice has a special character as well as ominous consequences on the longer run – and offers also some lessons both for company management in general and for decision makers responsible for the economic policy of a country.

A New Management Technique

Business in difficult situation fostered many management theories and practices in the last decades: Companies gasping for breath in crisis situations required a "soft landing cure" when their crisis was due to the deficiency of one of their functions (e.g. production management, finance or marketing). In these situations the weary function could be localized, cured – and the already healthy one integrated into the normal operation of the firm. Companies losing ground completely had usually a last chance of "quick take-off" directed by a crisis manager or managerial team. And East-European companies, being in a case of emergency amid the economic transition processes of the early '90s – when they lost their traditional East-European markets, were restricted by their outdated technology, hindered by missing institutions of a market economy and by a poor infrastructure – could put trust only in an "emergency take-off" subsidized mostly by benevolent or self-seeking investors from the West...

More sensitive managers forecasted the threatening crisis in time and tried to avoid the collision with the floating iceberg of bankruptcy by tournaround management techniques. Management's master strokes to make a turn a round were manifold: they changed strategies, markets or product lines, organizations, managerial systems, etc. The use of all these techniques had one basic condition, namely the flexibility of human resources and/or technologies of the firm. And an effective flexibility had in every special case its threshold of minimal changes required – usually a startlingly high one in the conditions of the speeded up changes of technical and economic developments all over the world.

Reckoning with the increased speed of change of the technical, economic and social environment, company management developed change management techniques. The aim of the new techniques was to keep level with the changes of the environment, i.e. to sail never again on seas of floating icebergs... This needed first of all sensitivity and creativity on part of the managers; innovation mindedness on part of the employees; and last but not least financial resources to implement the innovative ideas – a more and more risky and capital intensive act in conditions of today's more and more slaughterous competition.

Ten Trajectories For The Once State-Owned Companies In Eastern Europe

Passing through the changes of political systems in Eastern Europe and the start of transition from planned

to market economies, the large state-owned companies followed usually one of the following ten trajectories:

- The most competitive state-owned firms – priding themselves usually with large sales figures also on Western competitive markets and therefore well known by their Western competitors – have been privatized by full or good half acquisitions on part of Western professional investors. With the assistance of their new owners the firms got access to new capital, technology, markets, managerial skills and systems, i.e. they became even more competitive than before privatization.
- Some of the large East-European companies had to suffer a "hostile take-over": the Western competitors bought in reality not the Eastern firm but its domestic and export markets. (This was a consequence of the erroneous privatisation policy of some governments, preferring short-sightedly the high selling price instead of the mitigation of employment problems and mostly the long range future of the firm.) Production of large firms which followed this trajectory was stopped sooner or later and their outputs were substituted by products of the new owner also on the domestic market – what was made possible usually by the exaggerated liberalization policies of the East-European governments.
- Less competitive (at least by Western standards) companies continued to market their products mainly on the domestic and East-European markets. But demand on those markets was shrinking drastically and most of the firms' export partners on East-European markets (above all on those of the former Soviet Union) lost completely their soundness. These less competitive companies went into bankruptcy – often even after gaining large subsidies from their credulous or scared governments. (In some East-European countries the output of industry decreased by 40-45 percent during the first years of the '90s due mainly to the shrinking markets and bankruptcies of the large companies.)
- But there have been also some East-European companies which were able to reorganize their production without external assistance, to streamline their product lines and management systems to meet the requirements of quality and up-to-dateness of the Western competitive markets. But these successful companies have been rare as blue diamonds, especially in times when the cost of credit for new investments sky rocketed because of the countries' high inflation rates – and when even the successful companies' domestic business partners went into bankruptcy and could not pay even for the deliveries received long before...
- Quite a big number of the large and once successful companies had to follow a painful slimming cure. These companies have been usually the diversified ones. To survive in the new severe conditions they had to stop characteristic lines of production. But nobody wanted to buy their already cumbersome assets – partly because the firms' production systems were fully integrated ones (e.g. in the chemical industry), partly because of the outdated character of the plants closed down. (Most of these "downsized" companies were privatized by MBOs and/or by selling shares to employees; and the latter solution where practically nobody had additional capital to make big investments and to modernize, did not increase the popularity of the "countless small capitalists" system in the East-European countries.)
- In large East-European countries having huge domestic markets (e.g. Russia or the Ukraine) some large companies selling only on the domestic market, could survive even if demand was shrinking drastically on their market. But this survival had and will have a high price in the future: usually these companies can not accumulate the necessary funds for significant new investments - and therefore survival means for them a steadily growing technological backwardness.
- In smaller East-European countries some companies tried to maintain their big export businesses in their traditional East-European markets, especially on the markets of Russia and the Ukraine. Doing this they ran extremely high risks: they had to face the insolvency of their business partners or at least very late payments for goods shipped; to avoid the problems of insolvency they entered often into barter deals, but in this case they had to calculate not only with late shipments but also with huge quality problems in certain deliveries; to enter into a long term contract with partners on big East-European markets meant very often low quality requirements on part of the import partners (because they preferred cheap products for the local consumers, having very modest incomes), and this low level claim – if it was a long term phenomenon – set merciless brakes on the R+D activity of the shipping company, especially if a large part of its output was oriented to these markets.
- The small and medium-sized companies had two other trajectories in the first years of the economic transition of the '90s. They could survive or even grow by selling only on the domestic market. But this was a really hard task to accomplish: demand of consumer goods decreased by 20-25 percent in most of the East-European countries and the demand of industrial goods decreased even more; inflation rates were high and as a consequence also the interest went up (it was usually an unrealistic endeavour for a starting business to make profit and pay at least 40 percent interest rates when the market decreased at the same time by 20-25 percent!); and when tax burden of the enterpreneurs became increasingly heavy because of the lingering deficits in the budgets of most of the East-European governments.
- The SMEs faced huge difficulties also when they tried to build up business contacts with Western firms: usually this attempt reflected the "loneliness of the long-distance runner", because in most of the East-European countries no "Small Business Administration" existed and therefore the SMEs could not count on the informative, legal and financial aid of their government. As a consequence their business with a Western partner came often to a deadlock on the level of a quite miserably payed commission work.
- The last trajectory of the East-European enterprises was making profit in the black or companies gray econo-

my. When making business in this sector of the economy one foot of the enterpreneurs was already in jail – but temporarily they could make really huge profits (and wanted to make even bigger ones because of their uncertain tomorrow...). The governments had to give up hopes to collect taxes in these sectors, what increased the deficits in their budgets. But as a grotesque contradiction to the negative consequences on governmental level, the flourishing of the black and gray sectors of the economy solved many of the unemployment problems and was – sometimes the only really existing – driving force of economic growth in the East-European countries.

These 10 trajectories represented the hard facts behind the illusions of the first years of economic transition in the Eastern part of Europe in the first half of the '90s.

A New Challenge For East-European Company Management

One from the outlined trajectories represented a real new challenge for East-European company management: where companies were forced – because of their collapsed markets – to follow a drastic slimming cure by giving up 50-70 percent of their output, by dismissing their employees in the same percentage – but dragging along their plants and fixed assets because of the integrated nature of their technology or because of the outdated condition and therefore unmarketable character of their superfluous mills and equipments. But most of these companies could maintain for the time being their solvency – thanks to the slimming cure implemented in due time. Thus the managers of the "downsized" companies could use a new, "low flame management technique" to run their firms. But it turned out in the course of time that many unforeseen problems were hidden behind this new managerial challenge:

As a consequence of shut capacities, ROCE and ROI increased and fixed costs lained an increasingly heavy burden on the companies. This reduced considerably the firms' leeways in the stiffening competition of the East-European markets where more and more successful Western corporations launched their products.

Because of the drastically diminished capacities maintenance costs of the integrated technology represented an ever higher percentage of production costs – and at the same time closed mills and plants often required more intensive maintenance than running production lines. This too weakened the companies' financial positions.Business partners noticed immediately the decreasing outputs of the companies. As suppliers they began to lay down stricter conditions for their deliveries – as buyers they decided to find other, "more reliable" sources for their procurements or to obtain at least easier terms for their purchases. And often also the smaller quantity of goods ordered by the "downsized" companies increased the price of shipments. All this contributed to the weakening of the companies' competitive positions.

Supported only by decreasing sales figures, R+D activity of the firms shrinked, researchers became superfluous and left the companies – and there was a real threat that R+D will fall back in a short time below the "limit of critical size" dictated by the merciless competitors.

Most of the employees endured till their dismissal the inevitable slimming cures of the companies dragging along the superfluous assets. But noticing the arising threats many employees left the companies voluntarily – and these have been always the most creative people, the best professionals who could find easily new jobs elsewhere. As a consequence mostly second grade white and blue collar workers remained at the companies managed by low flame techniques.Experiencing the shrinking output of the firms the trust in management in the remaining employees was shaken more and more – and this was not suppressed at all by the maintained liquidity of the companies. As time passed, managements had to calculate with a growing loss of their reputation – mainly because they could not get rid of the burdens of the firms! Work moral diminished more and more on the working places. This was manifested by decreasing figures of work productivity as well as by increasing figures of quality defects. And not even the permanent threat of a further slimming cure (or a complete liquidation of the companies) strengthened work moral of the remaining employees: threat was rather inversely proportional to work moral!

As a consequence of this innovations nearly stopped at the companies: creativity of both white and blue collar workers was paralysed by the experiences of the dreadful past and expected threats of the future.As a result of all these phenomena the companies' PR lost a big part of its truthfulness, and the firms' goodwill shrinked. Company images have been shaken much more than it could have been justified by the shut technical facilities or by the unshaken financial situation of the companies.

"Low Flame Management": Trials And Errors

Managers in East-European companies had many choices when they tried to solve problems of their firms on the verge of a "low flame operation crisis".

Lucky managers could suggest a diversification. But usually it was impossible to use the shut plants and their technologies to produce brand new types of products; or the conversion of the existing technologies needed too much capital; or the marketing of new type goods was a too risky endeavour on the srinking domestic market and the unknown or unfriendly Western markets, often cut off by special regulations.

Rather theoretical was the idea of enlarging the markets and market shares of the products manufactured in the still operating plants and mills of the company. The reason for the more or less theoretical character of the

idea was not only the shrinking of the domestic market, but also the huge competition of Western firms supplying their up-to-date products with support of huge and very expensive marketing programmes.

To detect new and large solvent demand on expert markets for the still manufactured products could be realized in most of the cases only by selling the assets of the "downsized" companies to Western investors. But no Western financial or professional investor wanted to buy the shut parts of the East-European firms: this kind of investment would be much more expensive than a green field investment.

To orient these firms to less solvent markets, e.g. to develop renewed business relations by barter agreements in the Eastern part of Europe, was again a too risky endeavour. And the manufacturing companies did have neither the capital to bridge the time span between their deliveries and the sometimes year or half year late shippings of their foreign business partners.

Somewhat more realistic was the idea of signing delivery contracts with large Western firms, e.g. multinational manufacturers, retailer chains, etc. But even this had many limits: problems of changing quality, untimely shippings, too rigid and clumsy manufacturing systems, etc. made the Western partners very cautious. As a consequence the Western multinationals often preferred a green field investment fully owned by themselves than a delivery contract with an existing domestic company being on the brink.

The most realistic concept – better to say: the first element of it – was to base the production and marketing of products manufactured by the still operating part of the business on a new "pulling parameter" in comparison to the parameters of products and marketing of the competitors. But the successful – usually Western multinational – competitors could not be hoisted with their own petard even on the domestic markets of the local firms: for that the domestic firms, being on the brink, had to find new petards! This bound the requirement of pulling parameters of products or marketing actions to the innovation potential of the local company: its innovation talent and innovation capacity.

An example of this concept and its implementation was an East-European chemical company in the detergent business. The company was forced to close down 70 percent of its outdated production capacity and operating only the remaining 30 percent in the first years of the '90s. The competitors – Henkel, Procter and Gamble, Unilever – had excellent products on the local market, well established company images and huge, expensive advertising campaigns, mostly in the national tv programmes. The technical parameters of the local firms' products were close to those of the multinational competitors – but the local company had no funds to finance tv advertising. The "innovative pulling parameter" of the local company was at last a low price strategy targeted to large and price sensitive strata of the society (these people had to give up 25-30 percent of their living standards during the last five years of the country's economic transition) and supported by a drop-in-mail advertising campaign, accomplished by students during summer vacation. The slogan of the campaign was: "Instead of huge and expensive advertising campaigns we decreased the prices of our products!" – This concept worked and was the first step to end a low flame management process.

Namely low flame management requires also further steps. The main strategic task is "to rev up the engine of the company" (from the simple notion of work intensity to the much more sophisticated time concept of the firm's management and of all its employees) to 120-130 percent of the "revolution per minute" normally accepted by the smoothly running companies. And this means usually a 50-60 percent increase of r.p.m. at companies having low flame operations!

To carry into effect this main strategic goal many small steps have to be taken by low flame management :it has to establish and communicate a new management concept to speed up the growth of the company and to get rid of the firm's unused capacities andto introduce a new controlling system to detect the remaining sources of loss in the operation of the company;having done all this management has to plan and implement the reorganization of the operating part of the firm (this usually includes new dismissals and replacements) andto introduce a new incentive system, often also a new wage-system at the company;last but not least management has to create a new company image taking into account also the new pulling parameters and embodying also the above mentioned innovative ideas.

All these steps are familiar also in the traditional crisis and turnaround management processes. What is brand new in "low flame management" is the imperative disposal of the "dead assets" (shut plants, mills, technologies, etc.) of the company. Low flame management has three different kinds of actions to reach this ultimate goal:

If the technology of the firm is an integrated system, management has to separate the technology of the firm's viable part from the whole integrated system – even if this detachment needs very expensive investments and might be financed by credits highly depressive in the short run.

If nobody wants to buy the separated "dead assets" of the company (plants, mills, technologies) for a price more or less close to the presumed market value, management has to sell the assets even for a symbolic 1 dollar price: namely loss from the lack of return from sale is usually far smaller than losses resulting from the firm's low flame operation in the long run.

A third type of action — chosen quite often by managers of companies characterized by low flame operation - was not to sell but to let out their "dead assets" (e.g. to let by lease plants or mills not for manufacturing processes but simply for storing different types of commodities). This solution brings some earnings to the company - but does not drow back the firm's viable part from the brink of low flame operation.

Lessons For Management Theory And Practice

Some lessons can be drawn from the peculiar East-European "low flame management" cases also for general management theory and practice:Business needs a certain amount of resources (capital, technology, human resources, etc.) and possibilities (markets, business partners, advantageous financial regulations, etc.) for being successful. If resources and possibilities have shrunk below a certain limit but high level human resources operate in high spirit, the latter can substitute – in one or an other way, e.g by acquiring new external resources - the lack of financial or technical resources or of possibities in achieving a final success. But if level and spirit of human resources (manifested mostly in productivity, creativity, quality consciousness and self-esteem) decreases below a certain limit - what is the threat provoked by low flame management –, no other resources or possibilities can save the business in the longer run.

Large "dead capacities" – especially fixed assets like plants, mills, technologies - facing the remaining human resources of a company have a fatal effect even if the people still employed have to fight for their jobs, for their own or for their families' financial background and existence. Therefore in crises or when the company is close to the brink managers have to throw overboard as soon as possible the dead capacities of the firm – even if this requires huge financial sacrifice from the company.

For the long-range survival of a company not its size, market share or the amount of its resources are really decisive but the "revolution per minute" of the firm's operation. Therefore the main tasks of company management are to set right objectives for the company, to guarantee the highest possible r.p.m. of the firm, to control its goals and r.p.m. – and to eliminate outdated goals and breaks slowing down the r.p.m. Low flame management, the managerial concepts and techniques related to it are suicidal concepts and techniques, leading directly to plain crisis management.

Low flame management concepts and techniques of companies are strongly supported by economic regression of countries and even by prolonged periods of economic stagnation. And they are enormously stimulated by habits of employees – deep-rooted already in an era when the firm's low flame operation (characterized by low level productivity and quality consciousness, practically no individual responsibility, very loose links between performance and individual success) was a general symptom, as it happened in Eastern Europe during the decades of the communist regimes. To fight against low flame management temptations and consequences is not an easy task in the midst of external and internal conditions favorable to its rise.

Lessons Of Low Flame Management For Political Leaders

Some conclusions can be drawn also for political leaders of countries from low flame management practice in business:In governments' economic policies it is not prudent to drag along "dead capacities" (e.g. branches of industries showing long-lasting deficits, decision systems where the traditional degree of employment is the main criterion even if this puts brakes on modernization and economic recovery, time-honoured and for the population convenient social security systems jeopardizing the government's balance of payment, etc.) especially in periods of economic transitions, e.g. those of East-European or some third world countries. Low flame management on governmental level means losing ground in the international competition of countries for a long time - and this blunder must be redressed later on by more cruel crisis management procedures.

In privatization processes the first and decisive criterion for governmental decision makers should be the expected (in contracts warrented) "revolution per minute" of the privatized companies, and not the volume of return from sale, not the level of employment guaranteed by the new owner, not the reputation and reliability of the investor, etc. But the fulfilment of the r.p.m. criterion requires such an insight on part of governmental decision makers into the effects of the applicant investor's privatisation offer, which is mostly the gift of company management experts, who are acquainted with the finesses of business. The consequence is quite simple but strange nowadays: not politicians, civil servants or macro-economic experts but company managers should be the decision makers in the privatization processes of governments. (But till now very few governments left the fat tidbit of privatizations to outsiders...)

Without a reliable high r.p.m. at the national scene, including production as well as consumption, there is no way out of the country's low flame economic management. Therefore long lasting restrictions – even if they are grounded in unbalanced budgets back for years – will never speed up economic growth in a country but will start (especially when applied only by themselves!) cyclically returning and ever more severe restrictions. Maybe, this could be a lesson also for the IMF acting in the East-European region and turning attention only on financial equilibrium and restrictions... Last but not least: societies dragging along dead assets for a long time will lose all their faith in growth and development. Therefore it is not enough to stop the low flame management of an economy: it is vital for governments to communicate with the public about the canceling of the low flame economic management practice, about the forecasted short-term worries and expected long term achievements of the modified economic policy. But this communication needs a clear and well-founded forecast of the future: how will the values (not only assets!) thrown overboard speed up the ship of the society to reach new and secure coasts and to find there more stable values. People living for a long time under low flame management of their economy – as e.g. in Eastern Europe – are very sceptical when they listen to the baseless rumours of governments promising blankly a brighter future.

Szerzőnk a közgazdaságtudomány doktora,
tanszékvezető egyetemi docens
(JPTE Közgazdaság-tudományi Kar)