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FIRMS' CAPABILITIES RELATED TO THE ECONOMIC SYSTEM: CASES FROM UKRAINE AND RUSSIA

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Abstract

This paper suggests that certain capabilities of the firm are functional to the type of economic system (socialist, capitalist, transitional, etc.) in which the firm has to operate. Their presence in a firm can be an important factor in explaining its ability to survive and develop. It also suggests that concepts and definitions of the firm, offered by writers who have employed evolutionary and institutionalist models, yield useful perspectives on the processes of transition at the level of the individual enterprise. Cases from Russia and Ukraine are used to investigate this conjecture and to identify those capabilities distinctive to a market economy, in contrast with those required by their previous economic system. The capabilities, which have been conspicuously absent from the firms, which were relatively unsuccessful in adapting to the market economy, appear to relate particularly to management of purchasing, of innovation, of quality control, sales and trade credit.

1. Introduction

This paper aims to contribute to the study of the economic changes which occurred in many post Soviet firms as a consequence of the collapse of central planning[1]. It analyses a series of case studies conducted in firms belonging to a single industry, the footwear industry in Russia and Ukraine. This industry has been one of those suffering the most severely during the years of the transition process, with great losses of both output and employees[2].

We employ perspectives on the firm that have been developed by researchers using institutional and evolutionary approaches to the study of technological and organisational change. We consider whether the major transitional obstacles faced by the firms considered here went beyond the finding of new suppliers[3] and clients, to include also the acquisition of new capabilities in the fields e.g. of purchases, sales, production (innovation and quality control) and trade credit. Such capabilities are basic to firms in a capitalist economy and functional to the goals that such an economy gives to firms. More generally we suggest that each type of economic system rewards certain firm-level capabilities, and that these are idiosyncratic to it. We investigate whether those firms that acquired the needed capabilities more quickly and more completely, performed better.

Section 2 reviews previous studies that offer useful categories that we can adapt in describing the changes which occurred in the firms in former Soviet countries. The adaptation of existing theories to the specific case of the transition is undertaken in Section 3. The categories of "capabilities" and "routines", mostly used to study change due to technological innovation, are used in this context. Section 4 presents the changes, which actually occurred in nine companies, using as its evidence the records and the opinions offered by their managers[4]; and identifies capabilities and routines developed in the firms considered. Section 5 presents our conclusions.

1. Studies on firms' capabilities and routines

2.1. Ideas of firm

Institutionalist and evolutionary studies have provided a number of perspectives on, and models of the firm which may offer new insights into the processes of transition.
Table 1 summarises various models or definitions of the firm that have been used in these studies.

Table 1 Definitions of firm, from institutionalist and evolutionary studies.

a) institutions, i.e. structured groups of transactions (Williamson, 1975)
b) institutions, i.e. entities where groups of common habits[5] are embedded (Hodgson, 1998)
c) a "recurrent patterns of behaviour, habits, conventions and routines". (Langlois, 1995:1)[6]
d) "the incubators and carriers of "technologies" and other practices that determine "what they do" and "how productively" in particular circumstances". (Nelson, 1995:68-69)
e) a "co-ordinated set of resources that is idiosyncratically synergistic and vital to the goal of the organisation" (Langlois, 1995:13)
f) "information processing systems, whose efficiency hinges on the ability to build and maintain stable routines and information processing processes[7]" (Anderson and Tushman, 2001:700).

Definition a) draws attention to the disruption in a firm's operations which can occur when the type of transactions it has to carry out, changes. If transactions change, the firm's nature must also change[8].
Definitions b) and c) emphasise the importance of habit and repetition as explanatory variables of agents' behaviour which help to explain why firms do not change overnight, but only after lengthy processes. Definition c) and d) introduce the concepts of routines and practices as key aspects of firms' activity. Definition e) stresses the importance of the goals of the firm and also explains why changing goals can destabilise firms. The idea of co-ordination implies also coherency, which in turn may imply rigidity (Dosi et

al., 1992) so that “firms who do well in one context may have great difficulty in adapting to a new one” (Nelson, 1995:79)[9].

Definition f) stresses the role of information. The firm as information processing system faces a challenge when business activity can no longer be accommodated within existing routines[10].

2.2. Routines

“Routines are the building blocks of capabilities (…). Individual skills in turn are among the building blocks of organisational routines.” (Dosi et al., 2000:4). “The term ‘routine’ connotes (...) behaviour that is conducted without much explicit thinking about it, as habits and customs. (…) Routines can be understood, as the behaviours deemed appropriate and effective in the settings where they are invoked.” (Nelson, 1995:68-69) “The implicit ‘rationality’ in these models certainly is a ‘bounded’ one” (Nelson, 1995:70).

2.3. Capabilities

Capabilities are “knowledge, experience and skills” (Richardson, 1972:888) and they are what permits firms to carry out such activities as manufacturing, R&D and marketing (Richardson, 1972). They are “forms of organisational knowledge that account for the organisation’s ability to perform and extend its characteristic ‘output’ actions” (Dosi et al., 2000:1)[11]. Capabilities are made up of routines (Dosi et al., 2000).

Capabilities imply intentionality, while low-level routines have a quasi-automatic character (Dosi et al., 2000)[12].

2. The proposed view

3.1. Introduction

Our aim is to identify, within each economic system, specific capabilities that must be acquired in order to operate effectively in it. We do this by comparing some firms, which did cope with the transition, with other firms, which encountered major troubles;

we identify the capabilities possessed more by the former and less by the latter group. The capabilities are described in terms of the routines of which they are composed.
We show that certain transactions that firms must carry out (purchases, sales and connected trade credit) have changed (see -a- in Table 1) and that this was a major source of problems. We try to explain why it took so long to establish new transactions. It was necessary for firms in transition not only to substitute some relations for others (Blanchard and Kremer, 1997), but also to build relations of new types, specifically connected with the different economic system.
We also show the role played by habits in the management of firms (see -b- in Table 1), and how firms (managers and employees) found changing their habits and routines very difficult. They faced a hard learning process, hindered by different degrees of inertia and by the heritage of the past (see -c- in Table 1). The same fact that the Soviet system had –in its own terms– consistency and organisation implied also a certain degree of rigidity[13] embedded in the habits of individual agents and more generally in firms. Rigidity and habits rendered in some cases the process of learning[14] and acquisition of new capabilities[15] more difficult. Agents had their views of the society and of their function and of the available possibilities. Their behaviour was consolidated in those habits, which fitted the requirements of the system. Many of these things have lost their importance with the communist party losing its priority role. The identity and the nature of the "owner" of the system were changing and so the rules of the game (North, 1990). Those organisational capabilities, routines, skills and habits, which had made the planned economy work, were becoming no more useful and sometimes counterproductive. Often, the consistency, which had kept the system together, was not permitting an easy passage to a different system[16]. Similarly we show the benefits that some firms were able to derive from acquiring new habits and new routines.
Then we stress the fact that Soviet firms were orienting their energies towards certain goals which were different from those brought in by the market economy (see -e- in Table 1). We emphasise the heavy consequences of this change of goals, from those of a socialist planned economy to those of a capitalist market economy.
Finally, we present the problem brought to firms by the need of analysing and understanding situations completely outside their previous routines, in a contest of great

uncertainty (see -f- in Table 1).

We will call “economic system dependent capabilities” those, which are specifically related to a certain type of economy (planned, transitional, capitalist, etc.). They are: “forms of organisational knowledge that account for the organisation’s ability to perform and extend its ‘output’ actions according to the goals and the rules of an economic system”[17]. Certain capabilities were typical of the planned economy (reciprocal inter-organisational loyalty, plan bargaining, buffering against delays[18] etc.). Others are typical of the transitional-chaotic economy (e.g. capability of managing barter in absence of normal monetary circulation, capability of dealing with low levels of specialisation and random opportunities[19]) and finally others are specific to a market economy[20].

Until 1991, Soviet companies were organisations operating in an economic system, which required certain organisational capabilities and routines. In most cases, footwear companies were required to produce shoes, with little control on the choice of their suppliers or of their clients and with loose quality controls[21]. Managers did not have this type of problems, but had other problems. For example they had to guarantee a reasonable level of welfare among their employees, to report in detail to the planning authorities on many aspects of the corporate life, to keep relations with the communist

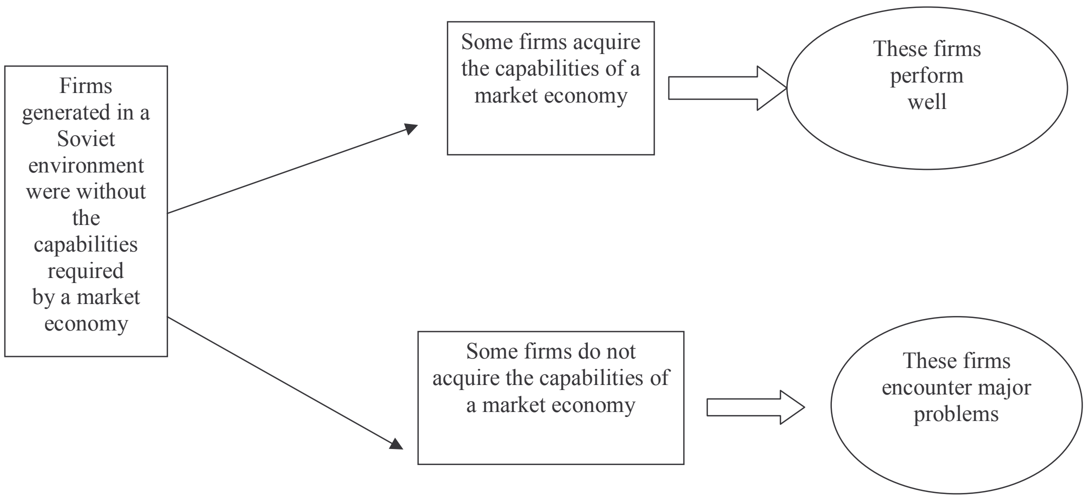

Figure 1 The relation between firm capabilities and performances

party, final guarantor of the functioning of the system, etc. Consistently, companies did not have to be innovative. Following the dictate of the “GosStandard”, the state authority for technical standards was the priority; quality of product was much less important. Relation with clients was minimal, because the state and the party were the real clients. The crisis of the Soviet system was probably originated not only by the disruption of its supply chain, but also by missing capabilities in dealing with clients, managing credit, developing products and controlling quality.
Firms will differ in the extent to which they have acquired the capabilities of a market economy. It is a plausible conjecture that those firms, which did not acquire such capabilities, will have encountered major problems in the course of the transition. These ideas are summarised in figure 1. In the following section, we present a synthesis of our case studies, which summarises the changes, which occurred in some Ukrainian and Russian footwear firms, as reported by manager-protagonists.

3. What we learn from case evidence

4.1. Objective of this section

This section describes and brings examples of the capabilities and routines of firms, coming from a planned economy, moving, at different speeds, towards a market economy, and passing through a transitional situation. It summarises the evidence collected in nine case studies[22]. The cases presented are consistent with the ideas presented in section 3 and identify important changes, which occurred in these footwear firms. Initially we look at the general characters of the companies, their labour force and their environment, then we continue considering their capabilities in the following fields:

- relations with suppliers;
- production and quality controls;
- relations with clients;
- trade credit.

4.2. General description of companies

Table 2 summarises some of the major features of the companies in our cases. It shows for every company several indicators. Each of them has its limits, but their joint use helps us to get an idea of the conditions of these companies. The indicators that we suggest to consider are:

- Physical labour productivity;
- Value labour productivity;
- Output trend;
- Employment trend;
- Percentage of employees not in forced holidays (use of labour capacity).

The first two indicators have been chosen to have a measure of the efficiency of the company; output trend has been chosen to see if a company is expanding or shrinking and indicators 4 and 5 have been chosen because they tell us if the company is able to create or maintain paid jobs. We see that four of the considered companies existed already before the perestroika[23]. In Table 2 former Soviet companies have an average size, in employment terms, larger than that of new companies. However, the considered new companies for five years have grown more than the old companies, which we visited. We observe firms in the year 2000 and we compare their situation with their situation in the year 1994 as described by them.

Iskra is an interesting case because is one of the biggest Russian footwear producers with an output measured in million pairs and a productivity, which in the years 1994-1999 has always been in the top quintile of the industry. It has not been able to reduce its workforce, but using functional flexibility it has been able to re-deploy staff from administrative functions to manufacturing roles. City is a former Soviet company, which is trying to solve its deep crisis. Deaf has just started a similar process; it finds very difficult to change the roles of employees. Glorious has gone bankrupt before restructuring. Among the new companies, Liner is small, in employment terms; it makes intensive use of numerical flexibility in the labour factor, hiring and firing staff, according its seasonal needs. David is very small, with a well-paid workforce. The former is not growing and has a low productivity, the second, just born, is growing fast

Table 2 Key figures about the nine companies visited in summer 2000

	City UA	David UA	Deaf RF	Glorious UA	Iskra RF	Lavender UA	Master UA	Liner UA	Right UA (supplier)
Year of creation	1929	1999	1935	1940	X <1980	1994	1990	1990	1995
Output dimension 2000 (in 1000 pairs)	150	8.5	20	////[24]	1500	Not said	180	5	Not said
Number of employees 2000	430	10	270	300	700	310	61	50 [25]	13
Employees Ratio 1999 1994	0.19	New	0.90	0.15	1.00	11.07	1.53	2.38	0.65
Productivity 2000 (pairs of shoes)	349	850	74	//////	2143	/////	2951	167	/////
Productivity 2000 (value expressed in euros)	7000	30,000	1000	////	32,145	?	74,000	5010	///
Output trend last 12 months in % terms	+34	New firm	Just restarted	0	-0.05	+30	+100	0	+50
Utilization of Labour Capacity (1 = full)	1	1	0.04	0.23	1	1	1	0.5	1

and has high productivity. Master and Lavender are two new companies of relatively larger size. Master has an absolute record productivity and is growing extremely fast, with a very limited administrative staff; Lavender is larger, but growing slower. Finally Right is a former footwear producer, which became first a wholesaler of supplies for the footwear industry and then a manufacturer of supplies. This case is exposed to bring information about the relation between producers and suppliers.

4.2.1. Uncertainty and market environment

4.2.1.1. Uncertainty

Some managers (Lavender, Master, Liner, Right) were noticing that in many cases the system had in 1994 a high degree of chaos, which was affecting the activities of any actor. They were observing that chaos and indetermination had reduced since then, but they were still remaining as a feature of an economy, which was probably starting to go towards the end of its transition. Managers of Master and Liner were particularly emphasising as chaos and unreliability of agreements were not strictly depending on specific individuals. They were connected with a whole uncertain environment, where electricity could be missing, telephones were unreliable, roads were dangerous, currency unstable, customs unpredictable, health of people not much guaranteed and, consequently, times out of forecasts. They were stressing as in such context the idea of individual responsibility was weak, because it was too difficult distinguishing between the behaviour of the individual and the conditions in which that behaviour was taking place. This chaos was occurring, but they perceived it as decreasing. The fact that many people did not know how to behave in changed conditions, having to learn the basic procedures or capabilities to connect their core activity and their skills with the market was probably contributing to the chaos.

4.2.1.2. Market environment

Managers of some companies (City, Liner, Lavender and Right) mentioned that market conditions from 1994 to 2000 had become stricter, with an increase of competition and of quality requirements. If in 1994 the Ukrainian market was substantially empty and was absorbing any product, even of approximate or bad quality, in the year 2000 consumers had become much more demanding. In Ukraine in 1994, selling was much easier. Foreign shoes were not available or affordable for many people. In 1994 companies perceived a market with relatively more money than goods, the opposite in the year 2000, when the Ukrainian society was also experiencing the definition of clear social classes with different purchasing powers. The difference of wealth between cities and small towns had increased as well, in the accounts of different managers.

In the following paragraphs, we survey some examples of capabilities acquired or not by firms. These changes are presented in the four areas of supplies, production, sales and trade credit.

4.3. Supplies

We must add to the disruption of specific relations between firms and suppliers, the destruction of network capital (Ickes et al., 1995), the fact that the average Russian firm missed the capability required for searching and selecting suppliers. This capability is close to the "linkage capability" (Lall, 1992) and to the network building capability (Radosevic, 1999)[26], but puts the emphasis more on search and selection of suppliers rather than on transmission of information from and to them. We stress that this capability has a certain identity in the system of market economy and is completely different in different economic systems. When we say that the capability was missing we mean that there were not established routines to do that, nor the organised structures to do that. While the average western manufacturing firm has a purchasing department or can rely on specialised firms, post-Soviet firms often did not have a department and could not rely on the service of anybody in such field. This can explain why it took so long for firms to find out alternatives and build “patterns of interactions” (Nelson, 1995:76). Add to this that all this process occurred contemporarily with the opening of the market to international competition (very true in the footwear case) with its possible effect of making restructuring more difficult[27]. To stand international competition firms should have been capable of selecting international suppliers (of soles, chemicals, leather, equipment, etc.), this would have immediately increased the quality of their product and their competitiveness. However, the capability for managing purchases abroad was very rare, among ordinary firms. Other new capabilities and routines concerned: testing of samples, attendance to specialised fairs, receiving visits of suppliers, visiting suppliers, search of suppliers on the internet, acquisition of suppliers directories, development and diversification of suppliers portfolio, development of an annual supply contract, daily talks for the management of supplies, controls on punctuality of deliveries, managing the warehouse, etc.

Individuals, companies and other organisations had to learn how to avoid the specificity of one or few suppliers; a solution to specificity can be found, learning how to deal with many reliable suppliers. It is necessary to learn where to look for them, how to select them, how to control them, trying to get credit from them, when possible.

The observed cases show some relevant changes in the management of supplies. They show that some former Soviet companies (Glorious and City) were hard affected, by the disruption of their relation with suppliers, the state chains of Soviet times. Some companies, as Glorious, were not able to learn how to find alternative suppliers and a dramatic event as a bankruptcy occurred before learning to solve the problem. Others, as Deaf, almost by chance (state protection for handicapped people) survived and could learn few things as for example looking for low cost supplies and agreeing purchases on the base of a sample. Some former Soviet firms (City and Iskra) introduced new suppliers with the reorganisation of their activity, even if, in few cases, they maintained relations with old suppliers. In certain cases, the managers of supplying firms created in Soviet times were not losing the habit of demanding for bribes in order to supply clients with first quality product[28]. In the transition from old chains to new suppliers, barter probably helped to smooth the process (Iskra, City, Deaf, Lavender). Many firms developed the ability of finding and selecting suppliers according to quality and payment conditions (Master, City, Iskra, David, etc) eliminating those with low quality, high prices, rigidity and late deliveries (Lavender). These aspects were not so obvious in Soviet times, when quality was simply defined by governmental guidelines (GosStandard) and payment conditions and prices were concerns in a much lesser degree. In many cases, we observe a new conscience of the importance of managing the warehouse. The awareness of capital costs led some producers to reduce their supply stocks in the warehouses (City and Liner) or to increase the frequency of deliveries from suppliers (Lavender). This led old and new companies (e.g. Liner and City) to give importance to punctuality and respect of deadlines in deliveries and in some cases to the introduction of sanctions on late deliveries (City and Liner). Other firms (Master)

Table 3 Period of acquisition of supplier used in the year 2000

	City	David	Glorious	Iskra	Lavender	Line	Master	Right
After 1998	60	100	100	60	40	30	65	0
Between 1994 and 1998	30	0		35	60	70	10	100
Before 1994	10	0		5	0	0	25	0

pursued a policy to depend no more on few suppliers, but on many, with a diversification of this type of risk. They developed the idea and the practice of a continuous search for new suppliers, based on the assumption that it is not essential looking for the culprit ("who was late? Who is to be punished?"), but solving the problem is essential. The attendance to national and international fairs helped firms in their diversification of supplies (Master, City, Iskra, etc.). Someone even used internet to find suppliers abroad (Right). The policy of reducing the stocks of inputs in the warehouses was not always the case: companies with a strong demand and good reputation as Master, often able to buy on credit, could afford large stocks of supplies, minimising the risk of interruptions in deliveries. Similarly, some producers (Master and Liner) tried to integrate vertically the production of some of their inputs such soles and heels, to limit their dependence on external factors. Firms were also keeping in consideration the type of service that they were receiving (Master, Iskra and Lavender).

Table 4 The capability of managing suppliers: Routines involved.

		City	Deaf	David	Iskra	Lavender	Liner	Master	Right
Routines	Attending fairs	X		X	X		X	X	X
	Continuous research of new suppliers	X			X			X	X
	Reverse engineering	X			X			X	X
	Control on punctuality of deliveries	X				X	X		X
	Control on quality of supplies	X		X	X	X		X	X
	Year framework supply contract	X				X		X	
	Telephone calls to integrate and modify the framework contract			X				X	X
	Search for cheap prices	X	X		X	X	X		
Learning mentioned as important		X	X		X	X			X

For example they were appreciating, if in situations of over demand they were receiving sufficient attention (Iskra) or if suppliers were ready to adapt themselves to the requests of small quantities coming from a small producer (Liner). Similarly, producers were appreciating the ability of suppliers to understand new situations not foreseen in contracts (Liner). Other producers (Lavender) were specifically mentioning that the establishment of a relation of trust was a precondition for operating successfully with a supplier. We know from a supplier (Right) that the attention to small producers (an important presence in western Ukraine) and to their needs was a specific policy of some of suppliers. Right, a supplier, was specifically mentioning that it was trying to sell not only footwear components to manufacturers, but also certainty, in a usually highly volatile environment.

A year framework contract had been another important tool developed by many companies. It regulated their relations with suppliers and was something novel, even if some type of contract also existed in Soviet times (Glorious). Telephone calls and talks (Iskra, Master, City and David) used to integrate this contract with specific requests each time, concerning quantities and quality.

In conclusion, we can say that the considered cases show the development of some new capabilities in the field of management of supplies. Many elements confirm the emergence of a new “pattern of interaction” (Nelson, 1995:76) between firms and suppliers.

Table 3 summarises the change of suppliers observed in case studies. Table 4 reports about the development in the case companies of the capability of managing suppliers.

4.4. Production

Companies had to produce with a variety and a level of quality, which could match the requirements of many individual clients, who, in the new conditions, could choose alternative national and foreign producers. Companies had to develop a larger product portfolio and stricter quality controls; many firms had to pass from the passive approach of eliminating failed products to the active approach of checking quality at every step of the production cycle. Firms also had to implement strict controls on the quality of inputs and of the service (e.g. deliveries and times of deliveries) that they offered to clients.

4.4.1. Product portfolio

Cases confirm that some companies were acquiring the capability of producing an ample higher quality product portfolio in response to the requests of the market. This is of course a phenomenon, which occurred in different ways in different companies and probably depended on their ability to learn and to acquire new skills. Acquiring new capabilities was bringing benefits to those firms who most were doing it. Part of the results is observable in Table 5, which shows the changes in product portfolio, which occurred in the companies of our cases. As we can see, in many cases product portfolio grew consistently. This was often accompanied by qualitative improvements.

Table 5 The development of a product portfolio

	City	David	Deaf	Iskra	Lavender	Line	Master	Right
1994	40	*5	*1	70	5	3	30	1
1999	200	**15	**12	300	55	20	218	13

*Data at beginning of 1999
**Data in June of 2000

Iskra and Master are respectively the examples of huge volumes and high productivity firms (see Table 2). In Table 5 they are also those firms, which built the largest product portfolios.

4.4.2. Quality controls

Many visited firms had introduced quality controls all over the production cycle (City, Master, Lavender, David, and Right). Some managers (City, Master, and Lavender) declared that it was not simply a matter of introducing these controls; in the years, their attitude towards quality controls considerably changed from an almost bureaucratic accomplishment to an attentive and motivated check on all the phases of the production. They declared that their companies slowly learned how to implement such controls, having some staff developing specific skills for this.

Table 6 The capability of producing a portfolio of quality price competitive footwear: routines involved

		City	David	Deaf	Glorious	Iskra	Lavender	Liner	Master	Right
Routines	Quality control at the end of the cycle			X		X		X		
	Quality control all over the cycle	X	X				X		X	X
	Random quality controls all over the cycle					X				
	Imitation of competitors products	X	X	X		X		X	X	X
	Purchase and dissection of competitors products	X				X			X	X
	Collection of images of competitors products	X	X							
	Attendance to fairs and exhibitions	X	X			X		X	X	X
	Attendance to courses	X	X	X						
	Speaking with competitors					X				
	Improvement of previous models	X	X	X				X		
	Selection of new designers	X	X				X		X	
	Reduction or definition of the lead time from order to delivery	X				X	X		X	
	Collection of opinions of clients on the product	X				X	X		X	X
	Control on the waste of inputs	X	X			X	X			
	Letting and selling not used spaces	X		X	X	X				
	Sale of not used equipment	X		X		X				
	Redesigning the production flow					X	X			
	Reduction of the warehouse stocks					X	X			
	Control on the waste of output	X								
	Control on the achievement of targets	X		X		X				
	Fines on those who waste resources	X					X			
	Clients on line	X				X				
	Use of Internet									X
	Learning mentioned as important	X	X			X	X		X	X

Some companies learned much less than others. They did not introduce and implement strict quality controls over all the production cycle, but just at its end (Deaf and Liner, two bad performers). Other firms, with very large output, used a mixed approach with quality controls on every piece at the end of the cycle and random controls at every phase of production (Iskra).

4.4.3. The innovation process

Companies have enlarged their product portfolio thanks to the establishment of several productive routines. Almost every company (all, but Glorious and Lavender) declared that they were imitating competitors` products. Some of them were imitating products, which were just potential competitors, but which had not yet reached their market (Master and David). Many firms had established the routine of collecting samples and images of quality products produced by other companies (City, David, Master and Right). This was giving substance to their attention to competitor's and western products.

Table 6 reports the presence of certain routines, which permitted companies to build the capability of producing a wide portfolio of quality cheap footwear products. The attention to the market was materialised in such routines as convening clients twice a year to collect their opinions on the product (City) or having a procedure, which involved marketing people refer to production staff the opinions of the clients on the product (Lavender, City and Iskra).
Some companies introduced the habit that marketing staffs regularly visit clients, writing reports about such visits (see below, when we speak about sales). All these were systematisations and transformations into routines of their desire of having a product, which changed according to the requirements of the demand. All these were bricks, which contributed to the construction of the capability of producing several products, which matched the tastes of the market. Similarly some companies tried to react more quickly to requests coming from clients, reducing their lead times (City, and Iskra) or

they simply became able of forecasting their lead times (Master and Lavender), while in previous years any forecast had been almost impossible.

4.4.4. The containment of costs

Several routines were introduced or strengthened in order to contain or reduce production costs, even in presence of improvements in the quality of products. Such routines encompassed controls on the waste of inputs (City, David, Iskra and Lavender), sales or lettings of not used assets (City, Deaf, Glorious and Iskra), efforts to redesign the production outlays (Iskra and Lavender) and reductions of the stocks in the warehouses (Iskra and Lavender). In some companies, old and new approaches were mixed together; we also observed the endeavours of introducing production plans or the establishment of fines on those who wasted resources (see City, Deaf, and Iskra). These practices were also quite common in the Soviet system, even if they find correspondents in western managerial procedures. Some managers were considering the ideas of putting suppliers and clients on line in order of better planning the production, but in Summer 2000 they were just partially implemented with reference to clients (City and Iskra) and in other cases considered as possibility for the future.

4.5. Sales

Companies had to develop the capability for finding many reliable and solvable clients, building their client portfolio. They had to face the "paralysis in the normal trade networks brought on by reforms" (Murrell, 1995:172; Dabrowski et al., 1991:422-423); different routines and some physical tools, such as vans and telephone lines make such capability. In some cases a marketing department was created, in other cases a distribution network was set up; in some cases the production of a products catalogue was enough. Many firms started to study the products of their competitors, in some cases buying them and making reverse engineering. Some firms established teams working in the street market, organised regular visits to clients and mechanisms to collect their feedback; in other cases, firms arranged seasonal receptions for clients to collect their suggestions. New communicational skills became important.

4.5.1. Sale patterns

Some cases (Glorious, City and Iskra) give us an idea of what probably was the sales and distribution behaviour of Soviet times footwear companies; in Ukraine till 1994 state distributors guaranteed sales, no advertising and no distribution effort were required. In Russia, state distribution network collapsed earlier. The considered companies had a production cycle varying between one and four months. At the end, a large (and expensive) stock of final product (one month of production in the case of Glorious) worked as buffer between production and deliveries. Usually clients were collecting the product, generally in large lots (City), at the warehouse of the producers, who could substantially ignore the final destination of their output. Producers were occasionally speaking by telephone with clients, but very rarely somebody from these footwear companies visited shops and clients. Five companies gave us an account of their sales in 1994. For them the state was still playing an important role, absorbing about fifty per cent of their sales. Large supermarkets, in the state network (23%) were their second best client, followed by shops and street markets; these companies made a considerable experience of market economy through the scarcely organized street markets. These same companies five years later had changed their clients. Their own distributor and other dealers in these companies accounted in 1999 for 55% of sales, while in 1994 they were not among the outlets of these companies.

4.5.2. Actions and routines supporting sale patterns

Understanding how the change of sale patterns occurred is maybe interesting. First of all, managers (Iskra) declared that the state and its shops were not reliable payers and they did not desire their orders, if not paid in advance. Some bad experiences had hurt.

Then it was necessary to find substitutes. Two former Soviet companies (City and Iskra) introduced a big change in the relation with their clients with the creation of a marketing

Table 7 The Distribution channels used in 1994 by five companies

	City	Glorious	Iskra	Lavender	Master
Own Distributor	0	0	0	0	0
Others dealers	0	0	0	0	0
Large super markets	0	0	0	15	100
Shops	0		75	5	0
Public Authority	100	100	25	0	0
Bazaars/ street markets	0	0	0	80	0

and distribution department. This was a punctual decisions, which, to be implemented, had to face several rigidities inside the companies. In the case of City, staffs were

Table 8 The Distribution channels used in 1999 by four survived companies

1999	City	Iskra	Lavender	Master
Own Distributor	50		50	
Others dealers		30	20	70
Large super markets	30	10	7	30
Shops		50	3	
Public Authority	20		10	
Bazaars		10	10	

moved from production to sales. They were even asked to sell the product of the firm on the street market. Lavender had similar policies of trading on the street market. *A posteriori*, they considered the street market a place good to get in touch with the final consumers and to overcome a period of chaos in the distribution networks, but not a very profitable outlet. In the case of Iskra, people were moved from bureaucratic functions to the marketing unit. In these cases, people without previous marketing experience had to start a new job and acquire new skills, showing a good degree of functional flexibility.

City introduced a delivery scheme; their van carried goods to clients. They also tried to be punctual. If they were late with their deliveries, they were committed to pay a small fine to their clients. Other firms (Iskra, Lavender and Master) simply tried to make their lead times reliable and when possible shorter than what they were in 1994 (City and Iskra).

The marketing policies of some firms were implemented in such routines as reaching the client at its place, visiting it regularly (City, Lavender and Iskra), drafting reports on these visits, inviting clients for meetings/events to discuss about the market and the product of the company (City). City also helped department stores to refurbish the rooms dedicated at the sale of its products. In Soviet times, a firm (Glorious) was very rarely visiting its clients, rare phone conversation was most of the contacts that they used to have.

Some firms tried to understand what clients wanted, bringing it to them, they also started to observe carefully prices of their competitors (City and Liner). For example, firms (City and Iskra) had agreements with some distributors and shops for being informed daily about what consumers were buying. Firms were not always keeping in touch with clients visiting them, some firms, strong of their reputation, were allowing the word of mouth spreading around their name and they were collecting information about clients when these were visiting the corporate shop (Master and David).

A firm with serious learning problems (Deaf[29]) was finding much harder its adaptation to market conditions. Some staff simply started to visit shops around the plant, trying to leave footwear to them with the “sell or return” condition; other companies considered this system risky and unprofitable[30]. Deaf also distributed part of its output through the personal contacts of its employees.

Almost every interviewed company (City, Iskra, Master and David) had favourite clients, who received a privileged treatment; similarly almost every firm had learnt to put its brand on its products. Master produced a catalogue of its products; Lavender printed a brochure and Right a corporate business card with a map showing how to reach its plant. David ordered a plate for its shop and City had tried some advertising on the radio. These were different steps, all with the common aim of leading buyers to the firms.

In the account of the interviewed managers, client's portfolios were growing because companies had progressively become more capable to deal with their market and to build their reputation (e.g. Master). Master and David did not have a distribution network and did not do advertising. They did not extend any credit to clients. Clients came to them because their product was valuable. All their attention was concentrated on producing it with high quality standards. They had a quite small warehouse of

Table 9 Client portfolios

	City	David	Deaf	Glorious	Iskra	Lavender	Master	Right
2000	700	70	25	0	900	*	100	100
1994	100	6 **	1 **	1	100	*	20	13

*They refuse to reply **data on the year 1999

finished product (one week of production) and consequently, in many cases, clients had to wait to see their orders satisfied.

Different policies, specific decisions, progressive introduction and implementation of new procedures, many mistakes and many learning processes underpinned these results.

Table 10 The marketing and distribution capability

		City	David	Deaf	Iskra	Lavender	Liner	Master	Right
Routines	Sale or return condition			X					
	Collection of information about their sales	X	X		X	X			X
	Collection of opinions about competitors products	X			X				X
	Collection of competitors` products (purchase and dissection)	X	X		X			X	X
	Collection of pictures of competitors` models	X	X					X	
	Collection of competitors` prices	X					X		
	Deliveries to clients	X				X			X
	Regular meetings with clients	X	X	X	X	X			X
	Regular talks with clients	X	X	X					X
	Drafting reports about visits to clients	X				X			
	Controls on the stocks of storage of finished products	X	X		X			X	X
	Controls on lead times of deliveries	X		X	X	X		X	
	Assistance to clients for the establishment of new shops	X							
	Definition of priority clients		X			X		X	
	Talks with competitors	X			X	X			
	Attendance to courses	X	X						
	Attendance to fairs and exhibitions		X		X				X
	Money back condition for defected products		X						
	Limited use of advertising	X	X	X		X		X	X
	Brand of the company on every product	X	X	X	X	X	X	X	X
Other Resources	Vans	X			X	X			X
	Catalogues, brochures and other advertising materials		X			X		X	X
	Shops	X	X		X				X

4.5.3. Clients portfolio

All the cases of companies, which had not gone bankrupt, showed enlargement of clients` portfolios (see Table 9). The client portfolio was probably the result of several procedures and routines, which underpin the marketing and distribution capability. Table 10 exposes this information.

4.6. Trade Credit

Trade credit is a substitute of bank credit, when bank credit is rationed (Biais and Gollier, 1997). In the transition economies where bank credit had been particularly rationed the only viable alternative for firms was trade credit, but also trade credit was not something easily available. At the beginning of transition, very few companies were getting it (Schaffer, 1998). Trade credit was a result of reputations. Trade credit is a function of trust, which can be strengthened if debtor is locked into a relation with her creditor, if the creditor has information about her debtor, e.g. visiting her workshop or having been in relation for a long period, and if creditor and debtor belong to the same network (McMillan and Woodruff, 1999)[31]. Companies, which had been able to build their reputation, obtained trade credit.

Our focus is on the capability of extending and receiving trade credit[32]. In Russia and Ukraine some companies developed the capability of giving credit to clients and became able to obtain trade credit from suppliers. This required the development of capabilities concerning keeping credit records, collecting information about solvability of clients (also visiting them), demonstrating their own solvability and establishing a reputation and trust. Probably firms established the capability of conceding credit, overcoming the informational problems encountered (bounded rationality in presence of small numbers and opportunism) with the repetition of their transaction of purchase and sale. This brought to the accumulation of experience in market relations and to a process of selection. The joint effect of the development of credit awarding capabilities and reputations, in presence of credit rationing, have probably led to the development of trade credit, one of the essential bricks of a market economy. We would expect to find that from 1994 to 2000 trade credit has grown, especially for companies that were more solid. Here we refer to those, which had usually honoured their debts. The birth of trade credit was probably one of the factors that made the transition go towards the end. Its initial absence was probably as the absence of oil in the engine of a market economy.

4.6.1. Credit from suppliers

Table 11 Days of trade credit from suppliers

Type of Supplier	City	David	Deaf	Iskra	Lavender	Liner	Master	Right
Local 1994	13.5			-3			-30	
Local 1999	13.5		0	+3			0	
CIS 1994				-3	0	0		
CIS 1999		0		+3	7.5	12		30
Foreign 1994	0				-30		-30	-30
Foreign 1999	0	0		-15	-30	-15	0[33]	-30

(Positive numbers mean "credit", negative number "advanced payments", 0 means "payments at delivery")

Companies with heavy records of barter such Iskra (70%), Lavender (80%) and City (50%), or debts (Deaf and City) were mentioning more problems than other companies in receiving credits; companies such Master and Right, which usually had avoided barter, were well known for being extremely solid with a quality product. They found much easier receiving credit from suppliers. Deaf, having just finished of paying its heavy debts with banks and having a market position extremely weak was not able of receiving any credit from its suppliers. Glorious was in bankrupt and all its financial resources were redirected to creditors. In most of cases, we observe as the companies that we visited in five years increased the amount of credit received from their suppliers. Credit grew more for companies, which had not practised barter, and usually credit was received only from national suppliers. It was extremely rare that foreign suppliers gave credit. Master was the exception. Foreigners probably had a more limited knowledge of their Ukrainian or Russian clients. All this happened when companies usually declared that they had extremely limited relations with banks; these very rarely (Lavender and Right) funded their investment projects[34].

4.6.2. Credit to clients

In Table 13 we see a summary of the credit behaviours of companies with their clients. In our cases, companies gave credit with the aim of gaining market share or generally with that of pushing a weak product. Deaf, Iskra and Lavender gave more credit than Master or David. We can notice that in all the observed cases credit is more common in 1999 than in 1994. Table 13 shows that, payment terms to clients have been often extended. This is consistent with the data shown in Table 12.

Table 12 End of year trade credit in Russia as a percentage of annualised GDP

Year	1990	1991	1992	1993	1994	1995	1996
$\frac{\text{Trade Credit}}{\text{GDP}}$	10	12	22	14	17	16	27

Source: Schaffer (1998).

We can observe a strong growth between 1990 and 1996, with 1992 being an outlying observation, easily explained by the *una tantum* shock of price liberalisation.

Table 13 Days of trade credit to clients

	Distributor	Dealers	Super Markets	Shops	Government	Street markets	Year
City					0		1994
	90		30				1999
David	/	/	/	/	/	/	1994
	0	0	0	0		0	1999
Deaf	/	/	/	/	/	/	1994
	0			90		0	1999
Glorious					-15		1994
	/	/	/	/	/	/	1999
Iskra				21	7.5	0	1994
		30	15	8.25	-15	7.5	1999
Lavender						0	1994
	90	0				0	1999
Master			-15				1994
		-15	-15				1999
Right			/				1994
			1.5				1999

(Positive numbers mean “credit”, negative numbers “advanced payments”, 0 means “payments at delivery”)

In our case studies, the major facts are the growth of credit towards large supermarkets, street markets, and dealers and of course the own distributor. Very few companies trusted the government and its orders were accepted only if paid in advance (e.g. Iskra). Relations with clients have been built with trust (Lavender). In many cases, the relation between firms and clients was new. The first times there was a high risk that people could disappear without ever paying their debt (Right was mentioning this). When suppliers were old acquaintances (as the owners of Lavender and Master) this facilitated the establishment of a credit relation. At the beginning of the transition very few people were able to show a credit record, being the latter something not needed in the past, when payments were guaranteed by the state payment system (Glorious, City and Iskra). We can also observe that some firms have developed a new capability in identifying the creditworthiness of clients, by monitoring their credits (Right, City, Deaf, and Lavender). We have seen examples of firms created in Soviet times (Glorious and City), which at the beginning of transition were not monitoring their credits. In our cases we have observed that many firms have tried to increase their contacts with clients and this facilitated their use of trade credit. Table 14 presents some of the routines, which contribute to the capability of extending credit to clients.

Table 14 The capability of extending credit to clients

		City	David	Deaf	Iskra	Lavender	Right
Routines	Monitoring Credits	X		X		X	X
	Regular meetings with clients	X	X	X	X	X	X
	Regular talks with clients	X	X	X			X
	Drafting reports about visit to clients	X				X	
	Talks with competitors	X			X	X	

4. Conclusion

This paper offers an explanation of why it took so long for former Soviet firms to replace those relations that broke down with the collapse of the planned economy and more generally for them to cope with the conditions of market economies. It suggests that firms needed not only to replace old relationships, but also to learn certain new capabilities critical to effective operation in a competitive market economy. It identifies the specific capabilities which appear to have been important in the case of this one industry in transition.

The key capabilities appear to have been the following:

- how to develop and manage new kinds of relations with suppliers;
- how to plan and programme production in response to a volatile and competitive market;
- how to find new clients and how to develop and manage new kinds of relations with them;
- how to obtain and extend trade credit.

The different firms in our study displayed a wide range of different adaptive or ‘learning’ behaviours: some being quick to acquire new competencies, others slow, and still others evidently incapable of taking measures essential to survival.
In order to speak about capabilities we refer to some studies, which have dealt with such categories, usually analysing technological change. Our hypotheses are followed by examples drawn from nine cases of post-Soviet (Russian and Ukrainian) footwear firms. We can say that the observed companies missed many capabilities, which are required by a market economy; according to what managers told us, some companies learned fast and acquired the needed capabilities, others were much slower, other went bankrupt in the process.
Companies as Master, Right and David developed strong capabilities in the fields of purchases, innovation, production and quality control. They achieved strong growth, high productivity and great reputation among clients. A company as Right was able to sustain the cost of a major investment abroad and was also growing fast. Master and David were two examples of firms with high productivity.
Companies as Iskra, City and Lavender were able to develop a balanced package of capabilities in the fields of sales, purchases, production and trade credit and this saved Iskra and City. The first was able to keep a huge market share and high productivity, while the second was able to preserve its relatively large size. Lavender was able to grow for many years, starting from scratch.

Other firms as Liner, Deaf or worse Glorious were very slow in learning new things and paid this with long periods of inactivity for many of their employees, low wages and even bankruptcy (Glorious).

These cases show how much the transactions of the firms and the rules of their game were modified and in what ways the competences that they had acquired in the past were rendered irrelevant by the new developments. We can observe how the habits of individuals should have been shocked. Many routines were to be abandoned. The co-ordinated set of resources, which firms represented had to be reoriented towards new goals.

The same coherency, which permitted firms as Iskra, City, Glorious and Deaf of being important or primary players in the conditions of Soviet economy put them a major challenge in their effort of adapting to new conditions; e.g. most of them found cutting staff difficult, some (Deaf) was even finding difficulty in switching staff between functions. They had to go through a learning process, sometimes slowed or blocked by the rigidity and the inertia (see Glorious and Deaf in particular) present to different degrees in all of them. For some, their prior experience, or 'intellectual capital' probably became a liability.

The ability of firms of processing information was severely tested by the high degree of uncertainty and by the many changes brought to their routines. Several firms (Lavender, Master, Liner, Right) have referred that this uncertainty has decreased with the passing of transition.

Finally, the analysis of these cases suggests that the categories developed in studies about technological innovation can be usefully applied to the study of firms in transition.

Notes

1 Broader interpretations of the transitional recession in these countries have been numerous. They have referred to the distortions in the structure of the economy, to the natural characteristics of the countries, to the degree of development of a market mechanism, to the occurrence of a Keynesian recession, to the presence of repressed inflation, to processes of creative destruction, to inadequate credit markets, to the absence of property rights and of solid rules of corporate governance, to soft budget constraints, and to

other more institutional explanations. Campos and Coricelli (2002), Djankov and Murrell (2002), Roland and Verdier (1999), Williamson (2000) offer many references on the different explanations.

2 The Russian footwear industry between 1990 and 1998 has lost more than 90% of its output expressed in physical terms (Goskomstat, 1999:332).

3 Working at the micro level, Blanchard and Kremer (1997) give an explanation of why firms lost their suppliers and argue that building new relations took time.

4 This information has been collected in nine case studies, which are available upon request.

5 Habits or routines adapt slowly or "mutate" as agents try purposeful attempts (Hodgson, 1998). "Habit can be defined as a largely non-deliberative and self-actuating propensity to engage in a previously adopted pattern of behaviour (Hodgson, 1998:178).

6 In this view "Organising means establishing reliable routines and associate structures and processes that fit environmental conditions and that become more efficient (...) as they are used" (Anderson and Tushman, 2001:700).

7 The authors cite: March and Simon, 1958; Nelson and Winter, 1982; Nelson, 1995.

8 When these transactions (e.g. acquisition of inputs or cession of outputs) change and their number is still small firms are open to the consequences of opportunism (Williamson, 1975).

9 Experience can become a liability (Langlois, 1995).). "What a firm can hope to do technologically in the future is narrowly constrained by what it has been capable of doing in the past" (Dosi, 1988:1130). Enterprise behaviour is a product of historical development (Murrell, 1992, 1995). This is the evolutionary idea of "a quest for understanding of the current state of a variable or a system in terms of how it got there. (...). It is presumed that there are strong inertial tendencies preserving what has survived the selection process" (Nelson, 1995:54). Firms can face innovations which are "competence destroying" (Langlois, 1995:106) for them. If the conditions change firms have to unlearn the lesson of the past (Anderson and Tushman, 2001).

10 There is "a change in the channels of economic routine or a spontaneous change in the economic data arising from within the system." (Schumpeter, 1934:82). In such case there is the need for "new combinations" (Schumpeter, 1934:66) in such fields as supplies and sales. Even if "dealing with uncertainty is the essence of the administrative process" (Anderson and Tushman, 2001:682) "organisations exhibit different structures and processes in uncertain, dynamic environments than under relatively certain, unchanging technological conditions (...). When a stable technological regime is destabilised, organisations with structure and processes that worked under more certain conditions may fail instead of successfully adapting to volatility" (Anderson and Tushman, 2001:686). "Environmental uncertainty requires incumbents to break from their pasts." (Anderson and Tushman, 2001:701).

11 "Capabilities fill the gap between intention and outcome, and they fill it in such a way that the outcome bears a definite resemblance to what was intended" (Dosi et al., 2000:2).

12 "Dynamic capabilities [can be considered] as the firm's ability to integrate, build, and reconfigure internal and external competences to address rapidly changing environments" (Teece et al., 1997:516).

13 Following section 2, this is an implicit reference to (Dosi et al., 1992).

14 "Learning is more than the acquisition of information; it is the development of new means and modes of cognition, calculation and assessment. This means that agents are building up new representations of the environment in which they operate (…). Learning is a transformative and reconstitutive process, involving the creation of new habits, propensities, and conceptual frameworks" (Hodgson, 1998:175).

15 "In acquiring and adapting their capabilities over a period of time, organisations are doing something that can reasonably be called organisational learning" (Dosi et al., 2000:16).

16 See note 13.

17 Here we modify the definition of (Dosi et al., 2000:1).

18 For example in Soviet times it was common " the use of special envoys (tolkachy), lobbying different department of Gossnab for priority treatment in the process of resource allocation, or trying to persuade production partners to deliver major inputs in time." (Kochevrin et al., 1994: 377).
19 Calvo and Coricelli (1996) and Coricelli (1998) describe dysfunctional institutions such as corruption, barter and payment arrears. They probably involved specific transitional capabilities. "The more playful and improvisational routines and processes required to attend to uncertainty during eras of ferment are fundamentally different from those more focused and efficient processes required in eras of incremental change" (Anderson and Tushman, 2001:701). The case Lavender shows an example of a firm, which had acquired a great ability in barter; this type of specialization was almost crowding out their capability of producing and selling shoes.
20 The capabilities of a market economy are largely those described by Lall (1992), Ernst et al., (1998), Radosevic (1999) and Yoruk (2001). Our emphasis is on their dependence on the economic system.
21 Firms of post-socialist countries were experiencing a change of focus from the mastery of production know-how to the non-tangible and non-technological skills usually referred to as those of ' management'. The reconstitution of enterprises and their links in post-socialism has revealed:

- a lack of marketing skills, finance, organisation;
- a lack of product system integration capabilities;
- a lack of network building capabilities at firm level" (Radosevic, 1999:296).

22 Case studies are available on demand.
23 None of the nine companies is a member of a global production network, where local firms supply some multinational corporation. As Ernst and Kim (2002) point out: "participation in global production networks is no substitute for domestic upgrading efforts. Without the latter, network integration of some "higher-tier" suppliers may well increase the divide between firms and districts that have and those that do not have access to the information and knowledge that it is necessary to reap the benefits of network participation" (Ernst and Kim, 2002:1428). Our study deals specifically with domestic upgrading efforts.
24 This company was not producing, but the firms, which it controlled, were producing.
25 Twenty of the employees are seasonal workers, hired and paid just in moments of peak production.
26 Networks of firms can be underpinned by political networks. (McDermott, 2000).
27According to Djankov and Murrell (2002) "increased competitive pressures are not associated with enhanced restructuring" ; " import competition in the CIS countries does not have a significant effect on enterprise restructuring and has negative sign" and "In the CIS, the rapid opening to competition from abroad acted to deter domestic restructuring" (Djankov and Murrell, 2002: 766).
[28] The manager of the firm David told that this was actually happening, giving us the name of the concerned firm.
29 Deaf was a former Soviet company owned by the Russian Association of Deaf People.
30 This is the case of Right, which had a quality product and a strong demand. They refused to sell anything with the sell or return condition.
31 Maybe Blanchard and Kremer (1997) also indirectly referred to these things when mentioning the importance of long term relations and the risks of opportunism. In any case, they do not seem to mention explicitly trade credit and we propose to consider it.
Trade credit is also a function of the trust that creditors have in courts' ability in enforcing contracts (Johnson et al., 2002).
32 McMillan and Woodruf (1999) offer a literature review on the reasons, which lead firms to trade credit.
33 This is an average between 50% of advanced payments and 50% of credits.
34 Some firms as Deaf had experience of relations with banks and were not ready to repeat it again.

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