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"The Issues of Enterprise Growth in Transition and Post-Transition Period: The Case of Polish Elektrim"

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THE ISSUES OF ENTERPRISE GROWTH IN TRANSITION AND POST-TRANSITION PERIOD: THE CASE OF POLISH 'ELEKTRIM'[1]

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'Elektrim's final product is shares'

Elektrim's ex-CFO Piotr Mroczkowski,
Global Finance, February 1997, p.23

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1. Introduction

Elektrim is one of the biggest private companies in Poland in terms of market capitalisation and the second largest publicly traded company after TPSA, the national telecom company. Before 1989, Elektrim operated as one of the large Polish foreign trade organisations which, during the course of transition, became a conglomerate. Elektrim S.A. manufactures cables, power, provides telecom services, mobile and fixed, and is in process of divesting a host of unrelated businesses.

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

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

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

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

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

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

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

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

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

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

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

Once companies like Elektrim become focused they face the challenge of independent growth given their huge financial and technology gaps. The question arises as to whether they can go grow as independent entities or whether they have no other option but to grow through alliances. Their alliances are with unequal partners which makes these alliances inherently unstable. With the liberalised domestic environment and financial gaps there are limited ‘compensatory mechanisms’ available to companies to use in overcoming their limited resources. Large opportunities in the domestic market cannot be exploited easily without close cooperation with foreign partners which then brings imminent dangers of foreign takeovers.

These preceding paragraphs form the background of how Elektrim grew up to become the largest private company in Poland and identify the main issues involved in its growth. In the next section we analyse Elektrim’s history and current restructuring activities.

3. Elektrim: history and profile

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

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

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

However, this strategy was not followed for long. Instead of building diversified business group in 1999 the company entered a new (third) stage, which can be described as consolidation, and focusing. According to Piotr Czarnowski of Elektrim, this shift was driven by a variety of factors among which the most important are: the lack of transparency of the conglomerate, inefficiencies in the allocation of capital among different businesses, lack of expertise in many newly acquired business segments, changes triggered by disclosure problems and by investors demanding streamlining and focusing. Its new Chief Executive Officer, Barbara Lundberg, set the focus for Elektrim on three core business: telecommunications, power generating equipment and cables, with strong expansion in telecommunications as a starting point[2]. This included take-overs of local operators and acquisitions of shares in telecom companies. This new strategy suggests that the days of frenzied acquisitions are now over and that Elektrim, like other ex-FTOs, faces consolidation. As part of this shift, out of more than 100 subsidiaries, only in 1999 Elektrim divested 70 of its non-core subsidiaries. Finally, Mrs Lundberg pledged to focus Elektrim on its core line of business, to improve productivity and to dispose of underperforming assets.

Elektrim is concentrating on construction of the telecommunication group, as a competitor to TP SA, the national telecom company, and as an operator delivering a full range of telecommunication services. Elektrim also intends to continue its operation related to the

[2] Elektrim SA has a staff of 160, after trading activity was devolved to subsidaries compensated under one of Poland’s first performance based play schemes. The image the company attempts to foster is one of very capable management. The arrival of a foreign national as CEO has reinforced this image but also changed Elektrim’s strategy.

performance of complete energy objects and their refurbishment. In the very near future it aims to raise the effectiveness of cable companies by way of further restructuring but ‘without too much investment’ [Elektrim, 2000 #7]. Other assets unrelated to the core line of business were transferred to Warsaw Equity Holdings Sp (ibid.). By 2000 Elektrim’s assets were in telecoms, energy and cables with only 3.7% of assets in other businesses (table 2).

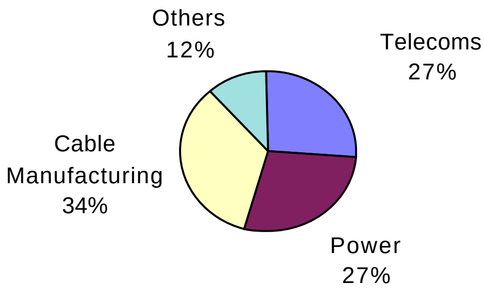
Table 2: Elektrim’s assets

Business	Electric's stake in it	Value of stake (Zlm)
Elektrim (holding company)		420
Telecoms		
Elektrim Telekomunikacja	51%	4,805
Fixed line telephony	87%	1,340
Power		
PAK	38.5%	935
Elektrim Megadex	97.3%	67
Rafako	49.9%	52
Mostostal Warsawa	28.4%	36
Energomontaz Polnoc	37%	31
Cable		
Elektrim Kable	70.5%	788
Others		325
Total		8,798
Total parent debt	2,892	

Source: Erste Bank, Central European, July/August 2000, p.26

In terms of sales, three major segments have similar shares with other business amounting to 12% (figure 1).

Figure 1: Consolidated Net Sales Revenues by Business Segments



Source: ET Annual Report , 2000

So far, the growth of Elektrim has been accompanied by strong growth in its market capitalization. Elektrim was the first company listed on Warsaw Stock Exchange in 1992, with a share price of 0.35 Polish zloty. In 1996, it was valued at around $620m [Times, 1996 #13]. By January 1997 the share price had risen to 31 zloty, bringing Elektrim's market capitalisation to $700m, and making it the largest non-bank market-capital stock on the Warsaw exchange. In 1999, its market value rose to $912.81million. Elektrim shareholders are mainly institutional investors (85%). (See table 3).

Table 3: Elektrim's largest investors

Institution	Country	$m value held	% of Equity
Bank Austria	Austria	79	6.1
Capital International	USA	67	6.9
Emerging markets Growth Fund	Malaysia	66	6.8
Merrill Lynch Mercury Asset Mgmt	United Kingdom	49	5.1
Schroder Investment Mgm (Hong Kong)	China	48	4.9
Barring Asset Management	United Kingdom	35	3.6
Fleming Investment Management	United Kingdom	31	3.2
Schroder Investment Management	United Kingdom	27	2.8
Capital Research & Management	USA	26	2.7
Dresdner Bank Investment Management	Germany	21	2.1
Other large investors		111	12.3

Source: Carson Group, Central European, July/August 2000, p. 25.

In central European terms, Elektrim is very large in terms of the value of total assets (EUR2.874bn) as well as sales (EUR0.96bn). However, in terms of internationalisation it is a company which is predominantly oriented towards the domestic market (see table 4). As an outward investor it has only 62 employees abroad, mainly in 9 sales/distribution centres (Austria, Germany, UK, Egypt, France, India, USA, Sweden, Turkey). Its transnationality index is very low (2.2%).

Table 3: **Elektrim: shares of assets abroad, sales and employment abroad**

	Proportion of total to abroad			Transnationality index (%)
	Assets	Sales	Employment	
1997	1.8%	4.6%	0.2%	2.2
1998	1.7%	4.8%	0.2%	2.2

* The index of transnationality is calculated as the average of three ratios: foreign assets to total assets, foreign sales to total sales, and foreign employment to total employment.
Source: Calculated based on [UNCTAD, 1999 #10]

4. Elektrim's main areas and strategy

Elektrim SA has five major groups subsidiaries: telecommunications, power, cable manufacturing, internet and others (table 4).

Table 4: Elektrim SA major subsidaries

ELEKTRIM SA

Telecommunications
ET Telekomunikcja Sp.
(51%, Vivendi 49%)
- Bresnan International Partners
(Poland) L.P. (100% ET)
- Polska Telefonia Cyfrowa Sp zoo
Era GSM (51% ET)
RST El-Net SA (92%)
Polish Phonesat Sp (93.39%)
Telefonia Regionalna Sp (99.39%)
Elektrim Tv-Tel Sp (100%)

Internet
VPN - Service Sp (former NASK Service Sp) (85%)
Inter Net Polska Sp (85%)
CT Creative Team Sp (60%)
Easy Net SA (50%)
AGS New Media Sp (505)

Cable Manufacturing
Elektrim - Kable SA (70.49%)

Power
Elektrim - Megadex SA (98.41%)
Rafako SA (49.9%)
ZE PAK SA (38.46%)
Elektrim - Volt SA (100%)
Gielda Energii SA (10%)

Others
Warsaw Equity Holding Sp
Mostostal Warszawa SA
Makler Market Sp
Enelka Ltd
Trasza Swietokyzyska Sp

Source: Elektrim Annual Report, 2000

4.1. Cable Manufacturing

Elektrim Kable SA is one of Elektrim's main subsidiaries. This company was established in March 1999 through a merger of Elektrim's cable companies, of which the three most important are: Bydgoska Fabryka Kabli S.A., Fabryka Kabli Ozarow S.A., and Fabryka Kabli Zalom S.A. This consolidation of three major Polish cable factories has enabled centralization of sales and procurement, rationalisation, specialization, reduction of employment and coordination of R&D. It is expected that the demand in Poland from telecommunications sector for copper and optical fibre cables will continue to grow. Elektrim Kable SA produces the highest quality cable in Central Europe and is the only manufacturer of high voltage power cable in Poland. Its management considers it to be in the upper half of the world's best cable firms. Cable and wire production from Elektrim Kable Polskie exceeds 50% of the domestic market share, and 30% of its products are exported to Western markets [Elektrim, 2000 #7].

Elektrim Kable currently has 2000 employees with sales of $300m.[3] The company has not paid any dividends during the 1996-99 period [www.profiles.wisi.com, #12]. The firm's good prospects have been reflected in its market performance.

The ownership of Elektrim Kable Polska SA by Elektrim as a telecom service company probably gives it an advantage over its competitors in the telecom market. It can purchase telecom cables from its own company as well as improve its own bargaining position towards other telecom companies. For example, Elektrim Kable signed an agreement with Telekomunikacja Polska SA (TPSA) for the supply of the local telecommunication cables to the value of PLN 19.5mn. However, Elektrim is also dependent on KGHM, a supplier of copper rods and a new entrant into telecoms, and thus a competitor to Elektrim[4].

4.2. Power

Since its formation Elektrim has been active in the field of power engineering in Poland and abroad. The first power plants under Elektrim contracts were built in China and India, followed by Turkey and other European countries (Yugoslavia, Czech R, Finland, Bulgaria and Hungary).

Elektrim Megadex

Elektrim Energetyka and Megadex were merged into Elektrim Megadex. The Elektrim energy group includes over 50 companies, among them large companies such as Rafako, Megadex, Energomontaz Pol, Remak, Elwo, Elektrim Energoblok Gdyna. As a result of the merger 200 people were made redundant and a much more decentralised management was introduced. The budget was split between three business centres: power energy, natural environment protection and industry. Elektrim Megadex is involved in the complex execution of investments in the energy and environment, a feasibility study of investments, design of objects,

[3] Personal communication with Piotr Czarnowski.

[4] The two companies signed a long term agreement and contract for the year 2000 worth $120m. Elektrim claims that the contract is profitable and important since raw material expenses amount to 65% of Elektrim's material costs [Bulletin, 1999 #14]. The contract defines a minimum annual purchase and guarantees increased supplies in case of higher demand

developer services, organisation of tenders, arrangement of financial structures and individual delivery of plant and installation works, as well as complete turnkey delivery of energy and ecology objects [Elektrim, 2000 #7]. Elektrim – Megadex co-operates with Fabryka Kotlow Rafako SA, a 49% subsidiary of Elektrim which designs, produces, exports, builds and services boiler facilities.

In March 1999, the Elektrim consortium, which consists of three Elektrim controlled construction companies: Megadex, Mostostal Warsaw and Energomontaz Polnoc, bought a 20% stake for $87.9m in the lignite fired 2700MW power generating company Patnow Adamow Konin (PAK). This was the first major privatization in the power plant sector in Poland. The consortium raised PAK's equity by $100m increasing its stake to 38.46%[5]. The take-over was part of a bid by a consortium, which includes also the US CalEnergy. The investor pledged to maintain the present employment level for the time of reconstruction and modernisation of the firm. PAK provides 11% of Poland's electricity and is the second largest Polish power generating company. Analysts estimate that PAK would require up to $1bn in investment over the next decade. Also, estimates are that PAK was purchased for $440m while its market value is much higher. In 1997, PAK's sales reached $320m and after tax profits of $9m. Over 10 years (1999-2008), the consortium will invest $1bn in the reconstruction and modernisation of PAK's old power blocks and in reducing environmental pollution. This is a significant amount but still only half of what would be required for full restructuring. Initially, National Power (UK) was poised to take over PAK. However, National Power (UK) required a five-year contract with Polish Power Grid for the immediate electricity delivery at guaranteed electricity prices. Elektrim did not make this a condition for partial take-over and because the Polish energy market had started to liberalise the government rejected the National Power offer.

[5] Elektrim purchased the shares of PAK at $150 per kilowat, compared to the price in Western Europe of between $600 and $1,000 per kilowat (ET, Annual Report, 2000)

Elektrim Volt

Elektrim Volt exports and imports high and low voltage equipment, transformer stations, transmission lines, electric energy, lightning equipment and other goods. Its largest contract, signed in 1993, is for the annual delivery of 1200 gigawat – hours until 2010 to Austria, valued at $450 mn (ET, 2000). It also offers its services in construction and installation of electric plants, power transmission and distribution, etc. Elektrim Volt is the co-ordinator of a project to construct environmentally friendly buses in Poland [Elektrim, 2000 #7]. In March 1999, its share capital rose from 3m zlotys ($0.8m) to 7.3m zlotys ($1.8m).

4.3. Elektrim Telekomunikacja

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

Polska Telefonia Cyfrowa Sp. z o.o. (Era GSM)
Regionalne Sieci Telekomunikacyjne El-Net S.A.
Telefonia Regionalna Sp. z o.o.
Bresnan International Partners
Elektrim Tv-Tel Sp. z o.o.
Zaklad Telekomunikacyjny Sw. Olaf
Polish Phonesat Sp. z o.o.[6]

Elektrim Telekomunikacja was set up on 12 May 1999. Initially its capital was 100% owned by Elektrim. The move was part of the company's strategy to concentrate on developing

[6] Phonesat is 100% Elektrim's subsidiary. It offers data data transmission (nationwide and international) including point to point satellite transmission. Phonesat obtained from the Telecommunication Ministry a licence for rendering telecom services and permission to set up and use a telecommunications network for a period of 15 years [Elektrim, 2000 #7].

the telecom sector and on restructuring and consolidating the Elektrim group[7]. Elektrim plans to expand its telecom business to become the second largest in Poland after TP SA, the state controlled operator. In line with this goal, the newly founded Elektrim Telekomunikacja company aims to become the telecommunication operator alternative to TP SA offering the highest technical level and the broadest scope of services. This decisive shift towards telecommunications is mainly due to Elektrim's chief executive, Barbara Lundberg, who took over Elektrim in February 1998 after the shareholders voted to get rid of her predecessor[8]. She immediately embarked on a high-profile billion-dollar acquisition spree designed to focus Elektrim first and foremost on telecoms. Within a few months, Elektrim had bought Bresnan, a local cable TV company, a regional phone operator, and had been awarded a licence to operate fixed-line services in Warsaw. However, the key acquisition was a packet of small stakes in Polska Telefonia Cyfrowa (PTC), Poland's top mobile company, which gave Elektrim a 51% stake - and brought it into negotiation with the minority shareholder, Deutsche Telekom (DT). The Germans, blocked by Polish telecommunications law from owning a majority stake, were in the process of increasing their share of PTC to 45%. They pushed for control of Elektrim's telecoms subsidiary once the law changed. Elektrim resisted and the negotiations fell through[9]. However, within a month, Ms Lundberg announced it had found a new partner, the French telecoms-to-utilities group Vivendi, which agreed to take a third of Elektrim Telekomunikacja, if the subsidiary managed to gain control of PTC. On 17 June 1999 the joint venture Elektrim Telekomunikacja was set up with the French conglomerate Vivendi.

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

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

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

Vivendi is renamed Societe Generals des Eaux, a French company and the world’s largest water company, which employs 193,000 people, with assets of $43.1bn and revenues of $28.6bn, [UNCTAD, 1999 #10]. In the last 20 years Vivendi has diversified into telecommunications, media and several other activities. Its activities include water distribution (Cie Generale des Eaux), thermal energy supply (Blanzy Ouest), building and heavy public construction projects (SGE), waste management (CGEA Onyx), transport (CGEA Transport), electrical energy services (Cie Generale de Travaux et d'Installations Electriques), real estate (Compagnie Generale d'Immobilier et de Services), telecommunications (Cegetel) and publishing and multimedia (HAVAS) activities. Vivendi is a major shareholder in Cegetel, the number two telecom company in France behind the incumbent France Telecom, offering fixed and mobile telephony, as well as internet access. Vivendi streamlined its organisation during 1997, disposing of 334 companies in the health, cable television, laundry, restaurant and car parking sectors (Table 5). The group consisted of 3371 companies in December 1998, of which 1394 were located abroad. Its major business is presented in table below.

Table 5: **Vivendi major businesses, 1998**

- share in revenues -

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

Source: Vivendi, 1999

Vivendi partly owns French Canal+, it has 16 Internet services, including joint ownership of the French no 1 – AOL France, has 40% of the French mobile telephone market (4mn subscribers), and has since the lifting of the state monopoly of France Telecom in January 1998 established over 600,000 connections of fixed line telephony. In some respects its experience of challenging France Telecom corresponds to Elektrim's strategy to challenge TPSA. Both companies are conglomerates and the second most important players in their domestic markets in fights against incumbent national operators, and both have experience in dealing with national administration, which is important in licensing in telecom. In addition, France Telecom has acquired a large stake in TPSA, the Polish national operator, which means that the oligopolistic competition from the French market has been transferred into Poland.

Initially, Vivendi took over a 30% share in Elektrim Telekomununikacja. Agreement was reached for the sale of over 45 mn shares in Elektrim Telekomunikacja for over $1.2 bn. Under the investment agreement Elektrim Telekomunikacja Sp. z o.o. must involve shares of the cellular telephone operator, Polska Telefonia Cyfrowa Sp. z o.o. (operating under the business name of ERA GSM), cable television and the telephone operator Bresnan Communications Poland, as well as shares of other telecommunication operators in the future. In this way it will be possible to integrate ERA GSM cellular telephone services with stationary telephone services and related services, such as Internet, data transmission and cable television.

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

As a result, DT stopped the Vivendi investment, blocked debt financing and threatened to force Elektrim into default on its massive short-term debt payments [Europe, 2000 #15]. For a time, it looked as if the Germans would take over. In order to secure the deal Elektrim had to sell a larger stake. Fortunately for Elektrim, Vivendi stepped in by investing $1.2bn, including $250m in cash, to clean up Elektrim’s balance sheet. In exchange, the French got a 49% stake in Elektrim Telekomunikacja and, indirectly, ownership of 25% of PTC.

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

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

However, the battle for control over PTC is far from over. DT has increased its 22.5% stake in PTC to 45% by acquiring MediOne International, a subsidiary of the US Media One

Group [Dawson, 2000 January #28]. DT paid between $1bn and $1.2bn for the stake in PTC. DT now controls 45% of PTC, but is fighting via the courts for another 3% against its co-shareholder Elektrim [FT.com, 1999 #17][11.] Regarding Elektrim's position in this battle it is important to bear in mind that Vivendi agreed to join in the legal fight against DT. At that moment the situation seemed at least temporarily settled.

However, serious difficulties of ownership and control of Elektrim and its telecommunications subsidiaries/operations have arisen in recent months. A collapse of the partnership between Elektrim and France's Vivendi has been made public in February of 2001 with steps taken by Vivendi to 1) bring suit in an international arbitrage court in London against Elektrim for breach of the investment agreement from December 1999 and 2) to ask a Polish regional court to prevent sale of Elektrim's assets which would prevent Vivendi from "undertaking its rights as a majority shareholder" in the joint telecoms holding (Reuters, 2/23/01, "Vivendi sues Elektrim over broken deal").

These steps by Vivendi resulted from the move taken by Elektrim's management in December of 2000 to sign a letter of intent to sell 51% [and thus strategic and operational control] of its fixed-line and data transmission companies to Deutsche Telekom for $180 million.[12] Vivendi claims in its case against Elektrim in the London Court of International Arbitration that relations/negotiations with Elektrim have reached an impasse (deadlock) and in accordance has made a set of far-reaching demands concerning Elektrim's telecommunications operations, including 1) that Elektrim transfer its shares in VPN Service and Inter-Net Polska to the Elektrim Telekomunikacja joint venture company, 2) that Elektrim discontinue negotiations or any contracting with Deutsche Telekom concerning fixed telephony (see below), 3) that

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

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

[12] These companies are RST El-Net SA, Telefonia Regionalna Ltd., Elektrim Tv-Tel Ltd, Internet Polska Ltd., VPN Service Ltd and Polish Phonesat Ltd.

Vivendi be enabled to sell its shares in Elektrim Telekomunikacja to Elektrim for a market price (Swiderek, 2/26/01, "Czy Francuzom chodzi o pieniadze," Rzeczpospolita).[13] [14]

Elektrim has publicly denied the validity of Vivendi's claims, asserting first and foremost that Vivendi never availed itself of the procedure for resolving a conflict/impasse between the sides, which would involve consultations between the Directors General of the two companies. Moreover, it claims that 1) Elektrim is not obligated to conduct its Internet operations under the Elektrim Telekomunikacja umbrella; 2) that Vivendi conducted "in bad faith lengthy negotiations concerning the acquisition of a stake in Elektrim S.A.'s fixed-line businesses for more than 12 months although it was obliged to present a serious proposal in this respect on or before February 14, 2000"[15]; 3) that it would be in the interest of the involved sides to attempt to resolve the impasse using the provisions in the Investment Agreement before initiating the share sellback process (Elektrim press release, "Stanowisko Elektrim SA w sprawie Umowy Inwestycyjnej z Vivendi," 2/25/01).

Elektrim has threatened to pursue a counter-case in international courts against Vivendi if the present charges are maintained (Borowski, Reuters, 2/26/01, "Elektrim threatens counter-suit against Vivendi").[16] The most recent actions taken have been the attempt by Vivendi's representative on the supervisory council to move for the dismissal of the Elektrim CEO, Barbara Lundberg, and her Deputy (March 21) (Gazeta Wyborcza, 3/21/01, "Vivendi chce odwolania prezesa Elektrimu"). This has been followed on March 22 with the Elektrim's agreement to place its management board under the control of its supervisory board, in

[13] As defined in the Investment Contract, this would involve each partner selecting an investment bank who would undertake a valuation of the shares involved, which would then be the purchase price for Elektrim.
[14] Vivendi's appeal in the Polish regional court was made primarily to keep Elektrim from taking any actions on the sale of shares to Deutsche Telekom before the process in the London Court could be completed. The Polish court has denied Vivendi's appeal.
[15] Moreover, Elektrim has gone further and claimed the following with regard to the fixed telephony operations: "Vivendi has recently attempted in unauthorized fashion to block the important cooperation agreements between Aster City Cable and El-Net, which constitutes an unjustified attempt at limiting the ability of Elektrim to conduct business in the area of fixed telephony. The Investment Agreement clearly foresees the possibility of cooperation and market-based contracting between companies from the Elektrim Telekomunikacja group and with other companies affiliated with Elektrim, including Aster City and El-Net" (Elektrim press release, "Stanowisko Elektrima SA w sprawie Umowy Inwestycyjnej z Vivendi," 2/25/01).
[16] It is worth noting that the letter of intent with Deutsche Telekom in January of 2001 has also produced a suspension of the legal case that the latter had brought against Vivendi in early 2000 concerning the

consequence of which 1) the move to dismiss Lundberg and her deputy has been withdrawn and 2) Vivendi has suspended its London arbitration case against Elektrim (Reuters, 3/22/01, "Vivendi suspends arbitration against Elektrim").

PTC – Era GSM

Era GSM, another Elektrim subsidiary, is Poland's top digital mobile telephony network. In terms of subscribers and users ERA GSM is the biggest GSM operator in Eastern Europe with 2.8 mn customers.

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

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

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disposition of shares in PTC (see earlier section on PTC in R/Y paper) (Borowski, Reuters, 1/12/01, Deutsche Telekom suspends arbitration against Elektrim").

Elektrim has also acquired 100% of the share capital of ‘Carcom Warszawa’ which holds 1.9% of the share capital of PTC. Separately, Elektrim’s minority affiliate, Elektrim Autoinvest holds 1.1% of PTC which gives Elektrim a total of a 51% share in PTC.

In the mobile/cellular market, there have been a number of important new developments. The first of these was the granting in December of 2000 to PTC GSM Era (Elektrim’s cellular subsidiary) of one of the three third generation concessions announced under the Ministry’s tender in mid-2000, for which it was to pay a fee of $650 mln by the end of 2002 (check).[17] To finance its cellular operations and its fee payments, PTC received a $650 mln loan from a consortium organized by Deutsche Bank in early 2001 payable over a five-year period (Teleinfo, Nr. 9/2001, 2/26/01, “PTC bez Vivendi”).

Operationally, PTC has established itself as the largest cellular operator in Poland and, for that matter, in East-Central Europe. At the end of 2000, it reported customers totaling in excess of 2.8 million (and surpassed 3 mln in March of 2001), compared with PTK Polkomtel at 2.4 mln and Centertel at 1.6 mln.[18] PTC constitutes the central asset in Elektrim’s portfolio, as Poland’s cellular market continues through 2000 to be perhaps the most dynamic market in Europe and one of the most dynamic in the world. With 6.8 mln total customers as of year-end 2000, the Polish cellular market increased in size by 75% over the course of the year. Present expectations are for the market to continue to grow dynamically over the next several years, with industry analysts predicting that the
number of cellular customers will surpass the number of fixed line customers (presently at 10.5 mln) by the end of 2003 (McClune, 6/19/000, ibid; Swiderek, Rzeczpospolita, 3/22/01,

[17] The Ministry initially wanted to grant five concessions each totaling $850 million in fees. These plans were objected to by the three existing GSM incumbents, who claimed that the fee was too high. The Ministry had also hoped to attract additional international players/investors into Poland’s cellular/UTMS market as part of this concessioning effort, but foreign investors rejected participation, first, because they considered the fees asked for as too high, and second, because they objected to some of the rules the Ministry had specified for the operation of the UTMS market (such as interconnection policy). In the end, the Ministry lowered the required fee to $650 mln and the three cellular incumbents in Poland, PTC, Polkomtel, and Centertel were the only operators to receive UTMS concessions in December.

[18] Centertel has shown strong growth in the last year, after the granting of the GSM license in August of 1999, seeing its share in the cellular market grow to 25%.

"Dobre wyniki Ery"; Rozynski, Gazeta Wyborcza, 3/21/01, "PTC ma zyski"; Borowski, Reuters, 1/8/01, "Polish mobile market in 73% explosion last year").[19]

PTC's financial performance also showed marked improvement in 2000 in comparison with previous years. The long period of intensive investment begun in 1997 when the company was first granted a GSM license by the Ministry has begun to finally pay dividends as PTC for the year 2000 for the first time generated a net profit, totaling 97.7 mln PZL.[20] on industry-leading revenues of 3632 mln PZL and EBITDA of 1136 mln PZL. Presently, PTC is attempting to move aggressively into the market of business customers, and thus is challenging Polkomtel's existing stronghold in this market segment, through the development of a consolidated package of services called 'Era Biznes'.

Fixed telephony activities

As part of its strategy to become the primary competitor to TP SA, Elektrim has been acquiring and consolidating telecom operators. Elektrim controls three regional fixed line telecom service providers: TV Tel - Plock[21], Telefonia Regionalna - Katowice, and El-Net, the third largest private operator, which hold licences to provide telecom services in six voivodships[22]. Elektrim also acquired Bresnan International Poland, the second largest cable TV operator in the country with total networks serving approximately 360,000 customers and passing nearly 700,00 homes nationwide. Bresnan also holds licences in 2 voivoidships. Take-over of Bresnan by Elektrim is Poland's largest take-over by a domestic company outside the financial services sector. The use of the infrastructure of the cable operator Bresnan International, which Elektrim acquired for $325 million in 1999, will allow the firm to cut the cost of connecting each user to $700 from over $1000 (Data Base Reuters Business Briefing).

[19] Though note also that there is an expected slowing of growth in 2001 as compared with 2000.
[20] Compared with a 200 mln PZL profit of Polkomtel for the year and a 659 mln PZL loss for Centertel. Polkomtel also generated a profit for 1999 of more than 100 mln PZL, in opposition to PTC which had a loss of 132 mln PZL in 1999 (Swiderek, 3/22/01, ibid).
[21] Elektrim will have to pay $112m over 5 years for this offer.

Bresnan International's biggest operation, the cable TV system Aster Citycable, serves 290,000 subscribers in Warsaw. AsterCity is currently offering an internet connection to its clients. Elektrim also hopes to use Bresnan's Warsaw cable TV network for telephony.

Elektrim controls the fixed line telecom operator El-Net, which owns a key licence for the service in the Warsaw region and six other regional licences. El-Net commenced its activity in September 1996 in Bydgoscz, where it has invested almost $41m. It also received licences from the Telecommunication Ministry for building a fixed line telephone network on the territory of 6 former voivodships. In June 1999, it received a licence for Warsaw for which it will pay $245m over the next five years. Elektrim expects business clients to make up 15-20 percent of all of its local clients and generate about 50 percent of all the revenue in Warsaw. The Warsaw licence gives it potential and non-exclusive access to 0.75m households. El Net is pivotal to Elektrim's strategy of offering a basket of telecommunications services including mobile, fixed line, cable TV and internet services for residential and business customers in Warsaw and other major cities in Poland.

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

In December of 1998, El-Net, Elektrim's fixed telephony subsidiary, already possessing a concession for the Bydgoszcz region, was selected by the Telecommunications Ministry as the alternative private operator in Warsaw to the national operator TP SA under the policy of local duopoly in operation at the time. This decision generated an outcry from El-Net's competitors in the concessioning competition,[23] who claimed that El-Net's application had misrepresented the

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[22] This strategy is a response to the Ministry's intention to have one private service provider in each of the 49 voivodships, which would compete with the state-owned Telekomunikacja Polska. In 1999, Poland changed its administrative system which is now based on 16 voivodships.

[23] Private operators were asked to submit a business plan and a price that they would pay for the concession.

financial status of the company and took the matter to court.[24] Elektrim, for its part, challenged this reasoning.

In the meantime new complications emerged when Ministerial concessioning policy changed and as a result, a new tender for a Warsaw concession was announced in mid-1999. Netia won this new concession and Elektrim, in turn, appealed the decision, claiming that it violated the local duopoly policy as written in the Telecommunications Law of 1990 (amended in 1995).

These legal cases lasted more than a year and a half. In the end, neither case was resolved conclusively. Instead, in the spring of 2000, the Ministry initiated a conciliation process between the two operators and, eventually, from out of the interactions a proposal emerged in the late spring/early summer in which Elektrim would receive a reduction in the fee it was to pay for the Warsaw concession in return for dropping the case against the Ministry's Netia concessioning decision. This proposal was consummated in July 2000 when Elektrim's concessioning fee was reduced from $290 mln to $145 mln and Netia's Warsaw concession was definitively authorized; this sum is due for full payment in November of 2001 (McClune, Communications Week International, 6/19/00, "Poland nears deal in local license dispute"; Reuters, 8/18/00, "Poland halves Elektrim's Warsaw permit fee").

With the resolution of these cases, the door has been opened to full-fledged competition in the lucrative Warsaw market between TP SA, El-Net and Netia. In the meantime, however, El-Net (as well as Netia) lost more than a year in the start-up of its Warsaw operations due to delays caused by the legal proceedings.[25] El-Net began serious investment activity in the spring of 2000 in Warsaw and in September of 2000 announced the introduction of its 'el' brand on the Warsaw market, constituting what it claims is the only integrated package of

[24] This stemmed from the deal with Kulczyk enterprises (see footnote 5), which was not reported in El-Net's Warsaw concession proposal. Also, there were additional issues underlying this formal complaint which were of importance to the market and the regulatory environment more generally, including the fact that El-Net to the point in time had been a very minor player in the local telephony arena, allegations of bribery, and the fact that Elektrim offered twice as much for the concession than any other operator, which was taken as an indication that the Ministry was only looking to pad its coffers rather than acting to improve the state of the telecommunications infrastructure more generally.

[25] Which is crucial in terms of revenues and first-mover advantage, because as of 2003, these concessions will no longer have much meaning due to planned liberalization of telecoms.

telecommunications services in Poland, combining cable TV access and video capabilities, Internet access, and local telephony offerings. This package is targeted primarily at business customers, numbering by March of 2001 more than 3,000. Elektrim's efforts in the individual consumer/household market in Warsaw have proven less successful (see website).

Elektrim Internet strategy

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

Elektrim announced its intention to buy a portal by the end of 2000. The strategy is to offer as broad as possible a package of services[26]. The company will probably cooperate with another internet service provider, since collaboration would cut costs and save time. Elektrim intends to invest PLN 2 bn ($490 million) in its forthcoming internet activities[27].

As part of its Internet strategy, Elektrim is to acquire Easy Net and AGS New Media, two Polish e-commerce companies. The total value of the share purchase in these two companies is estimated at $52.5mn. Elektrim will purchase 50% of the shares and invest $12.5m in Easy Net, which operates as a business to consumer e-commerce retailer under the

[26] Elektrim's CEO Lundberg highlights this by saying: "The issue for ourselves is strategically how we want to go about this business. The approach should be broad."

brand name empik.com. Easy Net is considered to be the most successful e-tailer in Poland. Elektrim also intends to acquire 50% of the shares of AGS, one of the leading Polish software houses focused on Internet solutions, with an option to increase its holding to 80%. AGS is the leading e-commerce, e-publishing and intranet services provider. The company has existed since 1992 and has a customer portfolio of over 60 leading institutions. AGS is running a team of 44 specialists including project managers, systems analysts, software designers, web and graphic designers, JAVA, XNML and OO programmers and database as well as operating systems experts.

Combining the abilities of both companies creates a powerful mix of content, product assortment and transactional capabilities. The costs of building such capabilities independently would be very high. Elektrim also intends to develop as a content provider. It will build on the teams of over 150 experts coming from newly acquired companies InterPolska, NASK service, CT Creative Team as well as AGS New Media and Easy Net. These new members of the Elektrim group bring with them Internet expertise in network development and implementation of content and e-commerce. Elektrim estimates that the current Internet market in Poland represents revenues of some $5.8bn per annum, mainly deriving from hardware sales and network services. Elektrim will offer to:

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

Elektrim in the last two years has begun to actively move into the Internet-based e-commerce and application service provision markets. Elektrim considers this a crucial area of its

[27] Elektrim spokesman clarified that "Elektrim will be active in the Internet and it will be a serious project, but the amount reported is speculation" [Briefing, 2000 #21].

expansion, as it expects the value of this market to grow three times in the next 10 years.[28] In addition to the earlier acquisitions, Elektrim in December 2000 formed a specialized Internet company, Elektrim Online, in which Internet-based initiatives are to be concentrated. Elektrim Online's strategic purpose is "the servicing of all important client groups – households, SMEs, and large enterprises" and its operations will also include the development of a web portal and the offering of financial services. Elektrim also created, in cooperation with the Polish Internet Investment Fund, a joint venture called eCenter SA, which "will be the first computer center for the service of electronic trade and Internet hosting" (all information and quotes from Elektrim webpage, www.elektrim.pl/firma_inet.htm). More generally, Elektrim's aim is to create a package of Internet-based capabilities providing both horizontal, general and vertical, specialized services for a large, varied base of users.

A second important development in the area of Internet activities is Elektrim's signing of a cooperation agreement with TP SA to provide joint access to infrastructure and to develop joint service offerings. This agreement, which came about at the end of 2000, appears to only be developing now and its eventual shape is unclear (Elektrim press release, 11/24/00, "Grupa Elektrim i Telekomunikacja Polska S.A. wspolnie daza do rozwoju spoleczenstwa informacyjnego"; Pietkiewicz, Bloomberg News, 11/27/00, "TPSA, Elektrim join forces to offer internet access").

Also noteworthy is that while Elektrim possesses data transfer subsidiaries, including VPN Service (formerly NASK, the original university-based data transfer network in Poland), it is not presently investing in a nationwide IP-based data transfer network, in opposition to other domestic operators such as TP SA, Szeptel, and Netia.

Focusing towards telecoms: opportunities and traps

One of the stated aims of Elektrim's is to bring about the increased integration of its various telecommunications capabilities and assets, which it claims is in line with consolidating trends in the global telecommunications industry (see table 5).

[28] According to research cited by Elektrim on its website, the number of Internet users in Poland will grow from the present 1.9 mln (5% of the population) to 14 million (35%) in 2004.

Table 5: Elektrim's telephony and internet assets

Era GSM – Poland's leading mobile operator
Five local telecom operators
Cable TV Aster City
Five Internet-related companies
Inter Net-Polska – provides services for tele-information systems, building wide-area internet networks
Nask service – as above
Easy Net – e-commerce, entertainment over fixed-line, mobile (WAP) cable TV and satellite systems
AGS New Media – internet service provider
GT Creative Team – value-added services for mobile systems

Source: Erste bank, Central European, July/August 2000, p. 26.

It states that its 'el' Warsaw brand "is the expression of successful cooperation between firms of the Elektrim Group: El-Net and Aster City Cable" (see website). The creation of Elektrim Online is also part of this broader attempt at telecommunications services integration; Elektrim hopes to integrate e-commerce and internet services into its fixed line and cellular services offerings. Additionally, at the end of 2000, Elektrim's fixed telephony subsidiaries signed an agreement to jointly offer interconnection services across their areas of operation and also signed an agreement of cooperation with PTC as a preliminary step in providing joint cellular/fixed services (see website; Elektrim press release, 2/28/01, "Spolki telekomunikacyjne Grupy Elektrim zaciesniaja wspolprace"). More generally, at least as stated, Elektrim is attempting to develop a business model attempting to develop an integrated complex combining capabilities at multiple points along the telecommunications value chain, including network, internet, data transmission, cellular, and fixed telephony services, as well as cable TV, in particular locations (see website).

While there has been progress in the development of Elektrim's telecommunications operations, there have also been serious setbacks and problems. First, Elektrim's fixed telephony operations have been seriously slowed. This has resulted, first, from the protracted legal and bureaucratic proceedings relating to the Warsaw concessioning case (see above). Second, problems with the development of fixed telephony operations have arisen on a national scale due to the continued anti-competitive activities of the national operator, TP SA, on local markets and the inability/unwillingness of the Ministry to limit this activity. Third, the lack of commitment of its international partner, Vivendi, to fixed telephony and the conflicts rising from that have, it appears unexpectedly, caused a severe slowdown in fixed telephony operations (see below).[29] Generally speaking, Elektrim has shown very limited growth in its base of fixed telephony customers over the past year (get data…) and its rate of investment there has taken a hard hit.[30]

Second, the series of moves and countermoves in mobile telephony appears to stem from one basic issue: control of Elektrim's prime asset, PTC.[31] Most analysts believe that Deutsche Telekom's purchase of Elektrim's fixed telephony companies is in large part a stratagem to obtain control of PTC. Because the joint involvement of Deutsche Telekom and Vivendi in Elektrim's telecommunications operations is presumably an unviable configuration of ownership interests, Vivendi will be under great pressure to sell its shares in Elektrim Telekomunikacja (in which it has 49% ownership and which in turn has 51% ownership of PTC). This would potentially provide Deutsche Telekom leverage to gain additional shares in PTC. Alternatively, if Elektrim is forced to buy out Vivendi's stake in Elektrim Telekomunikacja it may be forced to turn to its partner for funding, given its present problems with debt and liquidity, and thus presumably to cede control of PTC in exchange (Borowski, Reuters, 3/7/01, "Telekom to home in on Poland's PTC through Elektrim").

It appears that the stage is set at present for an intense period of negotiations, as the involved actors vie for control and attempt to clarify ownership of this tangled web of connections. Elektrim is facing a definitive resolution of its telecommunications-focussing strategy and is going into the bargaining game in a very uncertain, if not weak position. It stands to lose

[29] Vivendi initially entered into a joint venture agreement with Elektrim in December 1999 with what appears to have been a general agreement to the development of an integrated set of telecommunications services. Through 2000, this commitment appears to have waned, with Vivendi increasingly advocating the spin-off of Elektrim's fixed telephony subsidiaries. Though analysts presently are not emphasizing this issue, it appears that disagreement over the fixed telephony strategy has been one of the basic reasons for the broader ownership and financial conflicts which have risen up between the partners at the end of 2000 (for more, see above).

[30] Elektrim also lacks an intercity concession. The opening of this market according to some may be the key to the full liberalization of the fixed telephony market in Poland to real competition.

[31] PTC has become even more valuable, according to some accounts, because of continued developmental slowness and monopolization of the fixed telephony market. The cellular market has proven to be a crucial alternative to fixed telephony in providing Poles with affordable basic and more advanced telecommunications services.

operational control of all of its present telecommunications assets to Deutsche Telekom, if the present agreement to sell 51% of fixed telephony assets and the possible buy-out of Vivendi stock in Elektrim Telekomunikacja takes place. It is unclear if this is the aim of Elektrim management or if Elektrim possesses the resources necessary to maintain control and to continue to fund its telecommunications operations through alternative sources or own capital. One possibility that Elektrim has been sounding out is a new share issue in the spring (Borowski, Reuters, 1/19/01, “Elektrim mulls share issue in 2001”). One might also wonder if PTC might not be a source of funding for financing other telecommunications operations and/or Elektrim’s large debts.

4.6. Divesting activities

In accordance with its new focussing strategy, Elektrim is selling off assets that do not fit its new focus on the telecoms, energy or cable sectors. It has concluded a deal to sell 80 such subsidiaries. In June 1999, jointly with Clifton Consulting, Elektrim set up Warsaw Equity Holdings, a holding company in which it has a 15% share, the remainder falling to Clifton Consulting, which is entitled to 20% of the proceeds from the sale of any assets [Dawson, 2000 January #28]. Elektrim will obtain $62.7m from the transaction and will be reduced to 28 firms following the deal. [Agency, 1999 #19]. Subsequently Elektrim sold 15% of shares in Warsaw Equity Holding.

Elektrim’s share ownership of Chemia Polska has been reduced by 21.16% of the total votes (Feb 1998). The Dutch group, Campina Melkunie, in 1997 acquired Elektrim Food, a specialist in yoghurt and dairy dessert production, for an undisclosed sum. In its heyday Elektrim had an 8% of share of the Polish dairy market, but its companies in this sector have been in the red with regard to production, running at around only half of actual capacity. Interlektra of Luxembourg bought 3 of Elektrim’s motor producing subsidiaries for PLN 58 mn ($14.19m). The Luxembourgians are paying PLN 43 mn ($10.52m) for 99.94% of the motor producer Celma, another PLN 9 mn ($2.2mn) for 67.398% of a similar firm, Besel, and a further PLN 6 mln ($ 1.47m) for 100% of the shares of Elektrim Motor (Jan 2000). The acquisition of Celma is contingent on Celma's purchase from Elektrim of the holding's 69% stake in Indukta, another electric machinery factory. The envisaged transactions will enrich the firm's budget by zl 58m and allow it to pay off its most urgent debts and develop its priority project, the El-Net local telecom in Warsaw [Gospodarka, 2000 #22].

4.7. Financing growth

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

- $680m to acquire an additional 15.8% of PTC stock;
- $309m for the purchase of Aster City Cable TV from Bresnan International Poland,
- $140m to pay for the license of Telefonia Pilicka, a fixed line telephone operator,
- $300m (since reduced to $145m) for the licence fee for its El-Net subsidiary to start connecting fixed line telephones in Warsaw and surrounding area.

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

In the 1997-99 period Elektrim raised through convertible bonds $734mn which was used to purchase its new acquisitions[32]. See table 6.

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

Table 6: **Elektrim convertible bond issues, 1997-1999**, **based on business press**

Issuing date	***Issuing agent or partner***	***Amount in mn$***	***Description***
01/05/97	Elektrim	294	Two thirds will be used to reduce Elektrim's bank debts and cut financing costs, and to finance future purchases of power stations in conjunction with local banks and foreign power operators.
02/06/99	Elektrim	311	To fund the first stage of a plan to become the country's second largest telecommunications provider and to be used for an acquisition.
29/06/99	Elektrim	415	To fund its acquisition of Bresnan Communications Poland, because it should pay $325m by the end of June. (result: successfully subscribed by the US and European investors, worth Euro 400m.)
	Total	1020	

Source: SSEES Data Base

Also, new strategic partnerships are being created through the issuing of convertible bonds. At a general meeting of shareholders on 28 May, 1999, Elektrim decided that the company would issue convertible bonds, maturing after five years and worth $394m. These bonds (26.7m bonds) are convertible into common stock in the company, and hence carry an initial conversion premium of 15.3% on the fixed price. The proceeds from this bond issue were used to finance the company's investments in its telecom branch, for instance payment of $325m for Bresnan. The buyers of the bonds were Spain's Accion and Holland's Eastbridge. Eastbridge has a chain of music shops in Poland and plans to help Elektrim develop an Internet shopping system. Acciona plans to cooperate with Elektrim in its telecom, power industry and cable industry operations.

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

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

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

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

Restructuring and investments led Elektrim into the red in 1998 when it lost nearly PLN 330m ($95m). The loss was blamed on the transfer of PLN225m ($64m) of assets to Warsaw Equity Holdings, a company set up to unload Elektrim's interests in 80 firms that Elektrim regarded as non-core businesses [Bulletin, 1999 #25]. 1999 results show that the Elektrim parent company made a 107.7 million zloty profit ($30m)The company's results were boosted by 1.6 billion zlotys ($400m) in financial revenues in 1999, mainly from the sale of 49 percent of Elektrim Telekomunikacja shares to France's Vivendi whose $1.2 billion cash injection in late 1999 has stabilised the group. Although the company had to pay $50mn taxes from these operation, its balance sheet figures improved dramatically as a consequence. Elektrim's equity rose almost 54% against 1998. These transactions enabled Elektrim to reduce its short-term liabilities and improve liquidity [33] [Rzecpospolita, 2000 #24](p. 3).

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

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

4.8. Business relationships and growth of Elektrim

Annex (Tables 7 and 8) show the frequency and types of business relationships or broadly defined alliances of Elektrim. Business relationships are classified as mergers, acquisitions, joint ventures, alliances (international co-operative agreements), subcontracting, major contracts, government-approved licences and divestitures. They are summarised in the tables below.

Table 7: **Summary of types and frequency of business relations of Elektrim as reported in business press, 1990-2000 (mid-year)(see Annex)**

Table 8: **Business relations of Elektrim as reported in business press, 19990-2000 (mid year)(see Annex)**

The dominant types of relationship are minority and majority acquisitions, which reflect the dominant mode of growth of Elektrim as described in the previous section[34]. The second most frequent type of relationships are licences and major contracts. Licences are indispensable for increasing the company's potential for gaining market share in telecommunications. Major contracts show that Elektrim is building an important position in cables as well as continuing to

like with Vivendi, which can stabilise cash flow and provide breath for putting newly acquired assets into operation.

[34] The acquisitions are under-reported in the early transition years when Elektrim has acquired around 80 different business. It is now preparing to sell 80 subsidiaries whose operations are not connected with the

play a significant role as an engineering company and an organiser of new projects. Also, a number of divestitures that are either divestments of unrelated businesses or a diluting of its control in telecoms, shows that an intensive restructuring is taking place.

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

5. Analytical issues

Elektrim belongs to a group of large domestically controlled CEE enterprises that operated in the socialist period and which have managed not only to survive but also to expand in the transition period. What distinguishes Elektrim within this group is that it operated as a foreign trade organisation during the socialist period, and that it has become a conglomerate in the transition period, and has currently focused on cables, energy, and telecoms (see table 9).

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company's new strategy. The sizes of these businesses are very small and they probably represent a great burden on management.

Table 9: Elektrim Evolution –Development Dimensions

	Stage 1 – Foreign Trade Organization (-1990)	**Stage 2 – Production/ Trade Holding (1990-1997)**	**Stage 3 – Core Competency Search in Telecomms (1998-)**
Main Functional Area	Trading	Production	Infrastructure
Business Strategy	Exclusive Intermediation	Opportunistic Conglommeration	Diversified Specialization
State Relations	Role Exclusivity in foreign trade	Implicit Sponsorship of stock market maneuverings	Emerging Conflict
International Relations	Russian connection	Buffering by state/limited foreign ownership	Majority diversified foreign ownership
Corporate Governance	State ownership	Commercialization/some state ownership	Fully private Medium-number of owners (8-10)
Organizational structure	Unitary organization	Holding	Multi-divisional corporation
Primary Projects	--Intermediating Deals; --Intermediating Plan Bargaining	--Building financial management skills; --Building internal governance mechanisms in select business areas; --Cooperating in Cables (initial specialization); ERA GSM (initial diversification)	--Telecomms (fixed, cellular, internet); --Energy; --Centralizing business/ investment strategy; --profit-center creation; --Narrowing of the portfolio --alliance-building and financing projects

Here we highlight several analytical issues that link Elektrim's case to the broader literature on corporate and industrial change, and in CEE in particular. We want to raise several analytical and theoretically relevant questions which are based on the case study of Elektrim.

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

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

This situation raises several general issues. First, does Elektrim's shift from conglomeration to focusing reflect a change in general conditions in the Polish economy or merely the inability of the company to develop into a diversified industry group? Alternatively, is the shift towards focused strategy the result of the personal vision of a new CEO or is it partly determined by the difficulties of growing through conglomeration?

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

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

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

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

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

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

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

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

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

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

On the other hand, when Elektrim’s subsidiary, the cellular telecom Polska Telefonia Cyfrowa PTC, offered its cellular clients international connections via the Internet it brought Elektrim into conflict with TPSA, the state operator[35]. Also, Elektrim won the fixed telephony concession for Warsaw on the understanding that it would be the sole competitor to TPSA. Its subsidiary, El Net, was bidding for the licence in the conviction that for at least 3 years it would be the only alternative to the mammoth TPSA in the metropolitan area until the market was completely liberalised. However, the government has since issued a third licence to the rival operator Netia. Elektrim asked the Communications Ministry to block the execution of

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

operating licences for the Warsaw region won by its rival Netia. Since fixed-line telecoms means huge up-front costs and no quick profits on the horizon this regulatory shift does not fit into a picture of a cosy relationship between the state and Elektrim [Europe, 2000 #15].[36]

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

FOURTH ANALYTICAL ISSUE: The opening of the CEECs has led to relocations of EU and other MNCs into this region with the result that they are also transferring the oligopolistic competition from EU into new markets. The case of Elektrim shows how CEE companies and government regulations become factors in the oligopolistic competition between big EU companies. CEE companies and governments may use this

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

competition to their advantage but also their limited bargaining powers may lead to outcomes unfavourable to them.

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

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

Besides direct competition between domestic and foreign firms there is the transfer of competition from the EU to CEE markets. In the case of Elektrim this operates in the following way. France Telecom has won the right to negotiate for a stake in TPSA, a major competitor of Elektrim, which means that the oligopolistic competition from the French market between Vivendi and France Telecom may soon be transferred to Poland. Hence, the competition in CEE markets increasingly can be understood only if we take into account the oligopolistic competition on Western markets. The American Vodafone is a shareholder in PTC's rival Polkomtel. There is a possibility that Vodafone may buy Vivendi, which would have important effects on the control of PTC and on Elektrim. However, it seems that Vodafone does not intend to take over Vivendi within the next three years. This seems fairly certain given the recent Vodafone acquisition of the UK licence for a third generation of mobiles and its sale of Orange to France Telecom. This suggests that Elektrim's shareholders need not worry in the short-term.

However, it does not exclude this possibility in the medium term, even before Poland joins the EU. The effect of this may be, as a business analyst put it, that 'Elektrim, a small domestic operator, will not be around in two years' time in its current form. PTC is an extraordinarily valuable asset. How long the market will let Elektrim pour cash into PTC is an academic question. All that matters is who will bid, and whether management can extract the best price' [Dawson, 2000 January #28]. The management of Elektrim should welcome such a move as it is basically in line with its general philosophy. As Elektrim's ex-CFO Piotr Mroczkowski, put it 'Elektrim's final product is shares'.

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

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Table 7: Elektrim: Summary of types and frequency of business relationship- as reported by business press -

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

10-Dec-99								X	X		
14-Dec-99						X				X	
17-Dec-99						X				X	
20-Dec-99							X		X		
22-Dec-99								X	X		
25-Jan-00								X			X
18-Apr-00		X							X		
18-Apr-00		X							X		
18-Apr-00		X							X		
18-Apr-00						X					X
18-Apr-00						X					X
Total	**0**	**15**	**5**	**1**	**0**	**10**	**12**	**11**	**30**	**6**	**13**

Source: Annex 1, SSEES Data base

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

Table 8: Business relationship of Elektrim as reported in business press, 1990-200 (mid year)

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

Source: Annex 1, SSEES Data base

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

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